**THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

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**If you are in any doubt** as to any aspect of this Circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

**If you have sold or transferred** all of your shares in First Pacific Company Limited, you should at once hand this Circular to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

# FIRST PACIFIC COMPANY LIMITED

*(Incorporated with limited liability under the laws of Bermuda)*

*Website: http://www.firstpacific.com*

**(Stock Code: 00142)**

## (1) MAJOR ACQUISITION – THE ACQUISITION BY BEACON ELECTRIC ASSET HOLDINGS, INC. OF SHARES IN MANILA ELECTRIC COMPANY FROM PILIPINO TELEPHONE CORPORATION AND THE SUBSCRIPTION OF NEW SHARES IN BEACON ELECTRIC ASSET HOLDINGS, INC. BY PILIPINO TELEPHONE CORPORATION

## (2) POSSIBLE MAJOR ACQUISITION – POSSIBLE ACQUISITION OF 74,700,000 SHARES IN MANILA ELECTRIC COMPANY BY BEACON ELECTRIC ASSET HOLDINGS, INC. IF BEACON ELECTRIC ASSET HOLDINGS, INC. WERE TO EXERCISE A CALL OPTION GRANTED TO BEACON ELECTRIC ASSET HOLDINGS, INC.

A notice convening a special general meeting of First Pacific Company Limited to be held at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong on Tuesday, 30 March 2010 at 9:00 a.m. is set out on pages 316 to 318 of this Circular. Whether or not you are able to attend the meeting, you are requested to complete and return the accompanying form of proxy to the principal office of First Pacific Company Limited (Attention: Corporate Secretarial Department) at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for the holding of the meeting. Completion and return of the form of proxy will not preclude you from attending and voting in person at the meeting should you so wish.

13 March 2010

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*In this Circular, unless otherwise defined or the context otherwise requires, the following expressions shall have the following meanings:–*

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| "1 March Announcement" | the Company's announcement of 1 March 2010 relating to the entering into of the Omnibus Agreement and possible future exercise of the Call Option; |
| "Amended Shareholders' Agreement of Meralco" | the Amended, Consolidated and Restated Cooperation Agreement dated 20 November 2009 among the Lopez group, FPHC, First Philippine Utilities Corporation, Piltel, MPIC and PLDT; |
| "Beacon Electric" | Beacon Electric Asset Holdings, Inc. (formerly Rightlight Holdings Inc.), a wholly beneficially owned subsidiary of MPIC as at the Latest Practicable Date; |
| "Board" | the board of directors of the Company; |
| "Call Option" | the call option to acquire the Option Shares owned by FPHC; |
| "CB Closing Date" | the date of issuance of the Convertible Bonds and receipt by MPIC of the subscription amount; |
| "CB Term Sheet" | the binding term sheet entered into between MPHI and MPIC on 1 March 2010 in relation to the possible subscription by MPHI of the Convertible Bonds; |
| "Circular" | this Circular, which is issued by the Company to the Shareholders in respect of the proposed transactions; |
| "Company" or "First Pacific" | First Pacific Company Limited, a company incorporated in Bermuda with limited liability and which has its shares listed on the Stock Exchange; |
| "Convertible Bonds" | the convertible bonds to be potentially subscribed by MPHI and issued by MPIC, the principal terms of which are summarised under the heading "***Possible subscription by MPHI for Convertible Bonds of MPIC***" in the "***Letter from the Board***" section of this Circular; |
| "Directors" | the directors of the Company; |
| "ERC" | Energy Regulatory Commission; an independent regulatory body performing the combined quasi-judicial, quasi-legislative and administrative functions in the electric industry; |

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| "FPHC" | First Philippine Holdings Corporation, a holding company whose core businesses are in power and infrastructure, with strategic initiatives in manufacturing and property in the Philippines; |
| "Group" | the Company and its subsidiaries; |
| "Gwh" | Gigawatt hours with a gigawatt being a unit of electric power equal to 1,000,000,000 watts; |
| "HK$" | Hong Kong dollars, the lawful currency of Hong Kong; |
| "Hong Kong" | the Hong Kong Special Administrative Region of the People's Republic of China; |
| "Latest Practicable Date" | 11 March 2010, being the latest practicable date for the purpose of ascertaining certain information for the purpose of this Circular; |
| "Listing Rules" | The Rules Governing the Listing of Securities on the Stock Exchange; |
| "Meralco" | Manila Electric Company, a Philippine corporation with its shares listed on the PSE, which is the largest distributor of electricity in the Philippines with a service area spanning 9,337 square kilometres, where approximately a quarter of the total Philippine population resides. It has a customer base of about 4.7 million, comprising commercial, industrial and residential customers. In addition to electricity distribution, Meralco undertakes several related businesses, including operating fibre optic networks of over 1,000 kilometres and provides leased line connections, metro ethernet connections and disaster recovery transport services; |
| "Meralco Share Acquisition from Piltel" | the purchase by Beacon Electric from Piltel of the Piltel Meralco Shares pursuant to the Omnibus Agreement, as described in paragraph (3) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "MPHI" | Metro Pacific Holdings, Inc., a Philippine affiliate of the Company and the holding company of MPIC; |
| "MPIC" | Metro Pacific Investments Corporation., a Philippine listed corporation in which the Group has an approximately 55.6% economic interest through its Philippine affiliate, MPHI; |

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| "MPIC Meralco Shares" | the 163,602,961 common shares of Meralco, representing approximately 14.5% of the issued share capital of Meralco, to be sold by MPIC to Beacon Electric pursuant to the Omnibus Agreement; |
| "MPIC-Beacon Electric Subscription" | the subscription by MPIC of an additional 1,156,500,000 common shares of Beacon Electric and 801,044,415 preferred shares of Beacon Electric pursuant to the Omnibus Agreement, as described in paragraph (2) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "MPIC-Piltel Beacon Electric Share Sale" | the sale by MPIC to Piltel (upon completion of the transactions described in paragraphs (1) to (4) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular) of 12,500 common shares of Beacon Electric pursuant to the Omnibus Agreement, as described in paragraph (5) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "Omnibus Agreement" | the agreement entered into on 1 March 2010 between MPIC, Beacon Electric and Piltel in relation to the reorganisation of the current shareholdings of MPIC and Piltel in Meralco with a view to consolidating their Meralco shareholdings in Beacon Electric; |
| "Option Agreement" | the option agreement entered into on 1 March 2010 between FPHC and Beacon Electric in respect of the grant of the Call Option by FPHC to Beacon Electric; |
| "Option Shares" | the 74,700,000 common shares of Meralco which are to be transferred to Beacon Electric on exercise of the Call Option; |
| "PBR" | the performance based regulation; an internationally accepted rate making methodology incorporating the use of incentive and penalty mechanisms as determined by the performance of the public utility; |
| "Philippines" | The Republic of the Philippines; |
| "PhP" or "Peso" or "₱" | Philippine pesos, the lawful currency of the Philippines; |
| "Piltel" | Pilipino Telephone Corporation, a Philippine listed indirect subsidiary of PLDT; |

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| "Piltel Investment" | together, the Meralco Share Acquisition from Piltel, the Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale, as described in paragraphs (3), (4) and (5) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "Piltel-Beacon Electric Subscription" | the subscription by Piltel of 1,156,500,000 common shares of Beacon Electric pursuant to the Omnibus Agreement, as described in paragraph (4) under the heading "***The Omnibus Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "Piltel Meralco Shares" | the 154,200,000 common shares of Meralco, representing approximately 13.7% of the issued share capital of Meralco, to be sold by Piltel to Beacon Electric pursuant to the Omnibus Agreement; |
| "Piltel SPA" | the sale and purchase agreement entered into on 1 March 2010 between Piltel and Beacon Electric which documents the Meralco Share Acquisition from Piltel; |
| "Piltel Subscription Agreement" | the subscription agreement entered into on 1 March 2010 between Piltel and Beacon Electric which documents the Piltel-Beacon Electric Subscription; |
| "PLDT" | Philippine Long Distance Telephone Company, a 26.5% owned associated company of the Group; |
| "Property Dividend" | (i) certain property dividend which may be declared and distributed in respect of the MPIC Meralco Shares, the Piltel Meralco Shares and the remaining 68,800,000 Meralco common shares held by Piltel which would be assigned to FPHC as part of the terms of the Call Option subject to Beacon Electric exercising the Call Option and acquiring the Option Shares; and (ii) certain property dividend which may be declared and distributed in respect of the Option Shares which would be retained by FPHC subject to Beacon Electric exercising the Call Option and acquiring the Option Shares, further details of which are set out under the heading "***Call Option and Option Agreement***" in the "***Letter from the Board***" section of this Circular; |
| "PSE" | the Philippine Stock Exchange; |
| "SGM" | the special general meeting of the Company to be held at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong on Tuesday, 30 March 2010 at 9:00 a.m., the notice of which is set out in this Circular; |

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| "SGV" | SyCip Gorres Velayo & Co, a member firm of the Ernst & Young Global network and a firm of certified public accountants as registered with the Philippine Regulatory Board of Accountancy to practice in the Philippines; |
| "Shareholders" | the shareholders of the Company; |
| "Stock Exchange" | The Stock Exchange of Hong Kong Limited; |
| "U.S." | the United States of America; and |
| "US$" | United States dollars, the lawful currency of the U.S. |

*Unless otherwise specified, translations of quoted currency values in this Circular are made on an approximate basis and at the rate of US$1.00 = PhP46.2 = HK$7.8. Percentages and figures expressed in millions have been rounded.*

# FIRST PACIFIC COMPANY LIMITED

*(Incorporated with limited liability under the laws of Bermuda)*
*Website: http://www.firstpacific.com*
**(Stock Code: 00142)**

*Chairman:*
Anthoni Salim

*Executive Directors:*
Manuel V. Pangilinan *(Managing Director and CEO)*
Edward A. Tortorici
Robert C. Nicholson

*Non-Executive Directors:*
Ambassador Albert F. del Rosario
Sutanto Djuhar
Tedy Djuhar
Ibrahim Risjad
Benny S. Santoso
Napoleon L. Nazareno

*Independent Non-Executive Directors:*
Graham L. Pickles
Professor Edward K.Y. Chen, *GBS,CBE, JP*
Sir David W.C. Tang, *KBE*
Jun Tang

*Hong Kong Principal Office:*
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Two Exchange Square
8 Connaught Place
Central
Hong Kong

*Registered Office:*
Canon's Court
22 Victoria Street
Hamilton HM12
Bermuda

13 March 2010

*To the Shareholders*

Dear Sir or Madam,

**(1) MAJOR ACQUISITION – THE ACQUISITION BY BEACON ELECTRIC ASSET HOLDINGS, INC. OF SHARES IN MANILA ELECTRIC COMPANY FROM PILIPINO TELEPHONE CORPORATION AND THE SUBSCRIPTION OF NEW SHARES IN BEACON ELECTRIC ASSET HOLDINGS, INC. BY PILIPINO TELEPHONE CORPORATION**

**(2) POSSIBLE MAJOR ACQUISITION – POSSIBLE ACQUISITION OF 74,700,000 SHARES IN MANILA ELECTRIC COMPANY BY BEACON ELECTRIC ASSET HOLDINGS, INC. IF BEACON ELECTRIC ASSET HOLDINGS, INC. WERE TO EXERCISE A CALL OPTION GRANTED TO BEACON ELECTRIC ASSET HOLDINGS, INC.**

**Overview**

Reference is made to the 1 March Announcement, pursuant to which the Company announced that MPIC, Piltel and Beacon Electric entered into the Omnibus Agreement on 1 March 2010. Under the Omnibus Agreement, MPIC and Piltel have agreed to restructure their current shareholdings in Meralco. It is intended that, upon completion of the transactions contemplated by the Omnibus Agreement, Beacon Electric will become a 50:50 joint venture of MPIC and Piltel.

MPIC is a Philippine listed company in which the Group has an approximately 55.6% economic interest through its Philippine affiliate, MPHI. Piltel is a Philippine listed indirect subsidiary of PLDT, a 26.5% owned associate of the Group. Beacon Electric is, as at the Latest Practicable Date, a wholly beneficially owned special purpose vehicle of MPIC set up with the sole purpose of holding shares in Meralco.

Under the Omnibus Agreement, MPIC and Piltel will consolidate approximately 163.6 million common shares of Meralco (representing an approximately 14.5% interest in Meralco) and 154.2 million common shares of Meralco (representing an approximately 13.7% interest in Meralco), respectively, under Beacon Electric; thus giving Beacon Electric an approximately 28.2% interest in Meralco and making it the single largest shareholder of Meralco.

The Company also announced in the 1 March Announcement that the Call Option referred to in the Company's 10 November 2009 announcement, to be granted by FPHC to MPIC and conferring the right to purchase common shares of Meralco representing approximately 6.6% of Meralco, was granted to Beacon Electric on 1 March 2010.

The purpose of this Circular is to give you further details of:

1. the Omnibus Agreement;
2. the Piltel Investment; and
3. the Call Option.

**The Omnibus Agreement**

The Omnibus Agreement contemplates the following principal transactions:

(1) the sale by MPIC to Beacon Electric of 163,602,961 common shares of Meralco, representing approximately 14.5% of the issued share capital of Meralco, for a total consideration of PhP24,540,444,150 (equivalent to approximately US$531.2 million and approximately HK$4,143.2 million), which is equal to PhP150 (equivalent to approximately US$3.25 and approximately HK$25.3) per common share of Meralco;

(2) **MPIC-Beacon Electric Subscription** – the subscription by MPIC of an additional 1,156,500,000 common shares of Beacon Electric at the subscription price of PhP20 (equivalent to approximately US$0.43 and approximately HK$3.38) per common share and 801,044,415 preferred shares of Beacon Electric at the subscription price of PhP10 (equivalent to approximately US$0.22 and approximately HK$1.69) per preferred

share of Beacon Electric, which results in an aggregate subscription consideration of PhP31,140,444,150 (equivalent to approximately US$674.0 million and approximately HK$5,257.5 million);

(3) **Meralco Share Acquisition from Piltel** – the purchase by Beacon Electric from Piltel of 154,200,000 common shares of Meralco, representing approximately 13.7% of the issued share capital of Meralco for a total consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million), which is equal to PhP150 (equivalent to approximately US$3.25 and approximately HK$25.3) per common share of Meralco;

(4) **Piltel-Beacon Electric Subscription** – the subscription by Piltel of 1,156,500,000 common shares of Beacon Electric at the subscription price of PhP20 (equivalent to approximately US$0.43 and approximately HK$3.38) per common share of Beacon Electric, which results in an aggregate subscription consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million);

(5) **MPIC-Piltel Beacon Electric Share Sale** – the sale by MPIC to Piltel (upon completion of the transactions referred to in (1) to (4) above) of 12,500 common shares of Beacon Electric for a consideration per common share equal to their par value of PhP1.00 (equivalent to approximately US$0.02 and approximately HK$0.17) per common share of Beacon Electric, resulting in Beacon Electric becoming a 50:50 joint venture of MPIC and Piltel; and

(6) the assignment by MPIC to Beacon Electric of a right to be granted the Call Option.

Items (1) and (2), relating to MPIC's injection of Meralco shares in Beacon Electric and subscription of new shares in Beacon Electric, are part of an internal reorganisation of the Group's holdings of interests in Meralco.

Items (3), (4) and (5) above are collectively referred to hereinafter as the "Piltel Investment".

**The Piltel Investment**

The Piltel Investment consists of the Meralco Share Acquisition from Piltel, the Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale and is likely to be completed some time in May 2010.

*A. The Meralco Share Acquisition from Piltel*

Under the Listing Rules, the Meralco Share Acquisition from Piltel is an acquisition by the Group of further interests in Meralco. The Meralco Share Acquisition from Piltel is further documented in the Piltel SPA. Completion of the Meralco Share Acquisition from Piltel is subject to the following conditions:

(a) approval of the board of directors of Piltel, the board of directors of MPIC and the board of directors of the Company;

(b) approval of the shareholders of the Company; and

(c) approval of the shareholders of Piltel.

The consideration for the Meralco Share Acquisition from Piltel was determined based on the price at which MPIC contributed Meralco shares to Beacon Electric (i.e. MPIC's average investment cost in Meralco) and represents a 17.6% discount to the share price of Meralco as at 1 March 2010, being PhP182 (equivalent to approximately US$3.94 and approximately HK$30.73) per Meralco share.

The rights, title and interest that will be transferred to Beacon Electric by Piltel pursuant to the Piltel Investment shall include (i) all shares issued by Meralco by way of stock dividends on the Piltel Meralco Shares from 1 March 2010; (ii) all property or cash dividends declared or paid on the Piltel Meralco Shares from 1 March 2010, except for the Property Dividend (as described below under the heading "***Call Option and Option Agreement***" in this Circular) in respect of the Piltel Meralco Shares; (iii) all other rights accruing on the Piltel Meralco Shares from 1 March 2010; and (iv) the proceeds of the foregoing. Piltel may, at some future time and under such terms and conditions as may be agreed between Piltel and Beacon Electric, transfer to Beacon Electric its remaining 68,800,000 Meralco common shares.

The same rights, title and interest in respect of the MPIC Meralco Shares will be transferred to Beacon Electric. For the avoidance of doubt, the rights, title and interest in respect of the MPIC Meralco Shares will also exclude the Property Dividend (as described below under the heading "***Call Option and Option Agreement***" in this Circular) in respect of the MPIC Meralco Shares.

*B. The Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale*

The Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale are disposals of part of the Group's interest in Beacon Electric, on completion of which Beacon Electric would become a 50:50 joint venture of MPIC and Piltel.

The Piltel-Beacon Electric Subscription is further documented in the Piltel Subscription Agreement. The Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale are subject to the following conditions:

(a) approval of the board of directors of Piltel, the board of directors of MPIC and the board of directors of the Company;

(b) approval of the shareholders of the Company; and

(c) approval of the shareholders of Piltel.

The consideration for the Piltel-Beacon Electric Subscription was determined based on the pricing of the MPIC-Beacon Electric Subscription.

The consideration for the MPIC-Piltel Beacon Electric Share Sale was determined based on the original investment cost of MPIC in Beacon Electric, i.e. the par value (PhP1.00 (equivalent to approximately US$0.02 and approximately HK$0.17)) of the initial 25,000 common shares of Beacon Electric held by MPIC and is intended to ensure that, upon completion of the Piltel Investment, MPIC and Piltel will each hold 50% of Beacon Electric's common share capital.

*C. Listing Rules Implications of the Piltel Investment*

The Meralco Share Acquisition from Piltel is an acquisition by the Group of further interests in Meralco under the Listing Rules. The Piltel-Beacon Electric Subscription and the MPIC-Piltel Beacon Electric Share Sale are disposals of part of the Group's interest in Beacon Electric. Pursuant to Rule 14.24 of the Listing Rules, in the case of a transaction involving both acquisition and disposal elements, the transaction should be classified by reference to the larger of the acquisition or the disposal.

One or more of the percentage ratios applicable to each of the disposal element of the transaction and the acquisition element of the transaction exceeds 25% but each of the percentage ratios applicable to each of the disposal and the acquisition is less than 75% or 100%, respectively. Accordingly, each of the disposal element and the acquisition element of the Piltel Investment constitutes a major transaction for the Company under the Listing Rules. Therefore, the Piltel Investment is subject to the approval of the Company's shareholders. The acquisition element (when aggregated with the Group's previous acquisitions of interest in Meralco) is the larger of the two elements of the Piltel Investment, which is, therefore, classified as a major acquisition under the Listing Rules.

The Company does not expect to record any gain or loss in respect of the Piltel Investment.

Following completion of the Piltel Investment, Beacon Electric would cease to be a subsidiary of MPIC and would become a 50:50 joint venture between MPIC and Piltel. The Group currently has an approximately 14.5% effective interest in Meralco through MPIC and would have an approximately 14.1% effective interest in Meralco through Beacon Electric upon completion of the Piltel Investment (but without taking into account the possible exercise of the Call Option, described below).

**Proposed governance arrangements of Beacon Electric as a joint venture and shareholders' rights under the Omnibus Agreement**

The Omnibus Agreement also provides for certain governance arrangements in respect of Beacon Electric as a joint venture between MPIC and Piltel and certain shareholders' rights, if the Piltel Investment is completed. The governance arrangements and shareholders' rights are made subject to the Company's shareholders' approval having been obtained. The principal terms of those arrangements are summarised below:

*Board composition*

The board of directors of Beacon Electric shall comprise five (5) directors, two of whom shall be nominated by MPIC (for so long as MPIC holds 50% of the outstanding common shares of Beacon Electric) and two of whom shall be nominated by Piltel (for so long as Piltel holds 50% of the outstanding common shares of Beacon Electric). The remaining director shall be nominated by the shareholders of

Beacon Electric, provided that both MPIC and Piltel shall agree to nominate and vote in favour of the election of Mr. Manuel V. Pangilinan as the fifth (5th) director of Beacon Electric for as long as Mr. Manuel V. Pangilinan is the Chairman of MPIC and Piltel.

*Quorum and Voting*

A majority in number of the directors of Beacon Electric shall constitute a quorum for meetings of the board, provided that such quorum shall include one nominee of MPIC and one nominee of Piltel.

Matters presented to the board of directors of Beacon Electric shall be approved upon receiving affirmative majority votes of the total number of directors specified by the articles of association of Beacon Electric, provided that the following matters, amongst others, shall require an affirmative vote of a nominee director of each of MPIC and Piltel:

(i) disposition or encumbrance of all or substantially all of the shares in Meralco owned by Beacon Electric or the acquisition of additional Meralco shares which requires funding support from shareholders of Beacon Electric;

(ii) any material change in Beacon Electric's business or ceasing to carry on Beacon Electric's business or any substantial part thereof;

(iii) any merger or consolidation of Beacon Electric, or the reconstruction or amalgamation of Beacon Electric or any of its business;

(iv) promoting or approving a resolution that a vote of the director of Meralco nominated by Beacon Electric to be taken at any meeting of the board of directors of Meralco for the approval of (a) any material change in the business of Meralco or any substantial part thereof or (b) any merger or consolidation of Meralco with or into any other company or entity or the reconstruction or amalgamation of Meralco or any of its business, (c) the winding up of Meralco and (d) certain creditors related matters;

(v) promoting or taking any steps to effect the winding up of Beacon Electric or passing a resolution to liquidate Beacon Electric;

(vi) applying to any court, administrative agency or tribunal to order a meeting of creditors or any class of creditors or members or any class of members or to sanction any compromise or arrangement between creditors or shareholders of Beacon Electric;

(vii) acquisition of capital stock, equity interest, obligation or other security, or capital contribution or other investment in any corporation or person, whether as guarantor, surety or otherwise, or acquisition of all or substantially all of the assets of (i) such corporation or person or (ii) a business engaged in by such person, in each case whether directly or indirectly, involving an amount, or requiring funding commitment from Beacon Electric in an amount, exceeding US$50,000,000 (equivalent to approximately HK$390 million);

(viii) any direct or indirect investment in or financial support to any subsidiary or affiliate in excess of US$10,000,000 (equivalent to approximately HK$78 million);

(ix) capital expenditure (whether in a single transaction or a series of related transactions) exceeding US$50,000,000 (equivalent to approximately HK$390 million);

(x) creation of an executive committee or other committees and delegation of any power of the board of directors of Beacon Electric to an executive committee;

(xi) amendment of articles of incorporation;

(xii) increase or decrease of capital stock;

(xiii) adoption and amendment of bye-laws;

(xiv) sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of Beacon Electric's assets or property;

(xv) incurring, creating or increasing bonded indebtedness;

(xvi) merger or consolidation of Beacon Electric with another corporation or corporations;

(xvii) investment of corporate funds in any other corporation or business or for a purpose other than the primary purpose for which Beacon Electric was organised;

(xviii) dissolving Beacon Electric; and

(xix) declaration or issuance of stock dividends.

*Shareholder Approval*

Save for certain reserved matters which would require the affirmative votes of at least 2/3 of the outstanding capital stock of Beacon Electric, all corporate acts submitted for shareholders' approval must be approved by way of a majority of the outstanding capital stock of Beacon Electric, provided such majority shall always include at least one (1) common share of Beacon Electric held by MPIC and one (1) common share of Beacon Electric held by Piltel.

*Dividends and Distributions*

All unrestricted retained earnings of Beacon Electric shall be promptly distributed as dividends subject to any applicable dividend restrictions imposed by Beacon Electric's bank creditors. The board of directors of Beacon Electric shall (a) declare dividends on the preferred shares of Beacon Electric from the unrestricted retained earnings within three (3) months following the completion of its audited

accounts, and (b) upon the motion of any nominee director of the holders of the common shares, declare as dividends in favour of the holders of the common shares the remaining unrestricted retained earnings of Beacon Electric (after payment of the dividends payable in respect of the preferred shares of Beacon Electric).

*Deadlock*

There are deadlock provisions in the event that the parties reach an impasse in respect of material decisions affecting the structure, management or conduct of the business of Beacon Electric in respect of certain matters set out in the articles of Beacon Electric which by its continuance for an unbroken period of six calendar months prevents Beacon Electric from operating profitably. In such event, a termination notice may be given which provides for the parties to meet to discuss appropriate solutions to the impasse, including the sale of shares by one party. The obligation of a party to acquire all or a part of the shares of the other party shall be subject to compliance with applicable laws and regulations and obtaining any necessary regulatory approvals and consents, including any approvals and consents required under the rules of any relevant stock exchange.

*Preferred share rights*

The preferred shares of Beacon Electric are non-voting, redeemable by Beacon Electric and have no pre-emptive rights to any share or convertible debt securities or warrants issued by Beacon Electric. The preference shareholder is entitled to dividends and liquidation preference.

*Nominee Directors in Meralco*

Beacon Electric shall nominate its nominee directors in Meralco from among the list of nominees provided by MPIC and Piltel (each such Meralco nominee director herein referred to as a "Meralco Nominee Director" and collectively as the "Meralco Nominee Directors") for election to the board of directors of Meralco at each annual meeting of stockholders of Meralco; provided, that an equal number of Meralco Nominee Directors shall be chosen from each list of nominees provided by MPIC and Piltel; provided further, that if the number of Meralco Nominee Directors for Beacon Electric is an odd number, the remaining one Meralco Nominee Director shall be chosen alternatively first from the list of nominees provided by MPIC and then from the list provided by Piltel.

Beacon Electric shall vote its shares in Meralco and shall take all other action as may be necessary to elect the Meralco Nominee Directors.

Without prejudice to each Meralco Nominee Director's duty to exercise his own independent and best business judgment, Beacon Electric shall procure that their respective Meralco Nominee Directors in the Meralco board shall always have a common vote.

*Meralco Board Committees*

To the extent that Beacon Electric is entitled to nominate any of the members of the Meralco board committees for appointment by the Meralco board, Beacon Electric shall cause its Meralco Nominee Directors to jointly nominate and vote affirmatively for the appointment of such qualified individuals as may be selected by the board of directors of Beacon Electric from a list of nominees mutually agreed by MPIC and Piltel, as members of such Meralco board committees.

*Other terms of the Omnibus Agreement*

The Omnibus Agreement sets out customary provisions in respect of rights of first refusal in relation to transfer of shares in Beacon Electric as well as tag-along rights in the event of a transfer of shares in Beacon Electric by a shareholder to any third party.

**Call Option and Option Agreement**

Reference is made to the announcement of the Company dated 10 November 2009, relating to the agreement by FPHC to grant to MPIC the right to acquire the Call Option. The Call Option is an option to purchase from FPHC the Option Shares, representing approximately 6.6% of Meralco's issued common share capital. The agreement by FPHC to grant to MPIC the right to acquire the Call Option was announced as a discloseable transaction of the Company.

Reference is also made to the Company's announcement dated 29 January 2010 pursuant to which it was announced that the date of the grant of the Call Option by FPHC to MPIC had been extended to 28 February 2010. Given that the deadline for the grant of the Call Option, being 28 February 2010, was a Sunday it has been agreed between the parties that the deadline for the grant of the Call Option is deemed to be the business day immediately following 28 February 2010, i.e. 1 March 2010.

To the best of the directors' knowledge, information and belief, having made all reasonable enquiries, FPHC and its respective ultimate beneficial owner(s) are third parties independent of the Company and its connected persons.

Under the Omnibus Agreement, MPIC has agreed to assign its right to be granted the Call Option, to Beacon Electric. Accordingly, on 1 March 2010, FPHC and Beacon Electric entered into the Option Agreement, the principal terms of which are summarised below:

Parties: FPHC as grantor of the Call Option and Beacon Electric as grantee.

Option Shares: 74,700,000 shares of common stock of Meralco, listed on the PSE, representing approximately 6.6% of the issued share capital of Meralco.

| | |
|---|---|
| Exercise Price: | PhP300 (equivalent to approximately US$6.49 and approximately HK$50.65) per Option Share, which equates to an aggregate price of PhP22,410,000,000 (equivalent to approximately US$485.1 million and approximately HK$3,783.5 million) for all the Option Shares.<br><br>The exercise price was determined based on arms' length negotiations between MPIC and FPHC, having regard to the trend of the market price and anticipated future business prospects of Meralco. |
| Exercise Period: | The Call Option is exercisable only in full (and not in part), at the option of Beacon Electric, during the period from 15 March 2010 up to midnight on 15 May 2010. |
| Call Option Premium: | An amount of PhP3,000,000 (equivalent to approximately US$64,935 and approximately HK$506,494) has been paid by Beacon Electric for the grant of the Call Option. The Call Option premium has been determined by arms' length negotiation. |

As part of the terms of the Call Option following arms' length negotiation between the parties, FPHC will have the benefit of being assigned certain property dividend that may be declared and distributed in respect of the MPIC Meralco Shares, the Piltel Meralco Shares and the remaining 68,800,000 Meralco common shares held by Piltel, subject to Beacon Electric exercising the Call Option and acquiring the Option Shares. In respect of the Option Shares, in the event that the Call Option is exercised by Beacon Electric, FPHC will have the benefit of retaining certain property dividend that may be declared and distributed in respect of such Option Shares. The estimated value attributable to FPHC's right of potential Property Dividend assignment or retention is approximately PhP2.94 (equivalent to approximately US$0.064 and approximately HK$0.496) per Meralco share. The Property Dividend, if declared and distributed, would comprise shares in certain unlisted investments of Meralco which it is contemplated would principally include shares in Rockwell Land Corporation. Rockwell Land Corporation is a 51% subsidiary of Meralco engaged in real-estate business.

As at the Latest Practicable Date, no decision has been made as to whether or not the Call Option will be exercised and any such decision is a matter for the respective boards of directors of MPIC and Beacon Electric to deliberate. Shareholders should note, however, that the exercise period of the Call Option is relatively short and expires on 15 May 2010. It is expected that MPIC and Beacon Electric will each convene board meetings after the commencement of the Call Option exercise period on 15 March 2010 but before 30 March 2010 to consider whether or not the Call Option will be exercised. Shareholders will be informed, by way of an announcement to be published by the Company on the Company's website *(http://www.firstpacific.com)* and the Stock Exchange's website *(http://www.hkexnews.hk)* prior to the date of the SGM, if the respective boards of directors of MPIC and Beacon Electric approve any action relating to the Call Option. In order to allow the respective boards of directors of MPIC and Beacon Electric to have the flexibility to exercise the Call Option, should they decide to do so, the Company proposes to ask its shareholders to approve a possible future exercise of the Call Option as a major transaction for the Company under the Listing Rules. In that context, the Directors are of the opinion that updating the shareholders by way of announcement in respect of any action taken by the respective boards of directors of MPIC and/or Beacon Electric after 15 March 2010 but prior to the date of the SGM would not constitute the provision of information which would necessitate an adjournment of the SGM.

If the Call Option is exercised before the Piltel Investment is completed, the exercise of the Call Option would constitute a further acquisition of shares in Meralco by a wholly beneficially owned subsidiary of MPIC and, on that basis, would be classified as a major transaction (acquisition) for the Company under the Listing Rules. That is on the basis that one or more of the applicable percentage ratios (on an aggregated basis) would exceed 25% but all of the applicable percentage ratios would be less than 100%.

The Group currently has an approximately 14.5% effective interest in Meralco through Beacon Electric and would have an approximately 17.4% effective interest in Meralco through Beacon Electric if the Call Option is exercised and if the Piltel Investment is completed.

If the Call Option is exercised and if the Piltel Investment and the transfer of MPIC Meralco Shares to Beacon Electric are all completed, Beacon Electric would hold approximately 34.8% of the issued common share capital of Meralco.

As referred to in the Company's announcements dated 10 November 2009 and 23 November 2009, and on page 25 of the Supplementary Prospectus dated 10 November 2009 issued by the Company in connection with its rights issue, the Company's Philippine counsel has confirmed that the execution and delivery by MPIC of the Call Option, or an exercise of the Call Option by MPIC under the circumstances set out in such opinion, would not, in each case, trigger a mandatory tender offer obligation under the Philippine Securities Regulation Code or its Amended Implementing Rules and Regulations. Philippine counsel has confirmed that equally the entering into of the Option Agreement or exercise of the Call Option by Beacon Electric under the circumstances set out in such opinion, would not, in each case, give rise to a mandatory tender offer obligation under the Philippine Securities Regulation Code or its Amended Implementing Rules and Regulations.

*Shareholders' Agreement of Meralco and board representation of Meralco in case the Call Option is exercised*

If Beacon Electric exercises the Call Option, the Amended Shareholders' Agreement of Meralco would be amended to include Beacon Electric as a party and would provide for a pooling of votes among the parties to the Amended Shareholders' Agreement of Meralco in respect of matters presented for approval of shareholders of Meralco.

Under the Amended Shareholders' Agreement of Meralco, if the Call Option is exercised, the Lopez group will be able to nominate one Meralco director for their remaining approximately 6.6% Meralco common shares while Beacon Electric and Piltel will be able to nominate four Meralco directors. Together, the Lopez group and Beacon Electric/Piltel would be able to nominate five out of nine non-independent directors of Meralco.

If the Call Option were to be exercised, the exercise price of the Call Option would be partly funded by a fixed term bank loan of 10 years in the amount of up to PhP18 billion (equivalent to approximately US$389.6 million and approximately HK$3,039.0 million) to be provided to Beacon Electric by a syndicate of banks pursuant to a term sheet entered into between Beacon Electric and the bank syndicate. The bank loan would be without recourse to the shareholders of Beacon Electric. The facility, which would be secured by a certain number of Meralco shares owned or to be acquired by Beacon Electric, would be divided into a fixed rate tranche of up to PhP11.8 billion (equivalent to approximately US$255.4 million and approximately HK$1,992.2 million) and a floating rate tranche of up to PhP6.2 billion (equivalent to approximately US$134.2 million and approximately HK$1,046.8 million). The term sheet in relation to the bank loan is expressed to be subject to contract and subject to certain internal approvals having been obtained.

**Possible subscription by MPHI for Convertible Bonds of MPIC**

If the Call Option were to be exercised, it is contemplated that the remainder of the funding required to pay the exercise price would be financed from the proceeds of a possible subscription by MPIC for preferred shares of Beacon Electric, as described in paragraph (2) under the heading "***The Omnibus Agreement***" above. In order to enable MPIC to provide that financing to Beacon Electric, if the Call Option is exercised, MPHI and MPIC entered into the CB Term Sheet, pursuant to which MPIC can (by a "drawdown notice" given by MPIC to MPHI at any time during the Call Option exercise period) require MPHI to subscribe an aggregate amount of up to PhP6.6 billion (equivalent to approximately US$142.9 million and approximately HK$1,114.3 million) of Convertible Bonds to be issued by MPIC.

The principal terms of the Convertible Bonds can be summarised as follows:

| | |
|---|---|
| Maturity: | 3 years from the date of issue. |
| Status: | Senior, unsecured. |
| Coupon: | 4.5% p.a. payable semi-annually in arrears. |
| Issue Price per unit: | PhP100.00 (equivalent to approximately US$2.16 and approximately HK$16.88). |
| Conversion: | Convertible into new common shares of MPIC at an initial conversion price of PhP3.25 (equivalent to approximately US$0.07 and approximately HK$0.55) per common share of MPIC, subject to customary adjustments for matters affecting the share capital of MPIC. The events requiring an adjustment to be made to the conversion price will include MPIC making or paying a "capital distribution". The definition of "capital distribution" will include (amongst other things) making or paying cash dividends in respect of a financial year of MPIC exceeding, in aggregate, an amount equal to 3.5% of MPIC's average market capitalisation for the 12 months prior to the announcement of the relevant dividend. |

| | |
|---|---|
| | The initial conversion price represents a premium of approximately 14.0% to the closing share price of MPIC as at 1 March 2010, being PhP2.85 (equivalent to approximately US$0.06 and approximately HK$0.48) per share. |
| Closing Date: | The date of issuance of the Convertible Bonds and receipt by MPIC of the subscription amount. |
| Conversion Period: | At any time from the date immediately following the first anniversary of the CB Closing Date up to and including the 10th business day immediately preceding the final redemption date. |
| Early redemption at the option of MPIC: | At any time from the date immediately following the first anniversary of the CB Closing Date, MPIC has the right (by giving not less than 30 days nor more than 60 days' irrevocable notice) to redeem the Convertible Bonds at the accreted value of the Convertible Bonds plus any accrued interest thereon if the closing price of a common share of MPIC, quoted on the PSE for any consecutive period of not less than 30 trading days, is not less than 140% of the conversion price applicable during that period, or at least 90% in principal amount of the Convertible Bonds has already been converted, redeemed, purchased and cancelled. However, MPHI shall be entitled to convert the Convertible Bonds at any time during the conversion period and such right shall override the redemption right of MPIC. |
| Final Redemption: | To occur on the date which falls on the 3rd anniversary of the CB Closing Date and at the final redemption price of PhP103.21 (equivalent to approximately US$2.23 and approximately HK$17.3) per unit. |

If the possible subscription for Convertible Bonds of MPIC proceeds, the exercise of the Convertible Bonds would constitute a transaction for the Company under the Listing Rules. The Company would comply with all applicable Listing Rules requirements, as and when required, in connection with any future conversion of the Convertible Bonds.

**Impact of the Piltel Investment and possible exercise of Call Option on the assets, liabilities and earnings of the Group**

*Assets and liabilities*

Set out in Appendix III to this Circular is the unaudited pro forma statement of the consolidated assets and liabilities of the enlarged Group.

After the completion of the Piltel Investment, Beacon Electric will become a jointly controlled entity owned as to 50:50 between MPIC and Piltel. The results of Beacon Electric will be equity accounted for by the Group. Therefore, upon completion of (i) the Piltel Investment and the possible exercise of the Call Option and (ii) the Piltel Investment only, the unaudited pro forma consolidated assets and liabilities of the enlarged Group would remain unchanged. Please refer to the notes to unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group on pages 297 to 301 of the Circular.

Beacon Electric is currently a wholly beneficially owned subsidiary of MPIC. Therefore, following the possible exercise of the Call Option (without completing the Piltel Investment), the unaudited pro forma consolidated assets and liabilities of the enlarged Group would be increased by approximately US$342.2 million (equivalent to approximately HK$2,669.2 million). Please refer to the notes to unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group on pages 301 to 303 of the Circular.

*Earnings*

While the Piltel Investment has no material impact on earnings of the Group, the possible exercise of the Call Option is expected to be earnings dilutive. However, in view of the track record, earnings ability, value of the franchise and customer base of Meralco as well as the synergies to be generated between Meralco and MPIC/Piltel/PLDT, the Directors believe that the Piltel Investment and the possible exercise of the Call Option would enhance the Group's business development and will have a positive impact on the earnings of the Group in the future.

**Reasons for the Piltel Investment**

The effect of the Piltel Investment is to consolidate MPIC's and Piltel's shareholdings in Meralco into Beacon Electric with a view to making Beacon Electric the single largest shareholder of Meralco and to allow Beacon Electric to access bank loan financing for additional purchase of Meralco Shares.

**Reasons for seeking shareholders' approval for a possible exercise of the Call Option and, if applicable, the reasons for subscribing for the Convertible Bonds**

By seeking First Pacific shareholders' advance approval of a possible exercise of the Call Option, the Company intends to give the respective boards of directors of Beacon Electric and MPIC the ability (if they decide to do so) to exercise the Call Option during the Call Option exercise period and to complete the Call Option in accordance with the terms of the Option Agreement; which would not otherwise be possible if the approval of First Pacific's shareholders was only sought after an exercise of the Call Option. If the Call Option were exercised and if the Piltel Investment and the transfer of MPIC Meralco Shares to Beacon Electric are all completed, Beacon Electric would hold approximately 34.8% of the issued common share capital of Meralco, which would in turn give Beacon Electric a veto right in relation to all matters of Meralco requiring approval by shareholders' representing two-thirds of the outstanding capital stock.

The Convertible Bonds will only be subscribed by MPHI if Beacon Electric and MPIC make a decision to exercise the Call Option. However, in that event, the Directors consider that the proposed terms of the Convertible Bonds are reasonable terms upon which to provide further financing to MPIC.

**Views and recommendations of the Directors**

The Directors believe that the transactions contemplated under the Omnibus Agreement, the Piltel SPA, the Piltel Subscription Agreement, the Call Option and the Option Agreement are (or, in the case of those transactions which are only possible transactions, would if implemented in accordance with the terms summarised in this Circular be) on normal commercial terms and have been (or, in the case of those transactions which are only possible transactions, would if implemented in accordance with the terms summarised in this Circular be) entered into following arm's length negotiations between the parties. The Directors also believe that the terms of those transactions (or possible transactions) are (or, in the case of the possible transactions, would if implemented in accordance with the terms summarised in this Circular be) fair and reasonable and in the interests of the Shareholders as a whole. Accordingly, the Directors recommend that Shareholders vote in favour of the resolutions approving the Piltel Investment and possible future exercise of the Call Option at the SGM.

**General**

The Company is a Hong Kong-based investment and management company with operations located in Asia. The Company's principal business interests relate to Telecommunications, Consumer Food Products, Infrastructure and Natural Resources.

MPHI is a Philippine affiliate of the Company and the holding company of MPIC.

MPIC is a Philippine corporation which is part of the Group on account of the equity interests of an affiliate of the Company. MPIC's shares are listed on the PSE. The Group has an approximately 55.6% attributable economic interest in MPIC. MPIC is a flagship infrastructure company in the Philippines, with holdings in water distribution, tollroad, electricity distribution, health-care and ports development.

Piltel is an investment holding company which owns an approximately 19.8% interest in Meralco. Piltel is held as to approximately 99.5% by Smart Communications, Inc., which in turn is wholly owned by PLDT.

PLDT is a 26.5% owned associated company of the Group.

FPHC's major business segments are in power generation, roads and tollways operations, construction and sale of merchandise, and real estate in the Philippines.

Meralco is a Philippine corporation with its shares listed on the PSE. It is the largest distributor of electricity in the Philippines with a service area spanning 9,337 square kilometres, where approximately a quarter of the total Philippine population resides. It has a customer base of about 4.7 million, comprising commercial, industrial and residential customers. In addition to electricity distribution, Meralco undertakes several related businesses, including operating fibre optic networks of over 1,000 kilometres and provides leased line connections, metro ethernet connections and disaster recovery transport services.

Under Philippine Financial Reporting Standards ("PFRS"), the net assets of Meralco as at 31 December 2009 were PhP57,101 million (equivalent to approximately US$1,236.0 million and approximately HK$9,640.4 million). The net profits of Meralco before and after taxation and extraordinary items were PhP9,262 million (equivalent to approximately US$193.7 million and approximately HK$1,511.1 million) and PhP6,005 million (equivalent approximately US$125.6 million and approximately HK$979.7 million), respectively, for the financial year ended 31 December 2009. The net profits of Meralco before and after taxation and extraordinary items were PhP5,200 million (equivalent to approximately US$116.4 million and approximately HK$907.8 million) and PhP2,800 million (equivalent to approximately US$62.7 million and approximately HK$488.8 million), respectively, for the financial year ended 31 December 2008.

Under International Financial Reporting Standards ("IFRS"), the net assets of Meralco as at 31 December 2009 were PhP58,296 million (equivalent to approximately US$1,261.8 million and approximately HK$9,842.2 million). The net profits of Meralco before and after taxation and extraordinary items were PhP9,812 million (equivalent to approximately US$205.2 million and approximately HK$1,600.8 million) and PhP6,576 million (equivalent approximately US$137.5 million and approximately HK$1,072.8 million), respectively, for the financial year ended 31 December 2009. The net profits of Meralco before and after taxation and extraordinary items were PhP7,875 million (equivalent to approximately US$176.3 million and approximately HK$1,374.8 million) and PhP4,100 million (equivalent to approximately US$91.8 million and approximately HK$715.8 million), respectively, for the financial year ended 31 December 2008.

Beacon Electric is a Philippines corporation which was newly established in 2010 for the purpose of the transactions contemplated by the Omnibus Agreement. The entire issued share capital of Beacon Electric is beneficially owned by MPIC. Beacon Electric will be jointly owned by MPIC and Piltel on a 50:50 basis following completion of the Piltel Investment contemplated by the Omnibus Agreement. Given that Beacon Electric is a newly incorporated company, information in relation to the net profits of Beacon Electric for the two financial years immediately preceding the date of the 1 March Announcement is not available.

**SGM**

A notice convening the SGM to be held at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong on Tuesday, 30 March 2010 at 9:00 a.m. is set out on pages 316 to 318 of this Circular.

Voting at the SGM will be taken on a poll.

A form of proxy for use at the SGM is enclosed. Whether or not Shareholders are able to attend the meeting, they are requested to complete and return the enclosed form of proxy to the Company's principal office (Attention: Corporate Secretarial Department) at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for the holding of the meeting. Completion and return of the form of proxy will not preclude Shareholders from attending and voting at the meeting should they wish to do so.

To the best of the knowledge and belief of the Directors, as at the Latest Practicable Date, no Shareholder has a material interest in the matters which are the subject of the resolutions before the SGM such that he/she/it must abstain from voting. However, having considered that Mr. Manuel V. Pangilinan, Mr. Edward Tortorici and Ambassador Albert F. del Rosario hold, in aggregate, shareholdings of approximately 1.25% (approximately 48,197,866 ordinary shares) of the Company, approximately 0.06% of MPIC and approximately 0.24% of PLDT, these Directors will abstain from voting at the SGM. Any Shareholder with a material interest in the proposed transactions (together with his/her/its associates) are not permitted to vote at the SGM.

**Additional information**

In accordance with Rule 4.03 of the Listing Rules, the accountants' report of a business to be acquired by a listed issuer is required to be prepared by professional accountants who are qualified under the Professional Accountants Ordinance (Cap. 50 of the Laws of Hong Kong) for appointment as auditors of the Company. Rule 4.03 also provides that, in the case of a circular issued by a listed issuer in connection with an acquisition of an overseas company, the Stock Exchange may be prepared to permit the accountants' report to be prepared by a firm of accountants which is not so qualified but acceptable to the Stock Exchange, provided that such firm must normally have an international name and reputation and be a member of a recognised body of accountants.

Pursuant to a waiver granted by the Stock Exchange dated 25 January 2010, the Stock Exchange has waived the Company's obligations to strictly comply with Rule 4.03 in that the Stock Exchange permits SGV to prepare the accountants' report on Meralco (as set out in Appendix II to this Circular) for inclusion in this Circular.

Your attention is also drawn to the additional information set out in the appendices to this Circular.

Yours faithfully,
For and on behalf of the Board of
**First Pacific Company Limited**
**Manuel V. Pangilinan**
*Managing Director and CEO*

## 1. SUMMARY OF FINANCIAL RESULTS AND CONDITIONS OF THE GROUP

The following financial information has been extracted from the audited consolidated financial statements of the Group as published in the Company's annual reports for the years ended 31 December 2007 and 2008 and the unaudited condensed consolidated interim financial statements of the Group as published in the Company's interim report for the six months ended 30 June 2009.

| | Six months ended | Year ended 31 December | | |
|---|---|---|---|---|
| | 30 June 2009 | 2008 | 2007 | 2006 |
| | *US$ million* | *US$ million* | *US$ million* | *US$ million* |
| | (Unaudited) | (Audited) | (Audited) | (Audited) |
| Turnover | 1,809.1 | 4,105.3 | 3,040.8 | 2,474.8 |
| Profit before taxation | 353.3 | 397.4 | 754.5 | 293.3 |
| Taxation | (52.7) | (61.4) | (94.0) | (71.6) |
| Profit for the period/year from continuing operations | 300.6 | 336.0 | 660.5 | 221.7 |
| Profit for the period/year from a discontinued operation | 2.7 | 0.6 | 5.1 | – |
| Profit before minority interest | 303.3 | 336.6 | 665.6 | 221.7 |
| Minority interest | (139.0) | (135.8) | (160.8) | (57.2) |
| Profit attributable to owners of the parent | 164.3 | 200.8 | 504.8 | 164.5 |
| Ordinary share dividends | | | | |
| Interim – 2009: U.S. 0.51 cent (2008: U.S. 0.38 cent, 2007: U.S. 0.26 cent, 2006: U.S. 0.13 cent) per share | 16.5 | 12.3 | 8.2 | 4.1 |
| Special – 2008: Nil (2007: U.S. 0.38 cent, 2006: U.S. 0.12 cent) per share | N/A | – | 12.3 | 3.9 |
| Proposed final – 2008: U.S. 0.77 cent (2007: U.S. 0.64 cent, 2006: U.S. 0.45 cent) per share | N/A | 24.7 | 20.6 | 14.4 |
| Total | 16.5 | 37.0 | 41.1 | 22.4 |
| Earnings per share (U.S. cents) | | | | |
| – Basic | 5.11 | 6.23 | 15.72 | 5.15 |
| – Diluted | 5.05 | 5.93 | 15.29 | 5.06 |

*N/A: Not applicable*

**Assets and liabilities of the Group**

| | As at 30 June | As at 31 December | | |
|---|---|---|---|---|
| | **2009** | **2008** | **2007** | **2006** |
| | *US$ million* | *US$ million* | *US$ million* | *US$ million* |
| | (Unaudited) | (Audited) | (Audited) | (Audited) |
| Total assets | 7,569.4 | 7,199.0 | 5,221.1 | 2,883.5 |
| Less: Total liabilities | 4,832.3 | 4,823.8 | 3,098.1 | 1,850.7 |
| Minority interest | 1,410.1 | 1,245.1 | 991.7 | 450.1 |
| Net assets | 1,327.0 | 1,130.1 | 1,131.3 | 582.7 |

## 2. AUDITED CONSOLIDATED FINANCIAL STATEMENTS OF THE GROUP

The following are the audited financial statements of the Group for the year ended 31 December 2008 together with the accompanying notes as extracted from the annual report of the Company for the year ended 31 December 2008.

### Consolidated Profit and Loss Statement

| **For the year ended 31 December**<br>*US$ millions* | *Notes* | **2008** | **2007**<br>(Restated)[i] |
|---|---|---|---|
| **Turnover** | 4 | 4,105.3 | 3,040.8 |
| Cost of sales | | (3,103.4) | (2,320.7) |
| **Gross Profit** | | 1,001.9 | 720.1 |
| Gain on dilutions and divestments | | 28.7 | 356.1 |
| Distribution costs | | (273.9) | (254.2) |
| Administrative expenses | | (256.8) | (170.7) |
| Other operating (expenses)/income, net | | (144.9) | 0.6 |
| Net borrowing costs | 5 | (150.5) | (137.1) |
| Share of profits less losses of associated companies and joint ventures | | 192.9 | 239.7 |
| **Profit Before Taxation** | 6 | 397.4 | 754.5 |
| Taxation | 7 | (61.4) | (94.0) |
| **Profit for the Year from Continuing Operations** | | 336.0 | 660.5 |
| Profit for the year from a discontinued operation | 8 | 0.6 | 5.1 |
| **Profit for the Year** | | 336.6 | 665.6 |
| **Attributable to:** | | | |
| Equity holders of the parent | 9 | 200.8 | 504.8 |
| Minority interest | | 135.8 | 160.8 |
| | | 336.6 | 665.6 |
| **Ordinary Share Dividends** | 10 | | |
| Interim – U.S. 0.38 cent (2007: U.S. 0.26 cent) per share | | 12.3 | 8.2 |
| Proposed special – Nil (2007: U.S. 0.38 cent) per share | | – | 12.3 |
| Proposed final – U.S. 0.77 cent (2007: U.S. 0.64 cent) per share | | 24.7 | 20.6 |
| **Total** | | 37.0 | 41.1 |

| **For the year ended 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | (Restated)[(i)] |
| **Earnings Per Share Attributable to Equity Holders of the Parent** (U.S. cents) | 11 | | |
| Basic | | | |
| – For profit from continuing operations | | 6.23 | 15.67 |
| – For profit from a discontinued operation | | – | 0.05 |
| – For profit for the year | | 6.23 | 15.72 |
| Diluted | | | |
| – For profit from continuing operations | | 5.93 | 15.24 |
| – For profit from a discontinued operation | | – | 0.05 |
| – For profit for the year | | 5.93 | 15.29 |

*(i) Refer to Note 2(B)*

The accompanying notes form an integral part of the Financial Statements.

**Consolidated Balance Sheet**

| **At 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | (Restated)[i] |
| **Non-current Assets** | | | |
| Property, plant and equipment | 12 | 808.4 | 784.1 |
| Plantations | 13 | 744.5 | 881.5 |
| Associated companies and joint ventures | 15 | 1,202.3 | 1,304.7 |
| Goodwill | 16 | 675.6 | 347.2 |
| Other intangible assets | 17 | 1,538.5 | – |
| Accounts receivable, other receivables and prepayments | 18 | 3.0 | 37.0 |
| Prepaid land premiums | 19 | 153.2 | 151.4 |
| Available-for-sale assets | 20 | 1.7 | 6.0 |
| Deferred tax assets | 21 | 38.7 | 45.0 |
| Financial assets at fair value through profit or loss | 22 | – | 79.8 |
| Other non-current assets | 23 | 217.1 | 110.0 |
| | | 5,383.0 | 3,746.7 |
| **Current Assets** | | | |
| Cash and cash equivalents | 24 | 625.9 | 600.8 |
| Pledged deposits | 34(C) | 12.0 | – |
| Available-for-sale assets | 20 | 56.9 | 24.1 |
| Accounts receivable, other receivables and prepayments | 18 | 435.5 | 355.5 |
| Inventories | 25 | 557.4 | 494.0 |
| | | 1,687.7 | 1,474.4 |
| Assets of a disposal group classified as held for sale | 8 | 128.3 | – |
| | | 1,816.0 | 1,474.4 |

| **At 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | (Restated)[i] |
| **Current Liabilities** | | | |
| Accounts payable, other payables and accruals | 26 | 667.4 | 485.6 |
| Short-term borrowings | 27 | 1,207.0 | 1,000.1 |
| Provision for taxation | 28 | 55.8 | 52.9 |
| Current portion of deferred liabilities and provisions | 29 | 39.4 | 17.4 |
| | | 1,969.6 | 1,556.0 |
| Liabilities directly associated with the assets classified as held for sale | 8 | 106.1 | – |
| | | 2,075.7 | 1,556.0 |
| **Net Current Liabilities** | | (259.7) | (81.6) |
| **Total Assets Less Current Liabilities** | | 5,123.3 | 3,665.1 |
| **Equity** | | | |
| Issued share capital | 30 | 32.1 | 32.2 |
| Other reserves | 31 | 902.0 | 1,048.6 |
| Retained earnings | | 196.0 | 50.5 |
| Equity attributable to equity holders of the parent | | 1,130.1 | 1,131.3 |
| Minority interest | 32 | 1,245.1 | 991.7 |
| **Total Equity** | | 2,375.2 | 2,123.0 |
| **Non-current Liabilities** | | | |
| Long-term borrowings | 27 | 1,951.7 | 1,044.5 |
| Deferred liabilities and provisions | 29 | 432.4 | 180.5 |
| Deferred tax liabilities | 21 | 364.0 | 310.8 |
| Derivative liability | 33 | – | 6.3 |
| | | 2,748.1 | 1,542.1 |
| | | 5,123.3 | 3,665.1 |

*(i) Refer to Note 2(B)*

The accompanying notes form an integral part of the Financial Statements.

On behalf of the Board of Directors

**MANUEL V. PANGILINAN**
*Managing Director and Chief Executive Officer*

**EDWARD A. TORTORICI**
*Executive Director*

25 March 2009

**Company Balance Sheet**

| **At 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | |
| **Non-current Assets** | | | |
| Subsidiary companies | 14 | 996.2 | 906.2 |
| Loans to a joint venture | | – | 104.3 |
| | | 996.2 | 1,010.5 |
| **Current Assets** | | | |
| Cash and cash equivalents | 24 | 45.9 | 106.3 |
| Amounts due from subsidiary companies | 14(A) | 1,889.5 | 1,781.8 |
| Other receivables and prepayments | | 0.1 | 0.2 |
| | | 1,935.5 | 1,888.3 |
| **Current Liabilities** | | | |
| Amounts due to subsidiary companies | 14(B) | 832.6 | 814.5 |
| Other payables and accruals | | 0.6 | 0.6 |
| | | 833.2 | 815.1 |
| **Net Current Assets** | | 1,102.3 | 1,073.2 |
| **Total Assets Less Current Liabilities** | | 2,098.5 | 2,083.7 |
| **Equity** | | | |
| Issued share capital | 30 | 32.1 | 32.2 |
| Other reserves | | 1,182.2 | 1,162.5 |
| Retained earnings | | 344.0 | 348.1 |
| Equity attributable to equity holders of the parent | | 1,558.3 | 1,542.8 |
| **Non-current Liabilities** | | | |
| Loans from subsidiary companies | 14(C) | 540.2 | 540.9 |
| | | 2,098.5 | 2,083.7 |

The accompanying notes form an integral part of the Financial Statements.

On behalf of the Board of Directors

**MANUEL V. PANGILINAN**
*Managing Director and Chief Executive Officer*

**EDWARD A. TORTORICI**
*Executive Director*

25 March 2009

## Consolidated Statement of Changes in Equity

| US$ millions | Notes | Issued share capital | Share premium | Share options issued | Unrealized gains/ (losses) on available-for-sale assets | Unrealized (losses)/ gains on cash flow hedges | Exchange reserve | Capital and other reserves | (Accumulated losses)/ retained earnings | Total | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Equity attributable to equity holders of the parent | | | | | | | | | | |
| Balance at 1 January 2007 | | 32.0 | 964.2 | 11.3 | 51.9 | (6.6) | (42.7) | (2.6) | (424.8) | 582.7 | 450.1 | 1,032.8 |
| Changes in equity for 2007: | | | | | | | | | | | | |
| Exchange differences on translating foreign operations | | – | – | – | – | – | 84.2 | – | – | 84.2 | (29.5) | 54.7 |
| Unrealized gains on available-for-sale assets | | – | – | – | 3.9 | – | – | – | – | 3.9 | 2.2 | 6.1 |
| Realized gains on available-for-sale assets | | – | – | – | (45.5) | – | – | – | – | (45.5) | (3.3) | (48.8) |
| Unrealized gains on cash flow hedges | | – | – | – | – | 13.4 | – | – | – | 13.4 | – | 13.4 |
| Net income and expense recognized directly in equity | | – | – | – | (41.6) | 13.4 | 84.2 | – | – | 56.0 | (30.6) | 25.4 |
| Profit for the year | | – | – | – | – | – | – | – | 504.8 | 504.8 | 160.8 | 665.6 |
| Total recognized income and expense for the year | | – | – | – | (41.6) | 13.4 | 84.2 | – | 504.8 | 560.8 | 130.2 | 691.0 |
| Divestment and dilution of interest in an associated company | | – | – | – | – | 0.5 | 3.3 | – | – | 3.8 | – | 3.8 |
| Dilution of interest in subsidiary companies | | – | – | – | – | – | (0.8) | 0.3 | – | (0.5) | – | (0.5) |
| Acquisition of subsidiary companies | 34(A) | – | – | – | – | – | – | – | – | – | 203.5 | 203.5 |
| Change in attributable interests | | – | – | – | – | – | – | – | – | – | 222.9 | 222.9 |
| Dividends paid to minority shareholders | | – | – | – | – | – | – | – | – | – | (15.0) | (15.0) |
| Issue of shares upon the exercise of share options | 30(A) | 0.2 | 7.5 | (2.4) | – | – | – | – | – | 5.3 | – | 5.3 |
| Repurchase and cancellation of shares | 30(B) | – | – | – | – | – | – | – | (3.0) | (3.0) | – | (3.0) |
| Equity-settled share option arrangements | | – | – | 8.7 | – | – | – | – | – | 8.7 | – | 8.7 |
| 2006 special dividend | | – | – | – | – | – | – | – | (3.9) | (3.9) | – | (3.9) |
| 2006 final dividend | | – | – | – | – | – | – | – | (14.4) | (14.4) | – | (14.4) |
| 2007 interim dividend | 10 | – | – | – | – | – | – | – | (8.2) | (8.2) | – | (8.2) |
| Balance at 31 December 2007 (Restated)[i] | | 32.2 | 971.7 | 17.6 | 10.3 | 7.3 | 44.0 | (2.3) | 50.5 | 1,131.3 | 991.7 | 2,123.0 |

| *US$ millions* | *Notes* | Equity attributable to equity holders of the parent | | | | | | | | | Minority interest | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Issued share capital | Share premium | Share options issued | Unrealized gains/ (losses) on available-for-sale assets | Unrealized (losses)/ gains on cash flow hedges | Exchange reserve | Capital and other reserves | (Accumulated losses)/ retained earnings | Total | | |
| Balance at 31 December 2007 | | | | | | | | | | | | |
| As previously reported | | 32.2 | 971.7 | 17.6 | 10.3 | 7.3 | 44.2 | (2.3) | 56.1 | 1,137.1 | 992.6 | 2,129.7 |
| Prior year adjustments | 2(B) | – | – | – | – | – | (0.2) | – | (5.6) | (5.8) | (0.9) | (6.7) |
| As restated[(i)] | | 32.2 | 971.7 | 17.6 | 10.3 | 7.3 | 44.0 | (2.3) | 50.5 | 1,131.3 | 991.7 | 2,123.0 |
| Changes in equity for 2008: | | | | | | | | | | | | |
| Exchange differences on translating foreign operations | | – | – | – | – | – | (159.9) | – | – | (159.9) | (177.2) | (337.1) |
| Unrealized gains on available-for-sale assets | | – | – | – | 1.6 | – | – | – | – | 1.6 | 1.3 | 2.9 |
| Realized gains on available-for-sale assets | | – | – | – | (0.1) | – | – | – | – | (0.1) | – | (0.1) |
| Unrealized losses on cash flow hedges | | – | – | – | – | (5.9) | – | – | – | (5.9) | – | (5.9) |
| Net income and expense recognized directly in equity | | – | – | – | 1.5 | (5.9) | (159.9) | – | – | (164.3) | (175.9) | (340.2) |
| Profit for the year | | – | – | – | – | – | – | – | 200.8 | 200.8 | 135.8 | 336.6 |
| Total recognized income and expense for the year | | – | – | – | 1.5 | (5.9) | (159.9) | – | 200.8 | 36.5 | (40.1) | (3.6) |
| Divestment and dilution of interest in an associated company | | – | – | – | – | – | (0.3) | – | – | (0.3) | – | (0.3) |
| Dilution of interest in subsidiary companies | | – | – | – | – | – | 0.2 | – | – | 0.2 | – | 0.2 |
| Acquisition of subsidiary companies | 34(A) | – | – | – | – | 0.5 | – | (2.4) | – | (1.9) | 295.1 | 293.2 |
| Change in attributable interests | | – | – | – | – | – | – | – | – | – | 25.7 | 25.7 |
| Reserve of a disposal group classified as assets held for sale | | – | – | – | (0.1) | – | – | 0.1 | – | – | – | – |
| Dividends paid to minority shareholders | | – | – | – | – | – | – | – | – | – | (27.3) | (27.3) |
| Issue of shares upon the exercise of share options | 30(A) | 0.1 | 2.4 | (0.9) | – | – | – | – | – | 1.6 | – | 1.6 |
| Repurchase and cancellation of shares | 30(B) | (0.2) | – | – | – | – | – | 0.2 | (10.1) | (10.1) | – | (10.1) |
| Equity-settled share option arrangements | | – | – | 18.0 | – | – | – | – | – | 18.0 | – | 18.0 |
| 2007 special dividend | 10 | – | – | – | – | – | – | – | (12.3) | (12.3) | – | (12.3) |
| 2007 final dividend | 10 | – | – | – | – | – | – | – | (20.6) | (20.6) | – | (20.6) |
| 2008 interim dividend | 10 | – | – | – | – | – | – | – | (12.3) | (12.3) | – | (12.3) |
| **Balance at 31 December 2008** | | 32.1 | 974.1 | 34.7 | 11.7 | 1.9 | (116.0) | (4.4) | 196.0 | 1,130.1 | 1,245.1 | 2,375.2 |

*(i) Refer to Note 2(B)*

The accompanying notes form an integral part of the Financial Statements.

**Company Statement of Changes in Equity**

| *US$ millions* | *Notes* | Issued share capital | Share premium | Share options issued | Capital redemption reserve | Contributed surplus | Retained earnings | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2007** | | 32.0 | 964.2 | 10.7 | – | 173.8 | 265.6 | 1,446.3 |
| Profit for the year | | – | – | – | – | – | 112.0 | 112.0 |
| Issue of shares upon the exercise of share options | 30(A) | 0.2 | 7.5 | (2.4) | – | – | – | 5.3 |
| Repurchase and cancellation of shares | 30(B) | – | – | – | – | – | (3.0) | (3.0) |
| Equity-settled share option arrangements | 36(A) | – | – | 8.7 | – | – | – | 8.7 |
| 2006 special dividend | | – | – | – | – | – | (3.9) | (3.9) |
| 2006 final dividend | | – | – | – | – | – | (14.4) | (14.4) |
| 2007 interim dividend | 10 | – | – | – | – | – | (8.2) | (8.2) |
| **Balance at 31 December 2007** | | 32.2 | 971.7 | 17.0 | – | 173.8 | 348.1 | 1,542.8 |
| Profit for the year | | – | – | – | – | – | 51.2 | 51.2 |
| Issue of shares upon the exercise of share options | 30(A) | 0.1 | 2.4 | (0.9) | – | – | – | 1.6 |
| Repurchase and cancellation of shares | 30(B) | (0.2) | – | – | 0.2 | – | (10.1) | (10.1) |
| Equity-settled share option arrangements | 36(A) | – | – | 18.0 | – | – | – | 18.0 |
| 2007 special dividend | 10 | – | – | – | – | – | (12.3) | (12.3) |
| 2007 final dividend | 10 | – | – | – | – | – | (20.6) | (20.6) |
| 2008 interim dividend | 10 | – | – | – | – | – | (12.3) | (12.3) |
| **Balance at 31 December 2008** | | 32.1 | 974.1 | 34.1 | 0.2 | 173.8 | 344.0 | 1,558.3 |

The accompanying notes form an integral part of the Financial Statements.

**Consolidated Cash Flow Statement**

| **For the year ended 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | (Restated)[(i)] |
| **Profit Before Taxation** | | | |
| From continuing operations | | 397.4 | 754.5 |
| From a discontinued operation | | 1.3 | 6.8 |
| Adjustments for: | | | |
| Interest expenses | 5 | 185.3 | 167.8 |
| Loss/(gain) on changes in fair value of plantations | 6 | 97.7 | (22.0) |
| Foreign exchange and derivative losses/(gains), net | 6 | 83.2 | (20.0) |
| Depreciation | 6 | 79.2 | 64.5 |
| Impairment losses recognized | | 43.9 | 38.7 |
| Decrease/(increase) in accounts receivable, other receivables and prepayments (Non-current) | | 37.5 | (2.3) |
| Amortization of other intangible assets | 17 | 27.3 | – |
| Equity-settled share option expense | 36(A) | 18.0 | 8.7 |
| Recognition of prepaid land premiums | 6 | 7.1 | 2.8 |
| Share of profits less losses of associated companies and joint ventures | | (192.9) | (239.7) |
| Increase in other non-current assets | | (35.7) | (10.4) |
| Interest income | 5 | (34.8) | (30.7) |
| Gain on dilution of interest in subsidiary companies | 6 | (18.9) | (149.6) |
| Gain on divestment and dilution of interest in an associated company | 6 | (9.8) | (206.5) |
| Realized gain on sale of available-for-sale assets | 6 | (0.6) | (25.0) |
| Gain on sale of property, plant and equipment | 6 | (0.6) | (0.2) |
| Dividend income from available-for-sale assets | 6 | (0.5) | – |
| Dividend income from financial assets at fair value through profit or loss | 6 | – | (2.9) |
| Others | | (7.5) | 26.2 |
| | | 676.6 | 360.7 |
| Increase in accounts payable, other payables and accruals | | 69.1 | 137.1 |
| Increase in inventories | | (160.3) | (116.1) |
| Increase in accounts receivable, other receivables and prepayments (Current) | | (151.6) | (84.4) |
| Net cash generated from operations[(ii)] | | 433.8 | 297.3 |
| Interest received | | 40.7 | 30.3 |
| Interest paid | | (196.9) | (113.6) |
| Tax paid | 28 | (112.4) | (83.3) |
| **Net Cash Inflow from Operating Activities** | | 165.2 | 130.7 |

*(i) Refer to Note 2(B)*

*(ii) Changes in working capital are stated excluding movements due to acquisition and disposal of subsidiary companies.*

| **For the year ended 31 December** | | **2008** | **2007** |
|---|---|---|---|
| *US$ millions* | *Notes* | | (Restated)[(i)] |
| Dividend received from associated companies | 15(B) | 211.9 | 155.0 |
| Proceeds from sale of property, plant and equipment | | 20.8 | 7.8 |
| Acquisition of subsidiary companies | 34(A) | (611.8) | (517.6) |
| Purchase of property, plant and equipment | | (163.4) | (69.5) |
| Investments in associated companies | 34(B) | (140.5) | – |
| Investments in plantations | | (76.7) | (36.8) |
| Investments in intangible assets | | (67.8) | – |
| Acquisition of available-for-sale assets | | (38.9) | – |
| Loans and advances to a joint venture, net | | (19.0) | (96.0) |
| Deposits for increased investments in subsidiary companies | | (12.9) | – |
| Proceeds from divestment principally of financial assets at fair value through profit or loss | | – | 49.1 |
| Proceeds from disposal of available-for-sale assets | | – | 31.2 |
| Dividend received from financial assets at fair value through profit or loss | | – | 2.9 |
| Increased investment in associated companies | | – | (514.8) |
| Increased investment in a subsidiary company | | – | (25.6) |
| **Net Cash Outflow from Investing Activities** | | (898.3) | (1,014.3) |
| Proceeds from new borrowings | | 1,871.1 | 1,793.8 |
| Proceeds from sale of shares by a subsidiary company | | 62.1 | – |
| Proceeds from the issue of shares upon the exercise of share options | | 1.6 | 5.3 |
| Borrowings repaid | | (1,050.9) | (824.1) |
| Dividends paid to shareholders | | (45.2) | (26.5) |
| Dividends paid to minority interest by subsidiary companies | | (27.3) | (15.0) |
| Repurchase of shares | | (10.1) | (3.0) |
| Repurchase of subsidiary companies' shares | | (7.7) | – |
| Shares issued to minority interest by subsidiary companies | | – | 264.0 |
| Decrease in pledged deposits and restricted cash | | – | 31.3 |
| Payments in respect of financing arrangements | | – | (6.0) |
| **Net Cash Inflow from Financing Activities** | | 793.6 | 1,219.8 |
| **Net Increase in Cash and Cash Equivalents** | | 60.5 | 336.2 |
| Cash and cash equivalents at 1 January | | 600.8 | 267.4 |
| Exchange translation | | (35.4) | (2.8) |
| **Cash and Cash Equivalents at 31 December** | | 625.9 | 600.8 |

*(i) Refer to Note 2(B)*

The accompanying notes form an integral part of the Financial Statements.

## Notes to the Financial Statements

### 1. CORPORATE INFORMATION

First Pacific Company Limited is a Hong Kong-based investment and management company with operations located in Asia. Its principal business interests relate to telecommunications, consumer food products, infrastructure and natural resources.

The Group comprises the Company and its subsidiary companies.

The Company is a limited liability company incorporated in Bermuda. The address of its registered office is Canon's Court, 22 Victoria Street, Hamilton HM12, Bermuda.

The Company's ordinary shares are listed on the SEHK. Its shares are also available in the US through ADRs.

### 2. BASIS OF PREPARATION, SUMMARY OF PRINCIPAL ACCOUNTING POLICIES AND CHANGES

#### (A) Basis of Preparation

The Financial Statements have been prepared in accordance with HKFRSs (which include all HKFRSs, HKASs and Interpretations) issued by the HKICPA, Hong Kong GAAP and the disclosure requirements of the Hong Kong Companies Ordinance and the Listing Rules. The Financial Statements have been prepared under the historical cost convention except for plantations, financial assets at fair value through profit or loss, available-for-sale assets and derivative financial instruments which, as disclosed in the accounting policies below, are stated at fair value. These Financial Statements are presented in US (U.S.) dollars and rounded to the nearest million (US$ millions) with one decimal place except when otherwise indicated.

#### (B) Impact of New and Revised HKFRSs and Changes in Accounting Policies

Certain changes to Hong Kong GAAP have been implemented during 2008 as a consequence of the following new and revised HKFRSs issued by the HKICPA:

| | |
|---|---|
| HKAS 39 and HKFRS 7 Amendments | "Reclassification of Financial Assets"[(i)] |
| HK(IFRIC)-Int 11 | "HKFRS 2 – Group and Treasury Share Transactions"[(ii)] |
| HK(IFRIC)-Int 12 | "Service Concession Arrangements"[(iii)] |
| HK(IFRIC)-Int 14 | "HKAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"[(iii)] |

(i) Effective from 1 July 2008
(ii) Effective for annual periods commencing on or after 1 March 2007
(iii) Effective for annual periods commencing on or after 1 January 2008

The adoption of HKAS 39 and HKFRS 7 Amendments, HK(IFRIC)-Int 11 and HK(IFRIC)-Int 14 has had no effect on both the profit attributable to equity holders of the parent for the years ended 31 December 2008 and 31 December 2007 and equity attributable to equity holders of the parent at 31 December 2008 and 31 December 2007. The impact of adopting HK(IFRIC)-Int 12 is summarized as follows.

HK(IFRIC)-Int 12 covers contractual arrangements arising from private entities providing public services. The Group's adoption of HK(IFRIC)-Int 12 affects its accounting for the results of operations and financial position of its joint venture (which become a subsidiary company of the Group since July 2008), Maynilad. Maynilad holds an exclusive concession, granted by Metropolitan Waterworks and Sewerage System (MWSS) on behalf of the Philippine government, to provide water and sewerage services and charge users for the services provided in the area of West Metro Manila. Under HK(IFRIC)-Int 12, Maynilad (i) recognized the value of concession assets as intangible assets (subject to amortization) and the present value of concession fees payable (subject to accretion of interest expenses) during the entire concession period retrospectively, (ii) reclassified certain of its property, plant and equipment (representing the water infrastructure) which will be vested to MWSS at the end of the concession period as its concession assets and amortized on a straight-line basis over the concession period (which results in changes in depreciation and amortization expenses), (iii) recognized contract revenue, costs and margins for its services of constructing and upgrading the infrastructure used to provide its services, and (iv) retranslated the foreign currency denominated portion of the concession fees payable and loans based on the closing exchange rate at each balance sheet date and capitalized the foreign exchange differences as deferred credits or charges given the existence of a recovery mechanism for these foreign exchange differences in accordance with the concession agreement entered into between MWSS and Maynilad.

Upon DMWC's acquisition of Maynilad in January 2007, the Group has already accounted for Maynilad's concession assets at fair value and recognize the present value of concession fees payable the remaining concession life. Therefore, the financial impact of the Group's adoption of HK(IFRIC)-Int 12 is limited to (i) a reclassification of certain property, plant and equipment to concession assets and their amortization over the remaining concession life, (ii) a recognition of construction revenue, costs and margins, and (iii) a recognition of foreign exchange differences arising from the retranslation of foreign currency denominated portion of concession fees payable and loans as deferred credits or charges.

The effect of the above changes is summarized below:

*(a) Effect on the consolidated balance sheet at 31 December 2008 and 2007*

| **Effect of new accounting policies**<br>**At 31 December**<br>*US$ millions* | **2008** | **2007** |
|---|---|---|
| **Assets** | | |
| Decrease in property, plant and equipment | (382.5) | – |
| Increase in other intangible assets | 388.2 | – |
| Decrease in associated companies and joint ventures | – | (6.7) |
| | 5.7 | (6.7) |
| **Liabilities/Equity** | | |
| Decrease in deferred liabilities and provisions | (9.7) | – |
| Increase in deferred tax liabilities | 3.6 | – |
| Increase/(decrease) in retained earnings | 5.0 | (5.6) |
| Decrease in exchange reserve | (0.3) | (0.2) |
| Increase/(decrease) in minority interest | 7.1 | (0.9) |
| | 5.7 | (6.7) |

*(b) Effect on the consolidated profit and loss statement for the years ended 31 December 2008 and 2007*

| **Effect of new accounting policies**<br>**For the year ended 31 December**<br>*US$ millions* | **2008** | **2007** |
|---|---|---|
| Decrease in cost of sales | 0.5 | – |
| Decrease in other operating expenses, net | 18.7 | – |
| Increase/(decrease) in share of profits less losses of associated companies and joint ventures | 6.0 | (6.1) |
| Increase in taxation | (6.0) | – |
| Increase/(decrease) in profit for the year | 19.2 | (6.1) |
| Attributable to: | | |
| Equity holders of the parent | 10.6 | (5.6) |
| Minority interest | 8.6 | (0.5) |
| Increase/(decrease) in profit for the year | 19.2 | (6.1) |
| Increase/(decrease) in earnings per share attributable to equity holders of the parent (U.S cents) | | |
| Basic | 0.33 | (0.17) |
| Diluted | 0.33 | (0.17) |

**(C) Impact of Issued but not yet Effective HKFRSs**

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these Financial Statements.

| | |
|---|---|
| HKAS 1 (Revised) | "Presentation of Financial Statements" |
| HKAS 23 (Revised) | "Borrowing Costs" |
| HKAS 27 (Revised) | "Consolidated and Separate Financial Statements" |
| HKAS 32 and HKAS 1 Amendments | "Puttable Financial Instruments and Obligations Arising on Liquidation" |
| HKAS 39 Amendments | "Eligible Hedged Items" |
| HKFRS 1 and HKAS 27 Amendments | "Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate" |
| HKFRS 1 (Revised) | "First-time Adoption of Hong Kong Financial Reporting Standards" |
| HKFRS 2 Amendments | "Share-based Payment – Vesting Conditions and Cancellations" |
| HKFRS 3 (Revised) | "Business Combinations" |
| HKFRS 7 Amendments | "Financial Instruments: Disclosures" |
| HKFRS 8 | "Operating Segments" |
| HK(IFRIC)-Int 13 | "Customer Loyalty Programmes" |
| HK(IFRIC)-Int 15 | "Agreements for the Construction of Real Estate" |
| HK(IFRIC)-Int 16 | "Hedges of a Net Investment in a Foreign Operation" |
| HK(IFRIC)-Int 17 | "Distribution of Non-cash Assets to Owners" |
| HK(IFRIC)-Int 18 | "Transfer of Assets from Customers" |
| Annual Improvements to HKFRSs | "Improvements to HKFRS" |

HKAS 1 (Revised) shall be applied for annual periods beginning on or after 1 January 2009. The main change relates to the separation of owner and non-owner changes in the statement of changes in equity. Owners represent the holders of financial instruments classified as equity. The revised standard requires the statement of changes in equity to include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the revised standard introduces the statement of comprehensive income which presents all items of income and expense recognized in profit or loss together with all other items of recognized income and expense.

HKAS 23 (Revised) shall be applied for annual periods beginning on or after 1 January 2009. The main change is the removal of the option of immediately recognizing as an expense for borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. An entity is, therefore, required to capitalize borrowing costs as part of the cost of such assets.

HKAS 27 (Revised) shall be applied for annual periods beginning on or after 1 July 2009. The revised standard replaces the term "minority interest" with "non-controlling interest" and requires changes in a parent's ownership interest in a subsidiary company that do not result in a loss of control to be accounted for as equity transactions.

HKAS 32 and HKAS 1 Amendments shall be applied for annual periods beginning on or after 1 January 2009. The amendments require entitles to classify (a) puttable financial instruments and (b) instruments, or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation as equity, if they have particular features and fulfill certain specific criteria.

HKAS 39 Amendments address the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. They clarify that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item.

HKFRS 1 and HKAS 27 Amendments should be applied for annual periods beginning on or after 1 January 2009. The HKAS 27 Amendments require all dividends from subsidiaries, associates or jointly controlled entities to be recognized in the income statement in the separate financial statements. The amendments are applied prospectively only. The HKFRS 1 Amendments allow a first-time adopter of HKFRSs to measure its investment in subsidiaries, associates or jointly controlled entities using a deemed cost of either fair value or the carrying amount under the previous accounting practice in the separate financial statements.

HKFRS 1 (Revised) shall be applied for annual periods beginning on or after 1 July 2009. The revised version has an improved structure but does not contain any technical changes.

HKFRS 2 Amendments shall be applied for annual periods beginning on or after 1 January 2009. The amendments clarify that vesting conditions are service conditions and performance conditions only and that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

HKFRS 3 (Revised) shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on 1 July 2009. The revised standard requires (a) for partial acquisitions, non- controlling interests shall be measured either as their proportionate interest in the net identifiable assets or at fair value; (b) for step acquisitions, goodwill shall be measured as the difference at the acquisition date between the fair value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired; (c) the recognition of acquisition-related costs as expenses, rather than included in goodwill and (d) the recognition of contingent consideration measured at fair value at the acquisition date.

HKFRS 7 Amendments shall be applied for annual periods beginning on or after 1 January 2009. The amendments require fair value measurements to be disclosed by the source of inputs, using the three-level hierarchy of (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly (as prices) or indirectly (derived from prices) (Level 2) and (c) inputs for the assets or liabilities that are not based on observable market data (unobservable inputs) (Level 3).

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The standard adopts a management approach to reporting segment information. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. HKFRS 8 will replace HKAS 14 "Segment Reporting".

HK(IFRIC)-Int 13 shall be applied for annual periods beginning on or after 1 July 2008. This interpretation requires that loyalty award credits granted to customers as part of a sales transaction are accounted for as a separate component of the sales transaction. The consideration received in the sales transaction is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished.

HK(IFRIC)-Int 15 shall be applied for annual periods beginning on or after 1 January 2009. This interpretation standardizes accounting practice across jurisdictions for the recognition of revenue by real estate developers for sales of units, including the sale of properties before their constructions are complete. In addition, the interpretation provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of HKAS 11 "Construction Contracts" or HKAS 18 "Revenue" and, accordingly, when revenue from the construction should be recognized.

HK(IFRIC)-Int 16 shall be applied for annual periods beginning on or after 1 October 2008. This interpretation clarifies the issues of (a) whether risk arises from (i) the foreign currency exposure to the functional currencies of the foreign operation and the parent entity, or from (ii) the foreign currency of the foreign operation and the presentation currency of the parent entity's consolidated financial statements; (b) which entity within the group can hold a hedging instrument in a hedge of a net investment in a foreign operation and (c) how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item when the entity disposes of the investment.

HK(IFRIC)-Int 17 shall be applied for annual periods beginning on or after 1 July 2009. This interpretation provides guidance to the entities which distributes assets other than cash (i.e., non-cash assets to its owners acting in their capacity as owners) The interpretation requires entities to (a) recognize the dividend payable when the dividend is appropriately authorized and is no longer at the discretion of the entity; (b) measure the dividend payable at the fair value of the assets to be distributed and (c) recognize the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable in the profit and loss when the entities settle the dividend payable.

HK(IFRIC)-Int 18 shall be applied for the transfer of assets from customers received on or after 1 July 2009. This interpretation requires that when an entity receives from a customer a transfer of an item of property, plant and equipment, it should recognize the asset only if it acquires a control of that asset, instead of by reference to the receipt of a right of ownership.

Improvements to HKFRSs sets out certain amendments to HKFRSs made in response to International Accounting Standards Board's annual improvement projects, which include certain changes that may result in accounting changes for presentation, recognition or measurement purposes. The key amendments are summarized as follows.

HKAS 1 "Presentation of Financial Statements" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with HKAS 39 are examples of current assets and liabilities, respectively.

HKAS 16 "Property, Plant and Equipment" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment requires entities which routinely sell items of property, plant and equipment that it has held for rental to others to (a) recognize the proceeds from the sale of such assets as revenue in accordance with HKAS 18 and (b) transfer the carrying amount of the asset to inventories when the asset ceases to be rental and becomes held for sale.

HKAS 19 "Employee Benefits" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment clarifies that (a) a plan amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation; (b) plan administration costs are deducted in the calculation of return on plan assets only to the extent that such costs have been excluded from measurement of the defined benefit obligation; and (c) the distinction between short-term and long-term employee benefits should be based on whether benefits are due to be settled within or after 12 months of employee service being rendered.

HKAS 23 "Borrowing Costs" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment clarifies that interest expense should be calculated using the effective interest method defined in HKAS 39.

HKAS 27 "Consolidated and Separate Financial Statements" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment clarifies that where an investment in a subsidiary that is accounted for under HKAS 39, is classified as held for sale under HKFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", HKAS 39 will continue to be applied.

HKAS 28 "Investment in Associates" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment requires an investment in associate to be treated as a single asset for the purpose of impairment testing and any impairment loss not to be allocated to any specific assets, including goodwill that forms part of the carrying amount of the investment in the associate. Accordingly, any reversal of that impairment loss is recognized in accordance with HKAS 36 to the extent that the recoverable amount of the investment subsequently increases. In addition, the amendment clarifies that where an investment in associate is accounted for in accordance with HKAS 39, only certain rather than all disclosure requirements in HKAS 28 need to be made in addition to disclosures required by HKAS 32 "Financial Instruments: Presentation" and HKFRS 7 "Financial Instruments: Disclosures".

HKAS 31 "Interests in Joint Ventures" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment clarifies that where an investment in joint venture is accounted for in accordance with HKAS 39, only certain rather than all disclosure requirements in HKAS 31 need to be made in addition to disclosures required by HKAS 32 and HKFRS 7.

HKAS 36 "Impairment of Assets" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment requires disclosure equivalent to those for value-in-use calculation to be made when using discounted cash flow projections in determining fair value less costs to sell in assessing recoverable amounts.

HKAS 38 "Intangible Assets" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment (a) clarifies that an entity should recognize expenditure on goods and services received when it receives those goods or services in relation to advertising and promotional activities; and (b) removes the statement which is perceived as preventing an entity from using a method that results in a lower rate of amortization than the straight-line method.

HKAS 39 "Financial Instruments: Recognition and Measurement" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment (a) clarifies that it is possible for there to be movements into and out of the fair value through profit or loss category where a derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge; (b) removes the requirement for hedge accounting to be applied at segment level and (c) requires a revised effective interest rate to be used when remeasuring the carrying amount of a debt instrument on cessation of fair value hedge accounting.

HKAS 40 "Investment Property" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment requires (a) property that is under construction or development for future use as investment property to be accounted for as investment property in accordance with HKAS 40 and (b) investment property under construction to be measured at cost until its fair value becomes reliably determinable or construction is complete (whichever is earlier).

HKAS 41 "Agriculture" Amendment shall be applied for annual periods beginning on or after 1 January 2009. The amendment requires (a) the use of market-based discount rate in measuring the fair value of a biological asset based on its present value of expected net cash flows and (b) requires the inclusion of the net cash flows that market participants would expect the asset to generate in its most relevant market in calculating fair value.

HKFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" Amendment shall be applied for annual periods beginning on or after 1 July 2009. The amendment requires an entity that is committed to a sale plan involving loss of control of a subsidiary to classify all assets and liabilities of that subsidiary as held for sale when the criteria set out in HKFRS 5 are met.

The Group has not early adopted the above new and revised HKFRSs for the year ended 31 December 2008. The Company has already commenced an assessment of the impact of these new and revised HKFRSs but is not yet in a position to state whether these new and revised HKFRSs would have a significant impact on its results of operations and financial position and presentation of consolidated financial statements.

**(D) Summary of Principal Accounting Policies**

*(a) Basis of consolidation*

The Financial Statements include the financial statements of the Company and its subsidiary companies for the year ended 31 December 2008. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

A subsidiary company is an entity controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities.

The results of subsidiary companies acquired or disposed of during the year are included in the consolidated profit and loss statement from the effective date of acquisition, being the date on which the Group obtains control, or up to the effective date of disposal, as appropriate. The gain or loss on disposal of a subsidiary company represents the difference between the net proceeds from sale and the Group's share of its net assets, including the attributable carrying amount of goodwill.

The acquisition of subsidiary companies during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity investments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

Minority interest represents the interests of minority shareholders not held by the Group in the results and net assets of the Company's subsidiary companies. An acquisition of a minority interest is accounted for using the parent entity extension method whereby the difference between the consideration and the existing carrying amount of the share of the net assets acquired is recognized as goodwill.

For business combinations involving entities or businesses under common control (a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory), they are accounted for applying the principles of merger accounting which is consistent with Accounting Guideline 5 "Merger Accounting for Common Control Combinations" issued by the HKICPA. The method requires the combined entity recognizing the assets, liabilities and equity of the combining entities or businesses at the carrying amounts (i.e., existing book values from the controlling parties' perspective) in the consolidated financial statements of the controlling party or parties prior to the common control combination. There is no recognition of any goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identified assets, liabilities and contingent liabilities over the cost at the time of the common control combination to the extent of the controlling party's or parties' interests.

In the Company's balance sheet, investments in subsidiary companies are stated at cost less any provision for impairment losses. The results of subsidiary companies are accounted for by the Company on the basis of dividends received and receivable.

*(b)* *Cash and cash equivalents*

For the purpose of the balance sheets, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short-term highly liquid investments which are readily convertible into known amounts of cash, are subject to an insignificant risk of changes in value, less bank overdrafts which are repayable on demand and which form an integral part of the Group's cash management.

*(c)* *Inventories*

Inventories are stated at the lower of cost and net realizable value. Cost is calculated using the first-in, first-out method, the weighted average method or the moving average method, and in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. The cost of goods purchased for resale includes costs incurred in bringing the goods to their present location. Net realizable value is determined on the basis of current anticipated selling prices less estimates of costs to completion and selling expenses.

*(d)* *Property, plant and equipment*

Freehold land is stated at cost and is not depreciated. Other property, plant and equipment is stated at cost less accumulated depreciation and any impairment losses, calculated on the straight-line basis at annual rates estimated to write off their book values to residual values over their expected useful lives. Details of depreciation rates are set out in Note 12(A).

The initial cost of property, plant and equipment comprises its purchase price and any costs directly attributable in bringing the asset to its working condition and location for its intended use. Cost also includes asset retirement obligation, interest on borrowed funds used during the construction period and qualified borrowing costs from foreign exchange losses related to foreign currency denominated liabilities used to acquire such assets. Major costs incurred in restoring property, plant and equipment to their normal working condition are charged to the profit and loss statement. Improvements are capitalized and depreciated over their expected useful lives to the Group. When assets are sold or retired, their costs and accumulated depreciation, amortization and impairment losses, if any, are eliminated from the accounts and any gain or loss resulting from their disposal is included in the profit and loss statement.

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed periodically to ensure that the periods and method of depreciation are consistent with the expected pattern of economic benefits from items of property, plant and equipment.

*(e)* *Plantations*

Plantations, which primarily comprise oil palm and rubber plantations, are stated at fair value less estimated point-of- sale costs. Gains or losses arising on initial recognition of plantations at fair value less estimated point-of-sale costs and from the change in fair value less estimated point-of-sale costs of plantations at each reporting date are included in the profit and loss statement for the period in which they arise.

The fair value of the oil palm plantations is estimated by reference to independent professional valuations using the discounted cash flows of the underlying plantations. The expected cash flows from the whole life cycle of the oil palm plantations is determined using the market price of the estimated yield of the fresh fruit bunches (FFB), net of maintenance and harvesting costs, and any costs required to bring the oil palm plantations to maturity. The estimated yield of the oil palm plantations is dependent on the age of the oil palm trees, the location, soil type and infrastructure. The market price of the FFB is largely dependent on the prevailing market price of the crude palm oil (CPO) and palm kernel oil (PKO).

Oil palm trees have an average life that ranges from 20 to 25 years, with the first three to four years as immature and the remaining as mature.

Rubber tress have an average life that ranges from 20 to 25 years, with the first five to six years as immature and the remaining years as mature. Rubber plantations are considered mature when at least 70% of the trees per block are tapable and, the circumference of the trunk of the tree is 45 centimeters or more at the height of 160 centimeters from the ground.

*(f) Associated companies*

An associated company is an entity, not being a subsidiary company or a joint venture, in which the Group has a long-term interest of generally not less than 20% of the equity voting rights and over whose management the Group is in a position to exercise significant influence, including participation in the financial and operating policy decisions.

Investments in associated companies are accounted for by the equity method of accounting, less any impairment losses. The Group's investments in associated companies include goodwill (net of any accumulated impairment losses) identified on acquisition. The Group's share of its associated companies' post-acquisition profits and losses is recognized in the consolidated profit and loss statement, and its share of post-acquisition movements in reserves is recognized in consolidated reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Income from associated companies is stated in the consolidated profit and loss statement as the Group's share of profits less losses of associated companies. For the share of associated companies' post acquisition movements in reserves recognized in the Group's consolidated reserves, the Group will disclose them, when applicable in the consolidated statement of changes in equity.

Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

*(g) Joint ventures*

The Group recognized its interest in joint ventures using the equity method of accounting. Under the equity method of accounting, such interest is stated at cost plus post-acquisition changes in the Group's share in the net assets of the joint ventures, less any impairment losses. The profit and loss statement reflects the Group's share of the results of operation of the joint ventures from the date of incorporation of the joint ventures.

*(h) Intangible assets (other than goodwill)*

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired from business combinations is initially recognized at fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment loss. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date. The Group's concession assets represent the fair value of concessions of right granted by governments to charge users of public services provided. The concession assets are amortized using the straight-line method over the term of the concessions. The Group's brands represent the brands for its various milk-related products. The brands are amortized using the straight- line method over their estimated useful lives.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash- generating unit level. Such intangible assets are not amortized. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis.

*(i) Asset retirement obligations*

The net present value of legal obligations associated with the retirement of an item of property, plant and equipment that resulted from the acquisition, construction or development and the normal operation of property, plant and equipment is recognized in the period in which it is incurred.

*(j) Income tax*

Income tax comprises current and deferred taxes. Income tax is recognized in the profit and loss statement, or in equity if it relates to items that are recognized directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax liabilities are provided, using the liability method, on all taxable temporary differences (with limited exceptions) arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes.

Deferred tax assets are recognized for all deductible temporary differences, carryforward of unused tax assets and unused tax losses (with limited exceptions). The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Conversely, previously unrecognized deferred tax assets are recognized to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

*(k) Provisions and contingent liabilities*

A provision is recognized when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. When the effect of discounting is material, the amount recognized for a provision is the present value, at the balance sheet date, of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount, arising from the passage of time, is included in net borrowing costs in the profit and loss statement.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow is remote.

*(l) Impairment of assets*

An assessment is made at each balance sheet date as to whether there is any indication of impairment of assets including property, plant and equipment, certain investments, goodwill and other long-lived assets, or whether there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset’s recoverable amount is estimated. An asset’s recoverable amount is calculated as the higher of the asset’s fair value less costs to sell and value in use.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss statement in the period in which it arises, unless the asset is carried at a revalued amount, then the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognized impairment loss of all assets other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of the asset. However, this is limited and will not give rise to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortization), had no impairment loss been recognized for the asset in prior years.

A reversal of such an impairment loss is credited to the profit and loss statement in the period in which it arises, unless the asset is carried at a revalued amount, in which case the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

*(m) Accounting for acquisition and disposal*

(I) Results

The results of subsidiary or associated companies acquired or disposed of are accounted for from or to the effective date of acquisition or disposal.

(II) Fair value adjustments

On the acquisition of a subsidiary company or an interest in an associated company, the acquisition cost is allocated to the fair values of the identifiable assets, liabilities and contingent liabilities acquired.

(III) Goodwill

Goodwill represents the excess of the cost of the acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities acquired as at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is not amortized but reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired and its amount will be written down for impairment when it is considered necessary. A previously recognized impairment loss for goodwill is not reversed.

Any excess of the Group's interest in the net fair value of the acquirees' identifiable assets, liabilities and contingent liabilities over the cost of the acquisition, after reassessment, is recognized immediately in the consolidated profit and loss statement.

In the case of associated companies and joint ventures, goodwill is included in the carrying amount thereof, rather than as a separately identified asset on the consolidated balance sheet.

*(n) Foreign currencies*

(I) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The Financial Statements are presented in the currency of US dollars, which is the Company's functional and presentation currency.

(II) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the profit and loss statement (except for those which will be refunded or billed to customers through billings as approved by governments under service concession arrangements). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(III) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each profit and loss statement are translated at average exchange rates; and

(iii) all resulting exchange differences are recognized as a separate component of equity. On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to equity. When a foreign operation is sold, such exchange differences are recognized in the profit and loss statement as part of the gain or loss on disposal.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and are translated at the closing rate.

(IV) Cash flow statement

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiary companies are translated into US dollars at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries and jointly-controlled entities which arise throughout the year are translated into US dollars at average exchange rates of the year.

*(o) Turnover and revenue recognition*

Turnover represents the amounts received and receivable from the sale of goods and the rendering of services to third parties, falling within the ordinary activities of the Group's businesses. Turnover from sales is recognized when the ownership of goods sold has been transferred to the buyer. Turnover from services is recognized when it can be measured reliably by reference to stages of completion for the rendering of the said services.

Construction revenue is recognized by reference to the stages of completion. Dividend income is recognized when the Group's right to receive payment has been established. Interest income is recognized as it accrues taking into account the principal amount outstanding and the effective interest rate.

*(p)* *Segmental information*

A segment is a distinguishable component of the Group that is engaged either in providing certain products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. They are determined before intragroup balances and intragroup transactions are eliminated as part of the consolidation process.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year. The Head Office and other items mainly comprise the Head Office's assets, borrowings and overheads.

*(q)* *Leases*

Leases, where substantially all of the risks and rewards of ownership of assets remain with the lessor, are accounted for as operating leases. Where the Group is the lessee, rentals payable under operating leases are recorded in the profit and loss statement on the straight-line basis over the lease terms.

Prepaid land premiums for land lease payments under operating leases are initially stated at cost and subsequently recognized as expenses on the straight-line basis over the lease terms.

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalized at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Finance lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. A finance lease gives rise to a depreciation expense for the asset as well as a borrowing cost for each period. Finance charges are charged directly to current operations. The depreciation policy for leased assets is consistent with that for depreciable assets that are owned.

*(r)* *Employee benefits*

(I) Pension obligations

The Group operates defined contribution and defined benefit retirement schemes.

Contributions to defined contribution schemes by the Group and employees are calculated as a percentage of the employees' basic salaries. The Group's contributions to defined contribution schemes are expensed as incurred and are reduced by contributions forfeited by those employees who leave the schemes prior to the contributions vesting fully.

Contributions to defined benefit schemes are determined based on the value of the retirement scheme assets and estimates of the effects of future events on the actuarial present value of accrued pension obligations, and are determined on the basis of actuarial valuations using the projected unit credit method. The costs of defined benefit schemes are charged against profit on a systematic basis so as to be spread over the expected remaining service lives of the employees affected. Actuarial gains and losses are recognized immediately in the profit and loss statement as and when they occur.

(II) Long service payments

Certain of the Group's employees are eligible for long service payments in the event of the termination of their employment. A provision is recognized in respect of the probable future long service payments expected to be made. The provision is the best estimate of the probable future payments that have been earned by the employees from their service to the Group at the balance sheet date.

(III) Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value of the share options at the date at which they are granted. Fair value is determined using an option pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the relevant shares (market conditions).

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). The cumulative expense recognized for equity- settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that will ultimately vest, based on the best available estimate.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, an expense, as a minimum, is recognized as if the terms had not been modified. An expense is recognized for any increase in the value of the transactions as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(IV) Cash-settled transactions

The Group's associated companies grant share appreciation rights (SARs) to eligible key executives and advisors, and recognize the services received and the liability to pay for those services, as the eligible key executives and advisors render services during the vesting period. The liability is measured, initially and at each reporting date until settled, at the fair value of the SARs, by applying an option valuation model, taking into account the terms and conditions on which the SARs were granted, and the extent to which the eligible key executives and advisors have rendered service to date. Until settled, any changes in fair value at each reporting date will be recognized in the profit and loss statement.

(V) Paid leave carried forward

The Group provides paid annual leave to its employees under their employment contracts on a calendar year basis. Under certain circumstances, such leave which remains untaken as at the balance sheet date is permitted to be carried forward and utilized by the respective employees in the following year. An accrual is made at the balance sheet date for the expected future cost of such paid leave earned during the year by the employees and carried forward.

*(s)* *Borrowing costs*

Borrowing costs are interest and other costs incurred in connection with the borrowing of funds. Other costs include exchange differences on foreign currency borrowings. Exchange differences arising from foreign currency borrowings are included in borrowing costs to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs are expensed in the profit and loss statement in the year in which they are incurred, except to the extent that they are capitalized as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to prepare for its intended use or sale.

*(t)* *Financial assets and financial liabilities*

The Group recognizes a financial asset or a financial liability in the consolidated balance sheet when the Group becomes a party to the contractual provisions of the instrument and derecognizes a financial asset when the Group no longer controls the contractual rights to the cash flows that comprise the financial instrument which is normally the case when the instrument is sold, or all the cash flows attributable to the instrument have already expired or are passed through to an independent third party. A financial liability (or a part of a financial liability) is derecognized when the obligation is extinguished. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, are done using the trading date accounting, which means, the accounting based on the date that the Group commits to purchase or sell the asset.

Financial assets in the scope of HKAS 39 "Financial Instruments: Recognition and Measurement" are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available- for-sale financial assets, as appropriate. Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Group has the positive intention and ability to hold to maturity. Available-for-sale financial assets are non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in any of the other three categories.

A financial asset or financial liability can be designated as a financial asset or financial liability at fair value through profit or loss only upon its initial recognition. The Group may use this designation only in the case of a contract containing one or more embedded derivatives (as described below) or when doing so results in more relevant information, because either

(i) it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases; or

(ii) a group of financial assets, financial liabilities or both are managed and their performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the Group's key management personnel.

For a contract containing one or more embedded derivatives, the Group may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:

(i) the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or

(ii) it is clear with little or no analysis when a similar hybrid (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits that holder to prepay the loan for approximately its amortized cost.

Financial assets or financial liabilities are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit or loss. Fair value is determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities.

After initial recognition, the following financial assets and liabilities are measured at amortized cost using the effective interest rate method: (i) loans and receivables; (ii) held-to-maturity investments; and (iii) financial liabilities other than liabilities measured at fair values through profit or loss, whereas available-for-sale assets are measured at fair value with gains or losses being recognized as a separate component of equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the profit and loss statement. Amortized cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Amortized cost for held-to-maturity investments is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initially recognized amount and the maturity amount.

Investments in unquoted equity securities and derivatives linked thereon are measured at cost.

Amortization of discounts and premiums is taken directly to the consolidated profit and loss statement. Changes in the fair value of financial assets and liabilities measured at fair value of (i) all derivatives (except for those eligible for hedge accounting); (ii) other items intended to be actively traded; and (iii) any item designated as "at fair value through profit or loss" at origination, are taken directly to the profit and loss statement. Changes in the fair value of available-for-sale financial assets are recognized in equity, except for the foreign exchange fluctuations on available-for-sale debt securities and the interest component which is taken directly to net profit or loss for the period based on the asset's effective yield.

Financial assets and liabilities include financial instruments which may be a primary instrument, such as receivables, payables and equity securities, or a derivative instrument, such as financial options, futures and forwards, interest rate swaps and currency swaps.

Financial instruments are classified as a financial liability or a financial asset or an equity in accordance with the substance of the contractual arrangement. Financial instruments that contain both liability and equity elements are classified separately as financial liabilities, or equity instruments. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Group has a legally enforceable right to offset and the Group intends to settle either on a net basis or to realize the asset and settle the liability simultaneously.

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset is impaired.

(I) Assets carried at amortized cost

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognized in the profit and loss statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the profit and loss statement, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

(II) Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

(III) Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the profit and loss statement, is transferred from equity to the profit and loss statement. Impairment losses on equity instruments classified as available for sale are not reversed through the profit and loss statement.

*(u) Derivative instruments*

The Group uses derivative financial instruments such as long-term currency swaps, foreign currency options, interest rate swaps and forward currency contracts to hedge its risks associated with foreign currency and interest rate fluctuations. Such derivative financial instruments are stated at fair value.

The criteria for a derivative instrument to be classified as a hedge include: (i) the hedge transaction is expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk, (ii) the effectiveness of the hedge can be reliably measured, (iii) there is adequate documentation of the hedging relationships at the inception of the hedge, and (iv) for cash flow hedges, the forecast transaction, which is the subject of the hedge, must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.

For the purpose of hedge accounting, hedges are classified as either fair value hedges where they hedge the exposure to changes in the fair value of a recognized asset or liability and firm commitment; or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

In relation to fair value hedges which meet the conditions for special hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognized immediately in the profit and loss statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognized in the profit and loss statement.

In relation to cash flow hedges, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized directly in equity and the ineffective portion is recognized in the consolidated profit or loss statement. The gains or losses that are accumulated in equity are transferred to the profit and loss statement in the same period in which the hedged item affects the profit or loss.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the profit and loss statement.

*(v) Dividends*

Final dividends proposed by the Directors are recognized as a liability when they have been approved by the shareholders and declared in an annual general meeting.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and bye– laws grant the Directors the authority to declare interim dividends. Consequently, interim dividends are recognized immediately as a liability when they are proposed and declared.

*(w) Related parties*

A party is considered to be related to the Group if:

(I) directly, or indirectly through one or more intermediaries, the party (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(II) the party is an associate;

(III) the party is a joint venture in which the entity is a venturer;

(IV) the party is a member of the key management personnel of the Group;

(V) the party is a close member of the family of any individual referred to in (I) or (IV);

(VI) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (IV) or (V); or

(VII) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

*(x) Non-current assets (or disposal groups) held for sale*

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use.

## 3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of the Group's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

### (A) Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have significant effect on the amounts recognized in the Financial Statements:

*(a) Classification of financial assets and financial liabilities*

The Group determines the classification of certain of assets and liabilities as financial assets and financial liabilities by judging whether they meet the definition of financial assets and financial liabilities set out in HKAS 39. Accordingly, the financial assets and financial liabilities are accounted for in accordance with the Group's accounting policies set out in Note 2(D)(t).

*(b) Service concession arrangements*

In applying HK(IFRIC)-Int 12 for the service concession arrangements of Maynilad and Manila North Tollways Corporation (MNTC), the Group has made judgments that these arrangements qualify for the application of the intangible asset model. Details of the Group's accounting policy in respect of intangible assets (other than goodwill) are set out in Note 2(D)(h).

**(B) Estimation Uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*(a) Estimating useful lives and residual values of property, plant and equipment*

The Group estimates the useful lives and residual values of its property, plant and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives and residual values of the property, plant and equipment are reviewed annually and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, the Group's estimation of the useful lives and residual values of its property, plant and equipment is based on its collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in those estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives and residual values of the Group's property, plant and equipment would increase its recorded depreciation expenses and decrease its non-current assets.

*(b) Estimating useful lives of brands*

The Group estimates the useful lives of the brands for its various milk-related products. The estimated useful lives of the brands are reviewed annually and are updated if expectations differ from previous estimates due to changes in market situations or other limits. It is possible, however, that future results of operations could be materially affected by changes in those estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of the Group's brands would increase its recorded amortization expenses and decrease its other intangible assets.

*(c) Assets impairment*

Hong Kong GAAP requires that an impairment review should be performed when certain impairment indication is present. In case of goodwill, such assets are subject to yearly impairment test and whenever there is an indication that such assets may be impaired.

Purchase accounting requires extensive use of accounting estimates to allocate the purchase price to the fair market values of the assets and liabilities purchased, including intangible assets and contingent liabilities. The Group's business acquisitions have resulted in goodwill, which is subject to a periodic impairment test.

Determining the fair value of property, plant and equipment, plantations, and intangible assets (other than goodwill) at the date of acquisition of business, which requires the determination of future cash flows expected to be generated from the continued use (i.e., value in use) and ultimate disposition of such assets, requires the Group to make estimates and assumptions that can materially affect its consolidated financial statements. Future events could cause the Group to conclude that property, plant and equipment associated with an acquired business is impaired. Any resulting impairment loss could have a material adverse impact on its financial condition and results of operations.

The preparation of estimated future cash flows involves significant estimations. While the Group believes that its assumptions are appropriate and reasonable, significant changes in its assumptions may materially affect its assessment of recoverable values and may lead to future additional impairment charges under Hong Kong GAAP.

*(d)* *Deferred tax assets*

The Group reviews the carrying amounts at each balance sheet date and reduces deferred tax assets to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. However, there is no assurance that the Group will generate sufficient taxable profit to allow all or part of its recognized deferred tax assets to be utilized.

*(e)* *Financial assets and liabilities*

Hong Kong GAAP requires that the Group carries certain of its financial assets and liabilities at fair value, which requires extensive use of accounting estimates. While significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates and interest rates), the amount of changes in fair value would differ if the Group utilized different valuation methodologies. Any changes in fair value of these financial assets and liabilities would affect directly the Group's consolidated profit and loss and equity.

*(f)* *Estimating allowances for accounts receivable*

The Group estimates the allowance for accounts receivable based on two methods. The amounts calculated using each of these methods are combined to determine the total amount it provides. Firstly, the Group evaluates specific accounts where it has information that certain customers are unable to meet their financial obligations. In these cases, the Group uses judgment, based on the best available facts and circumstances, including but not limited to, the length of its relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific provisions for customers against amounts due to reduce its receivable amounts that the Group expects to collect. These specific provisions are re-evaluated and adjusted as additional information received affects the amounts estimated. Secondly, a provision is established as a certain percentage of age of status of receivables. This percentage is based on a collective assessment of historical collection, write-off, experience and changes in its customer payment terms.

The amounts and timing of recorded expenses for any period would differ if the Group utilized different estimates. An increase in the Group's allowance for accounts receivable would increase its recorded operating expenses and decrease its assets.

*(g)* *Estimating allowances for inventories*

The Group estimates the allowance for inventories based on the best available facts and circumstances, including but not limited to, the inventories' own conditions (i.e., whether they are damaged or become wholly or partially obsolete), their market selling prices, estimated costs of completion and estimated costs to be incurred for their sale. The provisions are re-evaluated and adjusted as additional information received affects the amount estimated.

*(h)* *Pension and other retirement benefits*

The determination of the Group's obligation and cost for defined benefits is performed by independent actuaries engaged by the Group and dependent on the selection of certain assumptions used by them in calculating such amounts. Those assumptions include among others, discount rates, expected returns on plan assets, rates of salary and pension increase and average remaining working lives of employees. In accordance with Hong Kong GAAP, actual results that differ from the Group's assumptions are recognized immediately in the profit and loss statement as and when they occur. While the Group believes that the actuaries' assumptions are reasonable and appropriate, significant differences in the Group's actual experience or significant changes in the Group's assumptions may materially affect its pension and other retirement obligations.

*(i) Measurement of fair value of plantations*

Hong Kong GAAP requires that the Group carries its plantations at fair value less estimated point-of-sale costs, which requires extensive use of accounting estimates. The determination of such fair value less estimated point-of-sale costs is performed by independent valuers engaged by the Group. Significant components of fair value measurement were determined using assumptions including average life of plantations, yield per hectare, plantation area and discount rates. The amount of changes in fair value would differ if the Group utilized different assumptions. Any changes in fair value of these plantations would affect directly the Group's profit and loss and equity.

*(j) Equity-settled share option expense*

Hong Kong GAAP requires that the Group measures its share options at fair value at the date at which they are granted, which requires extensive use of accounting estimates. The determination of such fair value is performed by an independent valuer engaged by the Group. Significant components of fair value measurement were determined using assumptions including expected volatility and dividend yield and average risk-free interest rate. The amount of fair value determined at the date of which the options are granted would differ if the Group utilized different assumptions. Any changes in fair value of the share options determined at the date of which they are granted would affect directly the Group's profit and loss in subsequent periods when these fair values are recognized as expenses over the share options' vesting period.

**4. TURNOVER AND SEGMENTAL INFORMATION**

| *US$ millions* | **2008** | **2007** (Restated) |
|---|---|---|
| **Turnover** | | |
| Sale of goods | 3,896.9 | 2,980.1 |
| Rendering of services | 208.4 | 60.7 |
| **Total** | 4,105.3 | 3,040.8 |

**Segmental Information**

Segmental information, relating to the Group's business and geographical segments, is analyzed as follows. Analysis by business segment is the Group's primary segment reporting format as this is more relevant to the Group when making operational and financial decisions. Details of the Group's principal investments are provided on pages 103 to 104.

**By Principal Business Activity – 2008**

| *US$ millions* | Telecom-munications | Consumer Food Products | Infrastructure | Natural Resources | Head Office | 2008 Total |
|---|---|---|---|---|---|---|
| **Profit and Loss** | | | | | | |
| Segment revenue – turnover | – | 3,992.5 | 112.8 | – | – | 4,105.3 |
| Segment results | – | 359.6 | 41.5 | – | (46.1) | 355.0 |
| Net borrowing costs | | | | | | (150.5) |
| Share of profits less losses of associated companies and joint ventures | 194.8 | 0.5 | (1.2) | (1.2) | – | 192.9 |
| Profit before taxation | | | | | | 397.4 |
| Taxation | | | | | | (61.4) |
| Profit for the year from continuing operations | | | | | | 336.0 |
| Profit for the year from a discontinued operation | | | | | | 0.6 |
| Profit for the year | | | | | | 336.6 |
| **Assets and Liabilities** | | | | | | |
| Segment assets | – | 3,951.2 | 1,933.7 | – | 14.5 | 5,899.4 |
| Associated companies and joint ventures | 1,043.8 | 15.4 | 48.0 | 95.1 | – | 1,202.3 |
| Unallocated assets | | | | | | 97.3 |
| Total assets | | | | | | 7,199.0 |
| Segment liabilities | – | 533.7 | 677.9 | – | 33.7 | 1,245.3 |
| Unallocated liabilities | | | | | | 3,578.5 |
| Total liabilities | | | | | | 4,823.8 |
| **Other Information** | | | | | | |
| Capital expenditure | – | 232.3 | 68.2 | – | – | 300.5 |
| Depreciation and amortization | – | 76.5 | 29.5 | – | 0.5 | 106.5 |
| Loss on changes in fair value of plantations | – | 97.7 | – | – | – | 97.7 |
| Foreign exchange and derivative losses, net | – | 73.6 | 3.3 | – | 6.3 | 83.2 |
| Impairment losses recognized | – | 5.6 | 1.9 | – | 36.4 | 43.9 |
| Other non-cash expenses | – | 7.1 | – | – | 18.0 | 25.1 |

**By Principal Geographical Market – 2008**

| *US$ millions* | The Philippines | Indonesia | Others | Head Office | 2008 Total |
|---|---|---|---|---|---|
| Segment revenue – turnover | 112.8 | 3,992.5 | – | – | 4,105.3 |
| Segment assets | 1,933.7 | 3,951.2 | – | 14.5 | 5,899.4 |
| Associated companies and joint ventures | 1,183.6 | 15.4 | 3.3 | – | 1,202.3 |
| Unallocated assets | | | | | 97.3 |
| Total assets | | | | | 7,199.0 |
| Capital expenditure | 68.2 | 232.3 | – | – | 300.5 |

**By Principal Business Activity – 2007**

| *US$ millions* | Telecom-munications | Consumer Food Products | Infrastructure | Natural Resources | Head Office | 2007 (Restated) Total |
|---|---|---|---|---|---|---|
| **Profit and Loss** | | | | | | |
| Segment revenue – turnover | – | 3,040.3 | 0.5 | – | – | 3,040.8 |
| Segment results | – | 410.8 | 38.3 | – | 202.8 | 651.9 |
| Net borrowing costs | | | | | | (137.1) |
| Share of profits less losses of associated companies and joint ventures | 209.2 | (0.3) | 30.8 | – | – | 239.7 |
| Profit before taxation | | | | | | 754.5 |
| Taxation | | | | | | (94.0) |
| Profit for the year from continuing operations | | | | | | 660.5 |
| Profit for the year from a discontinued operation | | | | | | 5.1 |
| Profit for the year | | | | | | 665.6 |
| **Assets and Liabilities** | | | | | | |
| Segment assets | – | 3,495.5 | 150.4 | – | 195.4 | 3,841.3 |
| Associated companies and joint ventures | 1,078.9 | 2.3 | 223.5 | – | – | 1,304.7 |
| Unallocated assets | | | | | | 75.1 |
| Total assets | | | | | | 5,221.1 |
| Segment liabilities | – | 532.2 | 83.1 | – | 74.5 | 689.8 |
| Unallocated liabilities | | | | | | 2,408.3 |
| Total liabilities | | | | | | 3,098.1 |
| **Other Information** | | | | | | |
| Capital expenditure | – | 104.5 | 1.6 | – | 0.2 | 106.3 |
| Depreciation and amortization | – | 63.4 | 0.7 | – | 0.4 | 64.5 |
| Impairment losses recognized | – | 35.8 | 2.9 | – | – | 38.7 |
| Other non-cash expenses | – | 2.8 | – | – | 12.3 | 15.1 |

**By Principal Geographical Market – 2007**

| *US$ millions* | The Philippines | Indonesia | Others | Head Office | 2007 (Restated) Total |
|---|---|---|---|---|---|
| Segment revenue – turnover | 0.5 | 3,040.3 | – | – | 3,040.8 |
| Segment assets | 150.4 | 3,495.5 | – | 195.4 | 3,841.3 |
| Associated companies and joint ventures | 1,296.7 | 2.3 | 5.7 | – | 1,304.7 |
| Unallocated assets | | | | | 75.1 |
| Total assets | | | | | 5,221.1 |
| Capital expenditure | 1.6 | 104.5 | – | 0.2 | 106.3 |

## 5. NET BORROWING COSTS

| *US$ millions* | 2008 | 2007 (Restated) |
|---|---|---|
| Bank loans and other loans | | |
| – Wholly repayable within five years | 163.6 | 159.7 |
| – Not wholly repayable within five years | 21.7 | 8.1 |
| **Total Borrowing Costs** | 185.3 | 167.8 |
| Less interest income | (34.8) | (30.7) |
| **Net Borrowing Costs** | 150.5 | 137.1 |

No borrowing costs were capitalized by the Group during the year (2007: Nil).

## 6. PROFIT BEFORE TAXATION

| *US$ millions* | *Notes* | 2008 | 2007 |
|---|---|---|---|
| **Profit Before Taxation is Stated after (Charging)/Crediting**[(i)] | | | |
| Cost of inventories sold | | (2,470.1) | (1,886.8) |
| Employees' remuneration | 36(A) | (347.3) | (280.7) |
| (Loss)/gain on changes in fair value of plantations | 13 | (97.7) | 22.0 |
| Cost of services rendered | | (96.7) | (28.0) |
| Foreign exchange and derivative (losses)/gains, net | 9 | (83.2) | 20.0 |
| Depreciation | 12 | (79.2) | (64.5) |
| Impairment losses | | | |
| – Associated companies and joint ventures[(ii)] | | (36.4) | (2.9) |
| – Accounts receivable[(iii)] | 18(C) | (7.0) | (2.5) |
| – Goodwill[(ii)] | 16 | (0.5) | (16.7) |
| – Other non-current assets[(ii)] | | – | (12.4) |
| – Property, plant and equipment[(ii)] | 12 | – | (4.2) |
| Amortization of other intangible assets | 17 | (27.3) | – |
| Operating lease rentals | | | |
| – Land and buildings | | (8.6) | (10.1) |
| – Hire of plant and equipment | | (3.6) | (0.4) |
| Recognition of prepaid land premiums | 19 | (7.1) | (2.8) |
| Auditors' remuneration | | | |
| – Audit services | | (2.1) | (1.9) |
| – Other services | | (0.6) | (0.6) |
| Gain on dilution of interest in subsidiary companies | | 18.9 | 149.6 |
| Gain on divestment and dilution of interest in an associated company | | 9.8 | 206.5 |
| Realized gain on sale of available-for-sale assets | | 0.6 | 25.0 |
| Gain on sale of property, plant and equipment | | 0.6 | 0.2 |
| Dividend income from available-for-sale assets | | 0.5 | – |
| Dividend income from financial assets at fair value through profit or loss | | – | 2.9 |

(i) Includes amounts (charged)/credited in respect of a discontinued operation
(ii) Included in other operating (expenses)/income, net
(iii) Included in distribution costs

## 7. TAXATION

No Hong Kong profits tax (2007: Nil) has been provided as the Group had no estimated assessable profits (2007: Nil) in Hong Kong for the year. Taxation on assessable profits generated outside Hong Kong has been provided at the rates of taxation prevailing in the countries in which the Company's subsidiary companies operate.

| *US$ millions* | **2008** | **2007** (Restated) |
|---|---|---|
| **Subsidiary Companies – Overseas** | | |
| Current taxation *(Note 28)* | 121.6 | 96.5 |
| Deferred taxation *(Note 21)* | (60.2) | (2.5) |
| **Total** | 61.4 | 94.0 |

Included within the share of profits less losses of associated companies and joint ventures is taxation of US$93.7 million (2007: US$107.9 million) and which is analyzed as follows.

| *US$ millions* | **2008** | **2007** |
|---|---|---|
| **Associated Companies and Joint Ventures – Overseas** | | |
| Current taxation | 94.9 | 60.4 |
| Deferred taxation | (1.2) | 47.5 |
| **Total** | 93.7 | 107.9 |

A reconciliation between profit before taxation multiplied by the applicable tax rates and the taxation amount as shown in the consolidated profit and loss statement is as follows.

| | **2008** | | **2007** (Restated) | |
|---|---|---|---|---|
| *US$ millions* | | % | | % |
| **Profit Before Taxation** | 397.4 | | 754.5 | |
| Notional tax on profit before taxation, calculated at the rates applicable to profits in the tax jurisdictions concerned | 140.6 | 35.4 | 261.4 | 34.6 |
| Tax effect of: | | | | |
| – Non-deductible expenses | 6.0 | 1.5 | 16.3 | 2.2 |
| – Income not subject to tax | (32.5) | (8.2) | (109.6) | (14.5) |
| – Share of profits less losses of associated companies and joint ventures | (32.8) | (8.3) | (92.7) | (12.2) |
| – Others | (19.9) | (4.9) | 18.6 | 2.4 |
| **Taxation** | 61.4 | 15.5 | 94.0 | 12.5 |

**8. A DISCONTINUED OPERATION**

Following a strategic review of MPIC's businesses and its focus on core infrastructure, MPIC's directors decided in late 2008 to divest approximately 21.0% of its interest in the property business, Landco Pacific Corporation (Landco), thereby reducing MPIC's interest in Landco from 51.0% to approximately 30.0%. The divestment of interest in Landco is expected to be completed in 2009. As at 31 December 2008, Landco was classified as a disposal group held for sale.

(A) The results of Landco for the year are presented as follows.

| *US$ millions* | **2008** | **2007** |
|---|---|---|
| Turnover | 27.7 | 34.2 |
| Cost of sales and operating expense | (29.4) | (31.4) |
| Net interest income | 2.8 | 4.1 |
| Share of profits less losses of associated companies and joint ventures | 0.2 | (0.1) |
| Profit before taxation | 1.3 | 6.8 |
| Taxation | (0.7) | (1.7) |
| **Profit for the Year from a Discontinued Operation** | 0.6 | 5.1 |

(B) The major classes of assets, liabilities and reserve of Landco classified as held for sale as at 31 December 2008 are as follows:

| *US$ millions* | **2008** |
|---|---|
| **Assets** | |
| Property, plant and equipment *(Note 12)* | 2.8 |
| Associated companies and joint ventures | 3.9 |
| Deferred tax assets *(Note 21)* | 9.3 |
| Accounts receivable, other receivables and prepayment (Current) | 56.1 |
| Inventories | 51.0 |
| Other assets | 5.2 |
| Assets classified as held for sale | 128.3 |
| **Liabilities** | |
| Accounts payable, other payables and accruals | (68.9) |
| Short-term borrowings | (16.5) |
| Long-term borrowings | (15.7) |
| Deferred tax liabilities *(Note 21)* | (5.0) |
| Liabilities directly associated with the assets classified as held for sale | (106.1) |
| **Net Assets Directly Associated with the Disposal Group** | 22.2 |

| *US$ millions* | **2008** |
|---|---|
| **Reserves** | |
| Unrealized gains on available-for-sale assets of the disposal group | 0.1 |

(C) The net cash flows of Landco are as follows:

| *US$ millions* | **2008** | **2007** |
|---|---|---|
| Operating activities | (21.3) | (2.6) |
| Investing activities | 1.0 | (7.9) |
| Financing activities | 21.1 | 8.6 |
| **Net Cash Inflow/(Outflow)** | 0.8 | (1.9) |

### 9. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The profit attributable to equity holders of the parent includes US$46.9 million of net foreign exchange and derivative losses (2007: gains of US$25.0 million (Restated)), which comprise a loss of US$43.0 million (2007: US$2.7 million) on the changes in the fair values of derivatives and foreign exchange translation differences on the Group's unhedged foreign currency denominated borrowings and payables and a loss of US$3.9 million (2007: a gain of US$27.7 million) on changes in the fair value of certain PLDT shares designated as financial assets at fair value through profit or loss and US$24.5 million (2007: US$286.6 million) of net non-recurring gains.

**Analysis of Foreign Exchange and Derivative (Losses)/Gains**

| *US$ millions* | **2008** | **2007** (Restated) |
|---|---|---|
| Foreign exchange and derivative (losses)/gains | | |
| – Subsidiary companies *(Note 6)* | (83.2) | 20.0 |
| – Associated companies and joint ventures | (17.7) | 14.3 |
| Subtotal | (100.9) | 34.3 |
| Attributable to taxation and minority interest | 54.0 | (9.3) |
| **Total** | (46.9) | 25.0 |

The non-recurring gains of US$24.5 million for 2008 mainly include (i) a gain on dilution of the Group's interest in Indofood of US$18.9 million (ii) a gain on divestment and dilution of the Group's interest in PLDT of US$9.8 million (iii) MPIC's gains arising from increase in interests in Maynilad and MDI totaling US$13.4 million (iv) a gain of US$10.5 million from a reduction in Indofood's deferred tax liabilities due to reduction in future tax rates and (v) MPIC's gain on sale of assets of US$3.9 million, partly offset by a Group's impairment provision of US$36.4 million in respect of its investment in Philex. The non-recurring gains of US$286.6 million for 2007 mainly comprise a gain on divestment of the Group's interest in PLDT of US$174.7 million on settlement of certain Head Office's Exchangeable Notes with PLDT shares and a gain on dilution of the Group's effective interest in Indofood's oils and plantations businesses of US$75.9 million.

Included within the profit attributable to equity holders of the parent for the year ended 31 December 2008 is a profit of US$51.2 million (2007: US$112.0 million) attributable to the Company.

## 10. ORDINARY SHARE DIVIDENDS

| | U.S. cent per ordinary share | | US$ millions | |
|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** |
| Interim | 0.38 | 0.26 | 12.3 | 8.2 |
| Proposed special | – | 0.38 | – | 12.3 |
| Proposed final | 0.77 | 0.64 | 24.7 | 20.6 |
| **Total** | 1.15 | 1.28 | 37.0 | 41.1 |

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

## 11. EARNINGS PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share is based on the profit for the year attributable to equity holders of the parent of US$200.8 million (2007: US$504.8 million (Restated)), and the weighted average number of 3,223.5 million (2007: 3,211.4 million) ordinary shares in issue during the year.

The calculation of diluted earnings per share is based on: (i) the profit for the year attributable to equity holders of the parent of US$200.8 million (2007: US$504.8 million (Restated)) reduced by the dilutive impact of (a) US$6.1 million (2007: US$4.2 million) in respect of the convertible notes issued by DMWC and (b) US$0.3 million (2007: US$0.1 million) in respect of the exercise of share options issued by its associated companies and (ii) a share base equal to the aggregate of the weighted average number of 3,223.5 million (2007: 3,211.4 million) ordinary shares in issue during the year (as used in the basic earnings per share calculation) and the weighted average of 54.1 million (2007: 62.1 million) ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options of the Company during the year.

The impact upon full conversion of the Head Office's Exchangeable Notes and MPIC's convertible notes has not been taken into account in calculating the diluted earnings per share because their anti-dilutive effect on the basic earnings per share for the year would actually increase the earnings per share.

## 12. PROPERTY, PLANT AND EQUIPMENT

| *US$ millions* | Land and buildings | Machinery, equipment and vessels | Consolidated |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2008 | 316.2 | 934.2 | 1,250.4 |
| Exchange translation | (46.3) | (152.4) | (198.7) |
| Additions | 9.0 | 151.0 | 160.0 |
| Acquisition of subsidiary companies *(Note 34(A))* | 30.2 | 62.5 | 92.7 |
| Disposals | (14.1) | (16.7) | (30.8) |
| Reclassification *(Note 8(B))*[(i)] | (5.2) | (2.1) | (7.3) |
| **At 31 December 2008** | 289.8 | 976.5 | 1,266.3 |
| **Accumulated Depreciation and Impairment** | | | |
| At 1 January 2008 | 86.5 | 379.8 | 466.3 |
| Exchange translation | (13.3) | (59.2) | (72.5) |
| Charge for the year *(Note 6)* | 14.7 | 64.5 | 79.2 |
| Disposals | (1.9) | (8.7) | (10.6) |
| Reclassification *(Note 8(B))*[(i)] | (1.3) | (3.2) | (4.5) |
| **At 31 December 2008** | 84.7 | 373.2 | 457.9 |
| **Net Book Amount at 31 December 2008** | 205.1 | 603.3 | 808.4 |

(i) To assets of a disposal group classified as held for sale

| *US$ millions* | Land and buildings | Machinery, equipment and vessels | Consolidated |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2007 | 280.1 | 853.0 | 1,133.1 |
| Exchange translation | (15.0) | (38.1) | (53.1) |
| Additions | 29.1 | 40.4 | 69.5 |
| Acquisition of subsidiary companies *(Note 34(A))* | 23.7 | 85.0 | 108.7 |
| Disposals | (1.7) | (6.1) | (7.8) |
| **At 31 December 2007** | 316.2 | 934.2 | 1,250.4 |
| **Accumulated Depreciation and Impairment** | | | |
| At 1 January 2007 | 76.5 | 339.8 | 416.3 |
| Exchange translation | (3.3) | (15.2) | (18.5) |
| Charge for the year *(Note 6)* | 13.3 | 51.2 | 64.5 |
| Impairment *(Note 6)* | – | 4.2 | 4.2 |
| Disposals | – | (0.2) | (0.2) |
| **At 31 December 2007** | 86.5 | 379.8 | 466.3 |
| **Net Book Amount at 31 December 2007** | 229.7 | 554.4 | 784.1 |

(A) The principal annual rates of depreciation:

| | |
|---|---|
| Freehold land | Nil |
| Freehold buildings | 2.5% to 20.0% |
| Leasehold buildings | Lesser of period of lease, or 2.5% to 20.0% |
| Machinery, equipment and vessels | 2.5% to 50.0% |

(B) The land and buildings are freehold and leasehold properties held outside Hong Kong.

(C) Property, plant and equipment with a net book amount of US$183.4 million (2007: US$81.8 million) was pledged as security for certain of the Group's banking facilities (Note 27(E)).

## 13. PLANTATIONS

| | Consolidated | |
|---|---|---|
| *US$ millions* | **2008** | **2007** |
| At 1 January | 881.5 | 275.0 |
| Exchange translation | (121.6) | (29.3) |
| Additions | 76.7 | 36.8 |
| Acquisition of subsidiary companies *(Note 34(A))* | 5.6 | 577.0 |
| (Loss)/gain on changes in fair value less estimated point-of-sale costs, net *(Note 6)* | (97.7) | 22.0 |
| **At 31 December** | 744.5 | 881.5 |

Physical measurement of oil palm, rubber and other plantations at 31 December is as follows.

| | Consolidated | |
|---|---|---|
| *Hectares* | **2008** | **2007** |
| Oil palm | | |
| – Mature plantations | 124,169 | 118,029 |
| – Immature plantations | 58,944 | 43,427 |
| Rubber | | |
| – Mature plantations | 17,873 | 18,956 |
| – Immature plantations | 4,537 | 3,048 |
| Sugar cane, cocoa, tea and others | | |
| – Mature plantations | 7,044 | 2,800 |
| – Immature plantations | 761 | 722 |
| **Total** | 213,328 | 186,982 |

(A) The Group's plantations mainly represent palm trees and rubber trees owned by Indofood. The palm trees are planted for the production of FFB, which are used in the production of CPO and PKO. The rubber trees are planted for the production of cup lump. The fair values of oil palm plantations are determined by an independent valuer using the discounted future cash flows of the underlying plantations. The expected future cash flows of the oil palm plantations are determined using the forecast market price of FFB which is largely dependent on the projected selling prices of CPO and PKO in the market. The fair values of rubber plantations are determined using the discounted future cash flows of the underlying plantations. The expected future cash flows of the rubber plantations are determined using the forecast market price of cup lump which is based on the projected selling price of Rubber Smoke Sheet 1 (RSS1). Significant assumptions made in determining the fair value of the plantations are:

(a) No new planting/re-planting activities are assumed.

(b) The palm trees have an average life that ranges from 20 to 25 years, with the first three to four years as immature and the remaining years as mature. The rubber trees have an average life of that ranges from 20 to 25 years, with the first five to six years as immature and the remaining years as mature.

(c) The yield per hectare of palm trees is based on guidelines from the Indonesian Oil Palm Research Institute which varies with the average age of palm trees. The yield per hectare of rubber trees is based on estimation made by Indofood's agronomists and reviewed by an independent valuer.

(d) The discount rates of 19.3% (2007: 18.1%) and 18.2% (2007: 17.7%), which represent the respective asset specific rates for Indofood's palm trees and rubber trees plantation operations, were applied in the discounted cash flow calculations.

(e) The projected selling price of CPO over the projection period is based on the consensus of reputable independent forecasting service firms for the short term and on the studies on historical actual CPO price for the last 20 years for the remaining projected period. The projected selling price of RSS1 over the projected period is based on the reference issued by the World Bank and historical selling prices of the Group.

(B) During 2008, Indofood's palm trees produced 2.5 million tons (2007: 1.5 million tons) of FFB and rubber trees produced 28.1 thousand tons (2007: 7.9 thousand tons) of rubber. The fair values of FFB and rubber harvested during 2008, determined at the point of harvest, amounted to US$342.4 million (2007: US$206.6 million) and US$54.4 million (2007: US$8.3 million), respectively.

(C) Plantations with a net book amount of US$421.5 million (2007: US$546.2 million) were pledged as security for certain of the Group's banking facilities (Note 27(E)).

**14. SUBSIDIARY COMPANIES**

| *US$ millions* | Company 2008 | 2007 |
|---|---|---|
| Unlisted shares at cost | 1,176.6 | 1,176.6 |
| Less provision for impairment loss | (180.4) | (270.4) |
| **Total** | 996.2 | 906.2 |

The Company's listed subsidiary companies are held through the intermediate holding companies.

(A) The amounts due from subsidiary companies are unsecured, interest-bearing at a range of 0% to 7.3 % per annum (2007: 0% to 8.3% per annum) and repayable within one year. The carrying value of the Company's amounts due from subsidiary companies approximates to their fair value.

(B) The amounts due to subsidiary companies are unsecured, interest-bearing at a range of 0% to 6.8% per annum (2007:0% to 5.0% per annum) and repayable within one year. The carrying value of the Company's amounts due to subsidiary companies approximates to their fair value.

(C) The loans from subsidiary companies are unsecured, interest-bearing at a range of 2.9% to 7.1% per annum (2007: 0% to 7.1% per annum) and not repayable within one year. The carrying value of the Company's loans from subsidiary companies approximates to their fair value.

(D) Details of the principal subsidiary companies which, in the opinion of the Directors, materially affect the results or net assets of the Group, are set out on pages 103 to 104.

## 15. ASSOCIATED COMPANIES AND JOINT VENTURES

| | Associated Companies | | Joint Ventures | | Consolidated | |
|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| *US$ millions* | | | | (Restated) | | (Restated) |
| Shares, at cost | | | | | | |
| – Listed | 1,983.0 | 1,785.9 | – | – | 1,983.0 | 1,785.9 |
| – Unlisted | 102.5 | 56.9 | 2.7 | 63.4 | 105.2 | 120.3 |
| Share of post-acquisition reserves *(Note 31)* | (884.8) | (750.1) | (1.1) | 46.4 | (885.9) | (703.7) |
| Loans (from)/to associated companies and a joint venture | – | (2.1) | – | 104.3 | – | 102.2 |
| **Total** | 1,200.7 | 1,090.6 | 1.6 | 214.1 | 1,202.3 | 1,304.7 |

(A) At 31 December 2008, both the listed and unlisted investments were located outside Hong Kong.

(B) At 31 December 2008, the market valuation of listed investments was US$2,281.6 million (2007: US$3,815.9 million) and the net dividends received during 2008 amounted to US$211.9 million (2007: US$155.0 million).

(C) Details of the Group's principal associated companies, PLDT and Philex, which, in the opinion of the Directors, materially affect the results or net assets of the Group, are set out on pages 103 to 104.

(D) PLDT was incorporated under the laws of the Philippines on 28 November 1928 to provide telephone services in the Philippines. PLDT's charter was initially limited to a period of 50 years but has since been extended twice for 25 years each, the last extension being for an additional 25-year period ending in 2028. Under its amended charter, which became effective on 24 August 1991, PLDT is authorized to provide virtually every type of telecommunication service, both within the Philippines and between the Philippines and other countries. PLDT operates under the jurisdiction of the Philippine National Telecommunications Commission which jurisdiction extends, among other things, to approving major services offered by PLDT and certain rates charged by PLDT.

(E) Philex was incorporated under the laws of the Philippines in 1995 to engage in mining activities. Philex primarily engaged in large-scale exploration, development and utilization of mineral resources. Philex has operated for the past 50 years at the deposit at Padcal, Tuba Benguet Province, Island of Luzons producing gold, copper and silver as its principal products.

(F) At 31 December 2008, the Group has made an impairment provision of US$36.4 million (2007: Nil) for its investment in Philex. The impairment provision was determined by an independent valuer, ATR Kim-Eng Capital Partners, Inc. after making reference to the fair values and recoverable amounts of Philex's Padcal and Boyongan mines based on Philex's financial projections and discounted cash flow models, applying a discount rate of 12.0%.

(G) Additional financial information in respect of the Group's principal associated companies, PLDT and Philex, as prepared under Hong Kong GAAP, is set out below.

| | PLDT | | Philex[i] |
|---|---|---|---|
| *US$ millions* | **2008** | **2007** | **2008** |
| **Operating Results** | | | |
| Turnover | 3,295.3 | 3,088.3 | 2.1 |
| Profit/(loss) before taxation | 2,121.2 | 1,724.4 | (3.6) |
| Profit/(loss) after taxation | 1,564.5 | 1,459.1 | (4.1) |
| **Profit (Loss) for the Year/Period** | 720.9 | 832.6 | (2.7) |
| **Net Assets** | | | |
| Current assets | 1,389.6 | 1,192.1 | 260.6 |
| Non-current assets | 3,931.7 | 4,613.7 | 360.2 |
| **Total Assets** | 5,321.3 | 5,805.8 | 620.8 |
| Current liabilities | (1,377.4) | (1,165.6) | (123.7) |
| Non-current liabilities and provisions | (1,805.6) | (2,004.3) | (100.7) |
| **Total Liabilities** | (3,183.0) | (3,169.9) | (224.4) |
| Minority interest | (30.2) | (33.9) | (31.8) |
| **Net Assets at 31 December** | 2,108.1 | 2,602.0 | 364.6 |

(i) Information in respect of Philex only relates to 28 November 2008 (date of the Group's investment in Philex) and after.

(H) The Group has discontinued the recognition of its share of losses of Prime Media Holdings, Inc., an associated company, because the share of losses of this associated company fully eroded the Group's investment. The amounts of the Group's unrecognized share of losses of this associated company for the current year and cumulatively were US$0.6 million (2007: US$0.1 million) and US$8.7 million (2007: US$8.6 million), respectively.

**16. GOODWILL**

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| At 1 January | 347.2 | 34.8 |
| Exchange translation | (25.2) | (9.6) |
| Acquisition of subsidiary companies *(Note 34(A))* | 354.1 | 335.1 |
| Increased investment in a subsidiary company | – | 3.6 |
| Impairment *(Note 6)* | (0.5) | (16.7) |
| **Net Book Amount at 31 December** | 675.6 | 347.2 |

(A) Goodwill is allocated to the Group's cash-generating units identified according to the business and geographical segments. The goodwill amount at 31 December 2008 relates to (a) Indofood's businesses (principally plantations and dairy) which contribute to the Group's consumer food products business segment located in Indonesia and (b) MPIC's businesses (water and toll road) which contribute to the Group's infrastructure business segment located in the Philippines. The goodwill amount at 31 December 2007 solely relates to Indofood's businesses (principally plantations).

(B) In assessing the impairment for goodwill, the Group compares the carrying amount of the underlying assets against their recoverable amounts (calculated as the higher of the assets' fair value less costs to sell and their value in use). The recoverable amounts of Indofood's and MPIC's businesses have been determined based on fair value less costs to sell or value in use calculations using cash flow projections covering periods from 4 years up to 10 years (for the plantation companies) for Indofood's businesses and 14 years for MPIC's water business. The discount rates applied to cash flow projections range from 15.7% to 20.6% (2007: 12.8% to 23.7%) for Indofood's businesses and 9.2% for MPIC's water business, which reflect specific risks relating to the relevant businesses.

In the assessment of the recoverable amount of Indofood's plantation businesses, the projected price of the CPO is based on the consensus of reputable forecast service firms for the short-term period and the World Bank forecast for the remaining projection period, while the projected sugar price is determined based on the average retail sales of sugar price in Indonesia for the past five years. The cash flows beyond the projected periods are extrapolated using an estimated growth rate of 5.0%, which does not exceed the long term average growth rate of the industry and country in which the businesses operate.

In the assessment of the recoverable amount of Indofood's dairy businesses, their value in use were calculated based on their cash flow projections as per the most recent financial budgets and forecasts, which management believes are reasonable and are management's best estimates of the ranges of economic condition that will exist over the forecast period. The cash flows beyond the projected periods are extrapolated using an estimated growth rate of 5.0%, which does not exceed the long term average growth rate of the industry and country in which the businesses operate.

In the assessment of the recoverable amount of MPIC's water business, its value in use was calculated based on its cash flow projections as per the most recent financial budgets and forecasts, which management believes are reasonable and are management's best estimates of the ranges of economic condition that will exist over the forecast period.

Changes to the above assumptions used by the management to determine the recoverable values can have significant impact on the results of the assessment. Management is of the opinion that no reasonably possible change in any of the key assumptions stated above would cause the carrying amount of the goodwill for each of the cash generating units to materially exceed their recoverable values.

Goodwill arising from MPIC's acquisition of First Philippine Infrastructure, Inc. (FPII) is still provisional and, therefore, has yet to be allocated to its particular cash generating unit. Impairment testing will commence in the period when the accounting of the acquisition is finalized, which should not be more than 12 months from the date of acquisition. Notwithstanding this, management believes that based on the financial budgets and forecasts of the toll road operations, there is no impairment of goodwill arising from the acquisition of FPII in 2008.

## 17. OTHER INTANGIBLE ASSETS

| *US$ millions* | **Concession assets** | **Brands** | **Consolidated** |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2008 | – | – | – |
| Acquisition of subsidiary companies *(Note 34(A))* | 1,199.0 | 346.0 | 1,545.0 |
| Exchange translation | (44.7) | – | (44.7) |
| Additions | 63.8 | – | 63.8 |
| **At 31 December 2008** | 1,218.1 | 346.0 | 1,564.1 |
| **Accumulated Amortization** | | | |
| At 1 January 2008 | – | – | – |
| Charge for the year *(Note 6)* | 27.3 | – | 27.3 |
| Exchange translation | (1.7) | – | (1.7) |
| **At 31 December 2008** | 25.6 | – | 25.6 |
| **Net Book Amount at 31 December 2008** | 1,192.5 | 346.0 | 1,538.5 |

(A) Concession assets represent the concessions held by (a) Maynilad for its exclusive right granted by MWSS on behalf of the Philippine government to provide water and sewerage services and charge users for the services provided in the area of West Metro Manila and (b) MNTC for its rights, interests and privileges to finance, design, construct, operate and maintain toll roads, toll facilities and other facilities generating toll-related and non-toll related income in respect of the Manila North Expressway (also known as North Luzon Expressway (NLEX)) – Phases 1, 2 and 3 during their respective concession periods.

In February 1997, Maynilad entered into a concession agreement with MWSS, with respect to the MWSS West Service Area. Under the concession agreement, MWSS grants Maynilad, the sole right to manage, operate, repair, decommission and refurbish all fixed and movable assets required to provide water and sewerage services in the West Service Area for 25 years ending in 2022. The legal title to all property, plant and equipment contributed to the existing MWSS system by Maynilad during the concession period remains with the Maynilad until the expiration date at which time, all rights, titles and interests in such assets will automatically vest to MWSS. Under the concession agreement, Maynilad is entitled to the rate adjustments of (a) annual standard rate adjustment to compensate for increases in the consumer price index subject to rate adjustment limit; (b) extraordinary price adjustment to account for the financial consequences of the occurrence of certain unforeseen events subject to grounds stipulated in the concession agreement; and (c) rate rebasing mechanism allows rates to be adjusted every five years to enable Maynilad to recover expenditures efficiently and prudently incurred, Philippine business taxes and payments corresponding to debt service on concession fees and Maynilad loans incurred to finance such expenditures.

In August 1995, First Philippine Infrastructure Development Corporation (FPIDC), the parent company of MNTC, entered into a joint venture agreement with Philippine National Construction Corporation (PNCC), in which PNCC assigned its rights, interests and privileges under its franchise to construct, operate and maintain toll facilities in the NLEX and its extensions, stretches, linkages and diversions in favour of MNTC, including the design, funding, construction, rehabilitation, refurbishing and modernization and selection and installation of an appropriate toll collection system therein during the concession period subject to prior approval by the President of the Philippines. In April 1998, the Philippine government, acting by and through the Toll Regulatory Board as the grantor, PNCC as the franchisee and MNTC as the concessionaire executed a Supplemental Toll Operation Agreement (STOA) whereby the Philippine government recognized and accepted the assignment by PNCC of its usufructuary rights, interests and privileges under its franchise in favor of MNTC as approved by the President of the Philippines and granted MNTC concession rights, obligations and privileges including the authority to finance, design, construct, operate and maintain the NLEX project roads as toll roads commencing upon the date the STOA comes into effect until 31 December 2030 or 30 years after the issuance of the Toll Operation Permit for the last completed phase, whichever is earlier. In October 2008, the concession agreement was extended for another seven years to 2037. Pursuant to the STOA, MNTC is required to pay franchise fees to PNCC and to pay for the government's project overhead expenses based on certain percentages of construction costs and maintenance works on the project roads. Upon expiry of the concession period, MNTC shall hand-over the project roads to the Philippine government without cost, free from any and all liens and encumbrances and fully operational and in good working condition, including any and all existing land required, works, toll road facilities and equipment found therein directly related to and in connection with the operation of the toll road facilities.

(B) Brands represent the brands held by PT Indolakto (Indolakto) for its various milk-related products.

(C) All of the Group's concession assets and brands were acquired by the Group as part of a business combination.

(D) The useful lives for amortization:

| | |
|---|---|
| Concession assets | Remaining concession life after being acquired, 15 – 29 years |
| Brands | 20 years |

**18. ACCOUNTS RECEIVABLE, OTHER RECEIVABLES AND PREPAYMENTS**

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| Trade receivables | 258.1 | 263.3 |
| Other receivables | 120.6 | 100.8 |
| Prepayments | 59.8 | 28.4 |
| **Total** | 438.5 | 392.5 |
| **Presented As:** | | |
| **Non-current Portion** | 3.0 | 37.0 |
| **Current Portion** | 435.5 | 355.5 |
| **Total** | 438.5 | 392.5 |

(A) The carrying amount of the current portion of accounts receivable, other receivables and prepayments approximates to their fair value. The fair value of the non-current portion of accounts receivable, other receivables and prepayments is US$3.4 million (2007: US$42.0 million) which is determined based on cash flows discounted using a weighted average prevailing interest rate of 10.5% (2007: 9.9%). The weighted average effective interest rate of the non-current portion of accounts receivable, other receivables and prepayments is 11.7% (2007: 12.2%).

(B) The ageing profile of trade receivables is analyzed as below.

| *US$ millions* | **Consolidated 2008** | **2007** |
|---|---|---|
| 0 to 30 days | 204.3 | 218.6 |
| 31 to 60 days | 12.0 | 4.8 |
| 61 to 90 days | 6.7 | 5.5 |
| Over 90 days | 35.1 | 34.4 |
| **Total** | 258.1 | 263.3 |

| *US$ millions* | **Consolidated 2008** | **2007** |
|---|---|---|
| Neither past due nor impaired | 234.5 | 225.2 |
| Past due but not impaired | | |
| – 0 to 30 days past due | 9.4 | 6.0 |
| – 31 to 60 days past due | 6.2 | 5.5 |
| – 61 to 90 days past due | 7.1 | 13.8 |
| – Over 90 days past due | 0.9 | 12.8 |
| **Total** | 258.1 | 263.3 |

Receivables that were neither past due nor impaired relate to a wide range of customers for whom there was no recent history of default.

Receivables that were past due but not impaired relate to a number of customers that have a good track record with the Group. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable.

(C) At 31 December 2008, trade receivables of US$24.8 million (2007: US$4.1 million) were collectively impaired and fully provided for. Movements in the provision for impairment of trade receivables were as follows.

| *US$ millions* | **Consolidated 2008** | **2007** |
|---|---|---|
| At 1 January | (4.1) | (1.8) |
| Exchange translation | 0.6 | 0.2 |
| Charge for the year *(Note 6)* | (7.0) | (2.5) |
| **At 31 December** | (10.5) | (4.1) |

(D) As the Group's trade receivables relate to a large number of diversified customers, there is no concentration of credit risk.

(E) Indofood allows export customers 60 days of credit and local customers an average of 30 days of credit. MPIC (a) allows 60 days of credit to its water service customers, (b) collects toll fees through Tollway Management Corporation (TMC) (an associated company of MNTC's parent company) by the users' prepaid and reloadable electronic toll collection devices and credit card payment arrangements.

(F) Accounts receivable with a net book amount of US$20.9 million (2007: US$16.6 million) were pledged as security for certain of the Group's banking facilities (Note 27(E)).

## 19. PREPAID LAND PREMIUMS

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| At 1 January | 151.4 | 48.4 |
| Exchange translation | (15.8) | (4.1) |
| Acquisition of subsidiary companies *(Note 34(A))* | 29.7 | 112.9 |
| Additions | – | 2.3 |
| Recognition during the year *(Note 6)* | (7.1) | (2.8) |
| **Total Prepaid Land Premiums** | 158.2 | 156.7 |
| Current portion included in accounts receivable, other receivables and prepayments | (5.0) | (5.3) |
| **At 31 December** | 153.2 | 151.4 |

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| **Overseas, Held On:** | | |
| Leases of between 10 and 50 years | 151.0 | 153.4 |
| Leases of less than 10 years | 7.2 | 3.3 |
| **Total** | 158.2 | 156.7 |

## 20. AVAILABLE-FOR-SALE ASSETS

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| Listed investments, at fair value: | | |
| – Equity investments – Overseas | 23.8 | 24.4 |
| – Debentures with a fixed interest rate of 14.0% (2007: 14.0%) and a maturity date of 1 October 2014 (2007: 1 October 2014) – Overseas | 0.3 | 0.4 |
| Unlisted investment, at cost less impairment provisions: | | |
| – Equity investment – Overseas | 32.8 | 3.0 |
| Unlisted investment, at fair value: | | |
| – Club debentures – Hong Kong | 1.7 | 2.3 |
| **Total** | 58.6 | 30.1 |
| **Presented As:** | | |
| **Non-Current Portion** | 1.7 | 6.0 |
| **Current Portion** | 56.9 | 24.1 |
| **Total** | 58.6 | 30.1 |

The fair values of the listed equity investments and debentures are based on quoted market prices. The fair value of the unlisted investment in club debentures has been estimated by reference to recent market transaction prices. The Directors believe that the estimated fair values by reference to market prices, which are recorded in the carrying amounts of the available-for-sale assets, and the related changes in fair values, which are recorded directly in the Group's equity, are reasonable, and that they are the most appropriate values at the balance sheet date.

## 21. DEFERRED TAX

The movements in deferred tax assets during the year are as follows.

| *US$ millions* | Tax loss carry forward | Allowance for doubtful accounts | Liabilities for employee retirement benefits | Others | Consolidated |
|---|---|---|---|---|---|
| **Deferred Tax Assets** | | | | | |
| At 1 January 2008 | 7.6 | 1.3 | 22.3 | 13.8 | 45.0 |
| Exchange translation | (1.4) | (0.2) | (2.3) | (2.2) | (6.1) |
| Acquisition of subsidiary companies *(Note 34(A))* | – | – | 4.7 | 13.3 | 18.0 |
| Credit/(charge) to the profit and loss statement *(Note 7)* | 3.0 | 0.9 | (7.7) | (10.5) | (14.3) |
| Transfer from provision for taxation *(Note 28)* | – | – | – | 5.4 | 5.4 |
| Reclassification *(Note 8(B))*[(i)] | – | – | – | (9.3) | (9.3) |
| **At 31 December 2008** | 9.2 | 2.0 | 17.0 | 10.5 | 38.7 |

(i) To assets of a disposal group classified as held for sale

| *US$ millions* | Tax loss carry forward | Allowance for doubtful accounts | Liabilities for employee retirement benefits | Others | Consolidated |
|---|---|---|---|---|---|
| **Deferred Tax Assets** | | | | | |
| At 1 January 2007 | 2.4 | 0.4 | 4.9 | 12.6 | 20.3 |
| Exchange translation | (0.1) | – | (0.7) | 0.5 | (0.3) |
| Acquisition of subsidiary companies *(Note 34(A))* | – | – | 5.3 | 0.1 | 5.4 |
| Credit/(charge) to the profit and loss statement *(Note 7)* | 5.3 | 0.9 | 12.8 | (1.4) | 17.6 |
| Transfer from provision for taxation *(Note 28)* | – | – | – | 2.0 | 2.0 |
| At 31 December 2007 | 7.6 | 1.3 | 22.3 | 13.8 | 45.0 |

The movements in deferred tax liabilities during the year are as follows.

| *US$ millions* | Allowance in excess of related depreciation of property, plant and equipment | Brands | Change in fair value of plantations | Withholding tax on undistributed earnings of subsidiary and associated companies | Others | Consolidated |
|---|---|---|---|---|---|---|
| **Deferred Tax Liabilities** | | | | | | |
| At 1 January 2008 | (184.3) | – | (103.1) | (22.0) | (1.4) | (310.8) |
| Exchange translation | 21.8 | – | 11.6 | 2.1 | 14.9 | 50.4 |
| Acquisition of subsidiary companies *(Note 34(A))* | (11.7) | (86.5) | – | – | (79.0) | (177.2) |
| Credit/(charge) to the profit and loss statement *(Note 7)* | 18.3 | – | 24.5 | (2.4) | 33.4 | 73.8 |
| Transfer from provision for taxation *(Note 28)* | – | – | – | – | (5.2) | (5.2) |
| Reclassification *(Note 8(B))*[(i)] | – | – | – | – | 5.0 | 5.0 |
| **At 31 December 2008** | (155.9) | (86.5) | (67.0) | (22.3) | (32.3) | (364.0) |

(i) To liabilities directly associated with the assets classified as held for sale

| *US$ millions* | Allowance in excess of related depreciation of property, plant and equipment | Brands | Change in fair value of plantations | Withholding tax on undistributed earnings of subsidiary and associated companies | Others | Consolidated |
|---|---|---|---|---|---|---|
| **Deferred Tax Liabilities** | | | | | | |
| At 1 January 2007 | (96.6) | – | (60.6) | (4.3) | (1.8) | (163.3) |
| Exchange translation | 4.8 | – | 5.7 | – | 3.9 | 14.4 |
| Acquisition of subsidiary companies *(Note 34(A))* | (93.3) | – | (41.6) | – | (8.9) | (143.8) |
| Credit/(charge) to the profit and loss statement *(Note 7)* | 0.8 | – | (6.6) | (19.2) | 8.2 | (16.8) |
| Transfer to/(from) provision for taxation *(Note 28)* | – | – | – | 1.5 | (2.8) | (1.3) |
| At 31 December 2007 | (184.3) | – | (103.1) | (22.0) | (1.4) | (310.8) |

At 31 December 2008, tax losses available to reduce future income tax, arising in the entities to which they relate, amounted to US$9.1 million (2007: US$7.4 million) in respect of non-Hong Kong tax losses, and US$30.2 million (2007: US$30.2 million) in respect of Hong Kong tax losses. The non-Hong Kong tax losses are available for offsetting against future taxable profits of the companies in which the losses arose for three to five years, whereas Hong Kong tax losses are available indefinitely for offsetting against future taxable profits of the companies in which the losses arose. No deferred tax assets have been recognized in respect of these losses as they have arisen in subsidiary companies that have been loss-making for some time. Except for this, deferred tax assets have been properly recognized.

Pursuant to the Philippines and Indonesian income tax laws, withholding taxes of 10% to 15% is levied on dividends declared to foreign investors. The Group is therefore liable to withholding taxes on dividends distributed by its subsidiary and associated companies in the Philippines and Indonesia. At 31 December 2008, the Group has fully recognized the deferred tax for the withholding taxes that would be payable on unremitted earnings that are subject to withholding taxes of its associated companies established in the Philippines. However, except for those earnings to be distributed as dividends, no deferred tax has been recognized for withholding taxes that would be payable on the unremitted earnings of the Group's subsidiary companies established in the Philippines and Indonesia. In the opinion of the Directors, it is not probable that these subsidiary companies will distribute such earnings in the foreseeable future. The aggregate amount of temporary differences associated with investments in subsidiary companies in the Philippines and Indonesia for which deferred tax liabilities have not been recognized totalled approximately US$22.5 million at 31 December 2008 (2007: US$25.2 million).

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

## 22. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

The amount at 31 December 2007 represents the fair value, determined based on a quoted market price, of certain PLDT shares designated as financial assets at fair value through profit or loss to offset against the exposure arising from changes in the fair value of the option element embedded in the Head Office's Exchangeable Notes. Following the full settlement of the Head Office's Exchangeable Notes in February 2008, the balances of these PLDT's shares were reclassified as the Group's interests in associated companies.

**23. OTHER NON-CURRENT ASSETS**

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| Deposits for acquisition of assets | 96.4 | 34.2 |
| Input value added taxes | 31.8 | 0.3 |
| Claims for tax refund | 7.5 | 5.6 |
| Deferred charges | 7.2 | 9.0 |
| Others | 74.2 | 60.9 |
| **Total** | 217.1 | 110.0 |

The deposits for acquisition of assets mainly represent Indofood's deposits for the acquisition of vessels and certain landrights.

The input value added taxes mainly represent MNTC's input taxes from its purchase of goods and services (including those in relation to project construction cost).

The claims for tax refund relates to the tax payment in advance made by Indofood in respect of wheat importation which is creditable against Indofood's corporate income tax payable.

The deferred charges mainly represent deferred costs and expenses relating to Indofood's systems implementation.

**24. CASH AND CASH EQUIVALENTS**

| | Consolidated | | Company | |
|---|---|---|---|---|
| *US$ millions* | 2008 | 2007 | 2008 | 2007 |
| Cash at banks and on hand | 478.1 | 492.1 | 34.5 | 0.1 |
| Short-term time deposits | 147.8 | 108.7 | 11.4 | 106.2 |
| **Total** | 625.9 | 600.8 | 45.9 | 106.3 |

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term time deposits are made for varying periods of between three days and one month depending on the immediate cash requirements of the Group, and earn interest at the respective short-term time deposit rates. The bank balances and time deposits are deposited with creditworthy banks with no recent history of default. The carrying amounts of the cash and cash equivalents approximate to their fair values.

**25. INVENTORIES**

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| Raw materials | 389.9 | 281.5 |
| Work in progress | 6.1 | 6.3 |
| Finished goods | 161.4 | 154.9 |
| Properties held for sale | – | 51.3 |
| **Total** | 557.4 | 494.0 |

(A) At 31 December 2008, inventories with a carrying amount of US$68.8 million (2007: US$63.8 million) were carried at net realizable value.

(B) At 31 December 2008, inventories with a carrying amount of US$9.4 million (2007: US$13.8 million) were pledged as security for certain of the Group's banking facilities (Note 27(E)).

## 26. ACCOUNTS PAYABLE, OTHER PAYABLES AND ACCRUALS

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| Trade payables | 233.4 | 213.0 |
| Accrued expenses | 287.0 | 140.9 |
| Other payables | 147.0 | 131.7 |
| **Total** | 667.4 | 485.6 |

The ageing profile of trade payables is analyzed as follows:

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| 0 to 30 days | 220.7 | 189.4 |
| 31 to 60 days | 8.5 | 2.0 |
| 61 to 90 days | 2.6 | 5.9 |
| Over 90 days | 1.6 | 15.7 |
| **Total** | 233.4 | 213.0 |

All of the accounts payable, other payables and accruals are expected to be settled within one year. The carrying amount of the Group's accounts payable, other payables and accruals approximate to their fair value.

## 27. BORROWINGS

| *US$ millions* | Effective interest rate (%) | Maturity | *Notes* | Consolidated 2008 | 2007 |
|---|---|---|---|---|---|
| **Short-term** | | | | | |
| Bank loans | 5.0 – 17.7 (2007: 5.9 – 11.0) | 2009 (2007: 2008) | (A) | 1,115.7 | 819.6 |
| Other loans | 2.5 – 12.5 (2007: 2.5 – 13.5) | 2009 (2007: 2008) | (B) | 91.3 | 180.5 |
| Subtotal | | | | 1,207.0 | 1,000.1 |
| **Long-term** | | | | | |
| Bank loans | 5.0 – 17.7 (2007: 7.3 – 11.0) | 2010 – 2018 (2007: 2009 – 2013) | (C) | 1,770.1 | 722.4 |
| Other loans | 10.0 (2007: 7.8 – 18.3) | 2010 – 2012 (2007: 2009 – 2010) | (D) | 181.6 | 322.1 |
| Subtotal | | | | 1,951.7 | 1,044.5 |
| **Total** | | | | 3,158.7 | 2,044.6 |

The balance of short-term borrowings includes US$163.1 million (2007: US$202.5 million) of current portion of long-term borrowings.

The maturity profile of the Group's borrowings is as follows:

| *US$ millions* | Bank loans 2008 | Bank loans 2007 | Other loans 2008 | Other loans 2007 | Consolidated 2008 | Consolidated 2007 |
|---|---|---|---|---|---|---|
| Not exceeding one year | 1,115.7 | 819.6 | 91.3 | 180.5 | 1,207.0 | 1,000.1 |
| More than one year but not exceeding two years | 110.4 | 64.0 | – | 105.8 | 110.4 | 169.8 |
| More than two years but not exceeding five years | 1,129.7 | 608.9 | 181.6 | 216.3 | 1,311.3 | 825.2 |
| More than five years | 530.0 | 49.5 | – | – | 530.0 | 49.5 |
| **Total** | 2,885.8 | 1,542.0 | 272.9 | 502.6 | 3,158.7 | 2,044.6 |
| Representing amounts repayable | | | | | | |
| – wholly within five years | 2,297.3 | 1,246.0 | 272.9 | 502.6 | 2,570.2 | 1,748.6 |
| – not wholly within five years | 588.5 | 296.0 | – | – | 588.5 | 296.0 |
| **Total** | 2,885.8 | 1,542.0 | 272.9 | 502.6 | 3,158.7 | 2,044.6 |

The carrying amounts of the borrowings are denominated in the following currencies:

| *US$ millions* | Consolidated 2008 | Consolidated 2007 |
|---|---|---|
| U.S. dollar | 1,752.4 | 934.1 |
| Rupiah | 924.0 | 1,026.6 |
| Peso | 482.3 | 83.9 |
| **Total** | 3,158.7 | 2,044.6 |

An analysis of the carrying amounts of borrowings into fixed and variable interest rates is as follows:

| *US$ millions* | Consolidated 2008 | Consolidated 2007 |
|---|---|---|
| Variable interest rate | 2,479.7 | 1,552.6 |
| Fixed interest rate | 679.0 | 492.0 |
| **Total** | 3,158.7 | 2,044.6 |

The carrying amounts and fair values of the long-term borrowings are as follows:

| | Carrying amounts | | Fair values | |
|---|---|---|---|---|
| *US$ millions* | **2008** | **2007** | **2008** | **2007** |
| Bank loans | 1,770.1 | 722.4 | 1,777.0 | 731.3 |
| Other loans | 181.6 | 322.1 | 155.3 | 332.9 |
| **Total** | 1,951.7 | 1,044.5 | 1,932.3 | 1,064.2 |

The fair values are based on published price quotations for listed notes and bonds issued by the Group and projected cash flows discounted using the borrowing rates ranging from 5.0% to 17.7% (2007: 5.9% to 10.0%) for the other fixed interest rate borrowings. The carrying amounts of the Group's variable interest rate borrowings approximate to their fair values due to frequent repricing.

The carrying amounts of the short-term borrowings approximate to their fair values.

Details of the borrowings are set out below.

**(A) Short-term Bank Loans**

The balance includes US$150.0 million (with an aggregate face value of US$150.0 million) of bank loans (2007: Nil) borrowed by two wholly-owned subsidiary companies of the Company with details summarized as follows.

(a) A US$100.0 million (with a face value of US$100.0 million) bank loan (2007: Nil) drawn in November 2008 secured by the Group's 3.3% interest in PLDT, subject to a variable London Inter-bank Offer Rate (LIBOR) based interest rate, which is repayable in November 2009.

(b) A US$50.0 million (with a face value of US$50.0 million) bank loan (2007: Nil) drawn in November 2008 secured by the Group's 20.1% interest in Philex and 8.5% interest in MPIC, subject to a variable LIBOR based interest rate, which is repayable in November 2009.

**(B) Short-term Other Loans**

The balance includes Rupiah 1.0 trillion (with a face value of US$89.1 million) of Rupiah bonds (which represents the original amount issued in July 2004 of Rupiah 1.0 trillion (US$91.3 million) less repurchase of the bonds with a face value of Rupiah 24 billion (US$2.2 million) during 2005) (2007: face value of US$103.6 million) issued by Indofood, with a coupon rate of 12.5%, are payable quarterly, and mature in July 2009.

**(C) Long-term Bank Loans**

The balance includes US$634.2 million (with an aggregate face value of US$641.3 million) of bank loans (2007: US$641.1 million) borrowed by various wholly-owned subsidiary companies of the Company with details summarized as follows:

(a) A US$44.6 million (with a face value of US$45.0 million) bank loan (2007: US$49.5 million) drawn in November 2005 secured by the Group's 1.4% (2007: 1.1%) interest in PLDT, subject to a variable LIBOR based interest rate, which is repayable in November 2012.

(b) A US$49.6 million (with a face value of US$50.0 million) bank loan (2007: US$49.5 million) drawn in July 2006 secured by the Group's 1.2% (2007: 1.0%) interest in PLDT, subject to a variable LIBOR based interest rate, which is repayable in July 2011.

(c) A US$46.0 million (with a face value of US$46.3 million) bank loan (2007: US$49.5 million) drawn in November 2006 secured by the Group's 1.1% (2007: 1.1%) interest in PLDT, subject to a variable LIBOR based interest rate, which is repayable in November 2013.

(d) A US$296.5 million (with a face value of US$300.0 million) bank loan (2007: US$295.6 million) drawn in January 2007 secured by the Group's 6.7% interest (2007: 6.6%) in PLDT, subject to a variable LIBOR based interest rate, which is repayable in December 2011.

(e) A US$197.5 million (with a face value of US$200.0 million) bank loan (2007: US$197.0 million) drawn in August 2007 secured by the Group's 3.9% interest (2007: 3.9%) in PLDT, subject to a variable LIBOR based interest rate, which is repayable in December 2012.

**(D) Long-term Other Loans**

The balance includes Rupiah 2.0 trillion (with a face value of US$182.6 million) of Rupiah bonds (2007: face value of US$212.3 million) issued by Indofood in May 2007, with a coupon rate of 10.0%, are payable quarterly, and mature in May 2012.

**(E) Charges on Group Assets**

At 31 December 2008, the total borrowings include secured bank and other borrowings of US$1,604.0 million (2007: US$773.6 million). Such bank and other borrowings were secured by the Group's property, plant and equipment, plantations, accounts receivable and inventories equating to a net book value of US$635.2 million (2007: US$658.4 million) and the Group's interest of 17.6% (2007: 13.7%) in PLDT, 8.5% (2007: Nil) in MPIC and 20.1% (2007: Nil) in Philex.

**(F) Bank Covenants**

The Group has complied with all of its bank covenants, except for those related to Metro Pacific Corporation (Metro Pacific). Since the fourth quarter of 2001, Metro Pacific has been unable to meet its debt obligations. At 31 December 2008, Metro Pacific had Pesos 109 million (US$2.3 million) (2007: Pesos 451 million or US$10.9 million) outstanding debt obligations. Metro Pacific has reached agreements with certain of its creditors for the settlement of some of the debt obligations and anticipates to further reduce the outstanding debt obligations during 2009.

## 28. PROVISION FOR TAXATION

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| At 1 January | 52.9 | 23.1 |
| Exchange translation | (7.2) | (1.7) |
| Acquisition of subsidiary companies *(Note 34(A))* | 0.7 | 17.6 |
| Provision for taxation on estimated assessable profits for the year *(Note 7)* | 121.6 | 96.5 |
| Transfer from deferred taxation *(Note 21)* | 0.2 | 0.7 |
| **Total** | 168.2 | 136.2 |
| Tax paid | (112.4) | (83.3) |
| **At 31 December** | 55.8 | 52.9 |

## 29. DEFERRED LIABILITIES AND PROVISIONS

| *US$ millions* | Pension | Long-term liabilities | Others | Consolidated 2008 | 2007 |
|---|---|---|---|---|---|
| At 1 January | 152.4 | 8.3 | 37.2 | 197.9 | 108.7 |
| Exchange translation | (21.9) | (17.7) | (6.2) | (45.8) | (3.0) |
| Additions | 0.6 | 2.1 | 4.8 | 7.5 | 59.9 |
| Acquisition of subsidiary companies *(Note 34(A))* | 11.1 | 276.8 | 102.3 | 390.2 | 37.2 |
| Payment and utilization | (4.5) | (9.8) | (63.7) | (78.0) | (4.9) |
| **At 31 December** | 137.7 | 259.7 | 74.4 | 471.8 | 197.9 |
| **Presented as:** | | | | | |
| **Current Portion** | – | 19.0 | 20.4 | 39.4 | 17.4 |
| **Non-current Portion** | 137.7 | 240.7 | 54.0 | 432.4 | 180.5 |
| **Total** | 137.7 | 259.7 | 74.4 | 471.8 | 197.9 |

The pension relates to accrued liabilities in relation to retirement schemes and long service payments.

The long-term liabilities mainly relate to Maynilad's concession fees payable to MWSS and deferred credits (which represent foreign exchange gains which will be refunded to the customers and foreign exchange differences arising from retranslation of the portion of Maynilad's foreign currency denominated concession fees payable and loans) and Indofood's accrued liabilities for dismantlement, removal or restoration in relation to property, plant and equipment.

The others mainly relate to MNTC's provision for value added taxes and a restructuring provision. The restructuring provision relates to the restructuring of the Group's shareholding structure in PLDT. The amount of the provision for the restructuring is estimated based on the anticipated transaction costs required to complete the restructuring. The estimation basis is reviewed on an ongoing basis and revised as appropriate.

## 30. SHARE CAPITAL

| *US$ millions* | Consolidated and Company 2008 | 2007 |
|---|---|---|
| **Authorized** | | |
| 5,000,000,000 (2007: 5,000,000,000) ordinary shares of U.S. 1 cent each | 50.0 | 50.0 |
| **Issued and fully paid** | | |
| At 1 January | 32.2 | 32.0 |
| Issue of shares upon the exercise of share options | 0.1 | 0.2 |
| Repurchase and cancellation of shares | (0.2) | – |
| **At 31 December** | | |
| 3,213,377,003 (2007: 3,224,143,003) ordinary shares of U.S. 1 cent each | 32.1 | 32.2 |

During the year, the movements in the Company's share capital were as follows.

(A) 7,060,000 (2007: 23,314,000) share options were exercised at the exercise price of HK$1.76 per share (2007: HK$1.76 per share), resulting in the issue of 7,060,000 (2007: 23,314,000) new ordinary shares of U.S. 1 cent each for a total cash consideration of HK$12.4 million (US$1.6 million) (2007: HK$41.0 million or US$5.3 million). Details of the Company's share option scheme are set out in Note 37(D)(a) to the Financial Statements.

(B) During the year, the Company repurchased 17,826,000 (2007: 3,964,000) ordinary shares on the SEHK at an aggregate consideration of HK$78.2 million (US$10.1 million) (2007: HK$23.3 million or US$3.0 million) before expenses. These shares were subsequently cancelled. Details of the repurchase are summarized as follows:

| Month of repurchases | Number of ordinary shares repurchased | Purchase price paid per share Highest | Lowest | Aggregate consideration paid | |
|---|---|---|---|---|---|
| | | *HK$* | *HK$* | *HK$ millions* | *US$ millions* |
| May 2008 | 3,320,000 | 5.50 | 5.20 | 17.7 | 2.3 |
| June 2008 | 3,152,000 | 4.99 | 4.83 | 15.6 | 2.0 |
| July 2008 | 2,226,000 | 4.62 | 4.24 | 10.0 | 1.3 |
| September 2008 | 4,392,000 | 4.50 | 3.90 | 18.0 | 2.3 |
| October 2008 | 4,736,000 | 3.88 | 2.20 | 16.9 | 2.2 |
| **Total** | 17,826,000 | | | 78.2 | 10.1 |

The repurchases were effected by the Directors with a view to benefiting the shareholders as a whole by enhancing the Company's net assets and earnings per share.

## 31. OTHER RESERVES

An analysis of the Group's exchange reserve, by principal operating company, is set out below.

| *US$ millions* | Consolidated 2008 | 2007 |
|---|---|---|
| PLDT | (27.2) | 51.0 |
| MPIC | (15.4) | 6.6 |
| Indofood | (75.5) | (17.4) |
| Philex | 3.0 | – |
| Others | (0.9) | 4.0 |
| **Total** | (116.0) | 44.2 |

An analysis of the accumulated reserves of associated companies and joint ventures, included within consolidated reserves, is set out below.

| | Associated Companies | | Joint Ventures | | Consolidated | |
|---|---|---|---|---|---|---|
| *US$ millions* | 2008 | 2007 | 2008 | 2007 (Restated) | 2008 | 2007 (Restated) |
| **Associated Companies and Joint Ventures** | | | | | | |
| Revenue reserve | (861.8) | (808.5) | (0.5) | 30.6 | (862.3) | (777.9) |
| Exchange reserve | (24.4) | 51.1 | (0.6) | 15.8 | (25.0) | 66.9 |
| Unrealized gains on cash flow hedges | 1.4 | 7.3 | – | – | 1.4 | 7.3 |
| **Total** *(Note 15)* | (884.8) | (750.1) | (1.1) | 46.4 | (885.9) | (703.7) |

The Group's capital and other reserves include US$0.2 million (2007: Nil) of capital redemption reserve.

The contributed surplus of the Company arose from a reorganization of the Group in 1988 and represents the difference between the nominal value of the share capital issued by the Company and the aggregate net asset value of the subsidiary companies acquired at the date of acquisition. Under the Companies Act 1981 of Bermuda (as amended), the Company may make distributions to its shareholders out of the contributed surplus provided certain conditions are met.

## 32. MINORITY INTEREST

An analysis of the Group's minority interest, by principal operating company, is set out below.

| *US$ millions* | Consolidated 2008 | 2007 (Restated) |
|---|---|---|
| Indofood | 1,060.7 | 949.9 |
| MPIC | 184.4 | 41.8 |
| **Total** | 1,245.1 | 991.7 |

## 33. DERIVATIVE LIABILITY

The amount at 31 December 2007 represents the fair value of the exchangeable option embedded in the Head Office's Exchangeable Notes. Following the full settlement of the Head Office's Exchangeable Notes in February 2008, all of the remaining amount of such derivative liability has been charged to the profit and loss statement.

## 34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

### (A) Acquisition of Subsidiary Companies

| *US$ millions* | Fair value recognized on acquisition | | | | | | | Carrying amount immediately before the acquisition | |
|---|---|---|---|---|---|---|---|---|---|
| | MPIC's consolidation of DMWC and its subsidiary company | MPIC's acquisition of FPII and its subsidiary companies | Indofood's acquisition of PT Lajuperdana Indah (LPI) | Indofood's acquisition of Drayton and its subsidiary companies | Others | 2008 Total | 2007 Indofood's acquisition of PT Perusahaan Perkebunan London Sumatra and others Total | 2008 Total | 2007 Total |
| **Consideration** | | | | | | | | | |
| Cash and cash equivalents | 107.9 | 242.2 | 41.0 | 351.5 | 5.9 | 748.5 | 573.6 | | |
| Joint ventures | 100.3 | – | – | – | – | 100.3 | – | | |
| Due from a joint venture | 21.1 | – | – | – | – | 21.1 | – | | |
| Due to a group company | – | 9.5 | – | – | – | 9.5 | – | | |
| Shares issued by IndoAgri | – | – | – | – | – | – | 132.1 | | |
| **Total** | 229.3 | 251.7 | 41.0 | 351.5 | 5.9 | 879.4 | 705.7 | | |
| **Net Assets** | | | | | | | | | |
| Property, plant and equipment *(Note 12)* | 11.6 | 2.2 | 40.9 | 36.0 | 2.0 | 92.7 | 108.7 | 82.8 | 80.8 |
| Plantations *(Note 13)* | – | – | 4.3 | – | 1.3 | 5.6 | 577.0 | 5.9 | 198.1 |
| Associated companies and joint ventures | – | 14.3 | – | – | – | 14.3 | – | 13.7 | – |
| Other intangible assets *(Note 17)* | 853.7 | 345.3 | – | 346.0 | – | 1,545.0 | – | 1,404.0 | – |
| Accounts receivable, other receivables and prepayments (Non-current) | – | 6.1 | – | – | – | 6.1 | 14.9 | 6.1 | 14.9 |
| Prepaid land premiums *(Note 19)* | – | – | 20.0 | 8.6 | 1.1 | 29.7 | 112.9 | 11.6 | 54.0 |
| Deferred tax assets *(Note 21)* | 11.3 | 4.3 | 2.1 | 0.3 | – | 18.0 | 5.4 | 3.7 | 0.2 |
| Other non-current assets | 15.1 | 33.4 | – | 3.1 | 5.3 | 56.9 | 9.5 | 57.1 | 9.5 |
| Cash and cash equivalents | 61.9 | 37.9 | 34.8 | 1.1 | 1.0 | 136.7 | 56.0 | 136.7 | 56.0 |
| Pledged deposits | 12.0 | – | – | – | – | 12.0 | – | 12.0 | – |
| Due from a group company | – | 9.5 | – | – | – | 9.5 | – | 9.5 | – |
| Available-for-sale assets | – | – | – | 1.2 | – | 1.2 | – | 1.2 | – |
| Accounts receivable, other receivables and prepayments (Current) | 23.2 | 2.9 | 4.2 | 35.3 | 0.1 | 65.7 | 17.8 | 65.7 | 17.8 |
| Inventories | 0.6 | 0.6 | 0.5 | 48.8 | 0.1 | 50.6 | 19.9 | 50.6 | 19.9 |
| Capital reserve | 2.2 | – | – | – | – | 2.2 | – | – | – |
| Accounts payable, other payables and accruals | (147.0) | (19.7) | (16.8) | (61.2) | (5.2) | (249.9) | (59.2) | (249.7) | (59.2) |
| Due to a group company | (95.0) | – | – | – | – | (95.0) | – | (95.0) | – |
| Short-term borrowings | (50.0) | (13.6) | (0.3) | (16.0) | – | (79.9) | (27.5) | (79.9) | (27.5) |
| Current portion of deferred liabilities and provisions | (22.5) | (3.9) | – | – | – | (26.4) | – | (26.4) | – |
| Provision for taxation *(Note 28)* | – | – | (0.1) | (0.6) | – | (0.7) | (17.6) | (0.7) | (17.6) |
| Long-term borrowings | – | (179.1) | (21.2) | (6.2) | – | (206.5) | (62.7) | (206.5) | (62.7) |
| Deferred liabilities and provisions *(Note 29)* | (345.0) | (40.1) | – | (5.1) | – | (390.2) | (37.2) | (340.9) | (19.7) |
| Deferred tax liabilities *(Note 21)* | (65.3) | (13.9) | (6.7) | (91.0) | (0.3) | (177.2) | (143.8) | (131.9) | (8.2) |
| **Total Net Assets** | 266.8 | 186.2 | 61.7 | 300.3 | 5.4 | 820.4 | 574.1 | 729.6 | 256.3 |
| Minority interest | (123.3) | (52.7) | (24.8) | (94.3) | – | (295.1) | (203.5) | | |
| **Total Net Assets Acquired at Fair Value** | 143.5 | 133.5 | 36.9 | 206.0 | 5.4 | 525.3 | 370.6 | | |
| **Goodwill** *(Note 16)* | 85.8 | 118.2[(i)] | 4.1 | 145.5 | 0.5 | 354.1 | 335.1 | | |
| **Net Cash Outflow Per the Consolidated Cash Flow Statement** | (46.0) | (204.3) | (6.2) | (350.4) | (4.9) | (611.8) | (517.6) | | |

(i) Provisional amount subject to revision upon further assessment of fair value of the share of identifiable assets acquired and liabilities and contingent liabilities assumed

In July 2008, MPIC (i) repaid Pesos 1.4 billion (US$31.8 million) of exchangeable debt and purchased US$20.0 million of convertible debt issued by DMWC from Ashmore Investment Management Limited and their affiliates (the Ashmore Funds) and (ii) purchased US$20.0 million of convertible debt issued by DMWC from the Company. Following these transactions, MPIC's voting interest in DMWC increased to approximately 55.4% on a fully diluted basis. As a result, DMWC changed from a joint venture to a subsidiary company of MPIC and MPIC consolidated DMWC's financial results and position starting from July 2008. In November 2008, a shareholders' agreement between MPIC and DMCI Holdings Inc. regarding their investments in DMWC was finalized. According to this agreement, MPIC's economic interest in DMWC also increased from 50.0% to 55.4% on a fully diluted basis.

In November 2008, MPIC acquired a 99.8% interest in First Philippine Infrastructure, Inc. (FPII). FPII owns approximately 67.1% interest in MNTC. MNTC was granted a concession in June 1998 to finance, design, construct, operate and maintain the toll roads, toll facilities and other facilities generating toll-related and non-toll-related income in respect of the NLEX in the Philippines.

In July 2008, PT Salim Ivomas Pratama (SIMP), a subsidiary company of Indofood, completed its subscription of a 60.0% of interest in PT Lajuperdana Indah (LPI) for a total consideration of Rupiah 375 billion (US$41.0 million). LPI engages in sugar cane plantation operations in Indonesia and owns approximately 21,500 hectares of plantation land.

In December 2008, Indofood acquired a 100% interest in Drayton Pte Ltd (Drayton) and a shareholder's loan of US$100.5 million to Drayton from Drayton's original shareholder, for a total consideration of US$350.0 million. Drayton owns a 68.6% interest in Indolakto. Drayton is an investment holding company. Indolakto engages in the production of processed milk and milk-related products in Indonesia.

The goodwill is mainly attributable to the premiums for the acquisition of control in the above acquired companies and the synergies expected to arise from the acquisition of them.

Since the date of acquisitions, the above acquired companies recorded a profit for the year of US$16.5 million, which is included in the profit and loss of the Group. If all of the above acquisitions had taken place on 1 January 2008, the turnover of the Group for the year ended 31 December 2008 would have been US$4,326.3 million. It is not practicable to disclose the profit for the year of the Group, as if the acquisitions had taken place at the beginning of the year, as the information of fair value of plantations of the acquired companies at the beginning of the year is not available to management. The subsidiary companies acquired during the year had net cash inflows from operating and financing activities of US$50.2 million and US$120.3 million, respectively, and had a net cash outflow of US$90.2 million in respect of investing activities during the year.

**(B) Investments in Associated Companies**

The cash outflow mainly relates to the Group's investment in a 20.1% interest in Philex in November 2008 of US$129.1 million and MPIC's investment in a 34.0% interest in Davao Doctors Hospital in June 2008 of US$11.4 million.

**(C) Pledged Deposits**

At 31 December 2008, the Group had US$12.0 million (2007: Nil) pledged bank deposits to secure a performance bond requirement of Maynilad in respect of payment of concession fees.

**(D) Major Non-cash Transaction**

During the year, the Group settled US$3.9 million of the Head Office's Exchangeable Notes through the transfer of 0.1% of PLDT's shares and Metro Pacific Corporation, a 96.6% owned subsidiary company of MPIC, settled Pesos 289 million (US$6.8 million) of borrowings through the transfer of certain property assets to its creditors.

**35. COMMITMENTS AND CONTINGENT LIABILITIES**

**(A) Capital Expenditure**

| *US$ millions* | **Consolidated** **2008** | **2007** |
|---|---|---|
| Commitments in respect of subsidiary companies: | | |
| Authorized, but not contracted for | 548.2 | 185.6 |
| Contracted, but not provided for | 6.3 | 41.9 |
| **Total** | 554.5 | 227.5 |

The Group's capital expenditure commitments principally relate to Indofood's purchase of property, plant and equipment, investments in plantations, and Maynilad's and MNTC's construction of water and toll road infrastructure.

At 31 December 2008, the Company has no commitments in respect of capital expenditure (2007: Nil).

**(B) Leasing Commitments**

At 31 December 2008, the Group had total future minimum lease payments under non-cancelable operating leases falling due as follows.

| *US$ millions* | **Consolidated** **2008** | **2007** |
|---|---|---|
| **Land and Buildings** | | |
| – Within one year | 2.8 | 1.9 |
| – Between two and five years, inclusive | 1.6 | 1.9 |
| – After five years | 1.8 | 3.2 |
| Subtotal | 6.2 | 7.0 |
| **Plant and Equipment** | | |
| – Within one year | 0.1 | 0.3 |
| – Between two and five years, inclusive | 0.1 | 0.3 |
| – After five years | 0.1 | 0.8 |
| Subtotal | 0.3 | 1.4 |
| **Total** | 6.5 | 8.4 |

At 31 December 2008, the Company did not have any leasing commitments (2007: Nil).

**(C) Contingent Liabilities**

At 31 December 2008, except for US$53.7 million (2007: US$73.4 million) guarantees given by Indofood to loan facilities obtained by certain plantation farmers in relation to arrangements for those farmers' production and sale of fresh fruit bunches to Indofood, neither the Group nor the Company had any significant contingent liabilities (2007: Nil).

**36. EMPLOYEES' BENEFITS**

**(A) Remuneration**

| *US$ millions* | **Consolidated** **2008** | **2007** |
|---|---|---|
| Basic salaries | 209.6 | 179.7 |
| Bonuses | 44.3 | 28.5 |
| Benefits in kind | 29.5 | 41.4 |
| Pension contributions | 35.1 | 14.1 |
| Retirement and severance allowances | 10.8 | 8.3 |
| Equity-settled share option expense | 18.0 | 8.7 |
| **Total** *(Note 6)* | 347.3 | 280.7 |
| **Average Number of Employees** | 65,015 | 51,722 |

The above includes the remuneration of the Directors. Detailed disclosures in respect of Directors' remuneration are set out in Note 37(A) to the Financial Statements.

**(B) Retirement Benefits**

The Group operates both defined contribution and defined benefit schemes. In addition, the Group has made provisions for estimated liabilities for employee benefits for meeting the minimum benefits required to be paid to the qualified employees as required under Indonesian's labour law.

*(a) Defined contribution schemes*

The Group operates five (2007: five) defined contribution schemes covering approximately 17,884 (2007: 19,351) employees. The assets of these schemes are held separately from the Group and are administered by independent trustees. Contributions to the schemes, either by the Group or by the employees, are determined by reference to the employees' salaries and length of service and range from 0% to 10% (2007: 0% to 10%). Under the terms of the schemes, the Group cannot be requested to make additional payments over and above these levels of contributions. In three (2007: three) of the schemes, forfeited contributions may be used to reduce the existing levels of employer contributions and, in 2008, no amount (2007: Nil) was used for this purpose. At 31 December 2008, the forfeited contributions had been fully utilized.

*(b) Defined benefit schemes and estimated liabilities for employee benefits*

The Group operates five (2007: three) defined benefit schemes covering approximately 2,615 (2007: 753) employees. The assets of four (2007: two) of these schemes are held separately from the Group and are administered by independent trustees. Benefits are determined by reference to employees' final salaries and length of service, and the schemes have undergone independent valuations. These actuarial valuations, performed by the actuaries of PT Sentra Jasa Aktuaria (a member of the Fellow Society of Actuary of Indonesia and Expert in Life Insurance in Indonesia), Actuarial Advisers, Inc. and Institutional Synergy, Inc, FASP (members of Actuary Society of the Philippines), were based on the projected unit credit method. The plan assets do not include any financial instruments of the Group or property occupied by, or other assets used by, the Group. At 31 December 2008, the Group's level of funding in respect of its defined benefit schemes was 59.5% (2007: 57.3%).

The Group has made provisions for estimated liabilities for employee benefits covering approximately 45,953 (2007: 42,291) employees. The amounts of such provisions were determined by reference to employees' final salaries and length of service and based on actuarial computations prepared by the actuaries of PT Sentra Jasa Aktuaria and PT Jasa Aktuaria Praptasentosa Gunajasa (members of the Fellow Society of Actuary of Indonesia and Expert in Life Insurance in Indonesia) using the projected unit credit method.

(I) The amount of liability under defined benefit schemes and estimated liabilities for employee benefits included in the balance sheet is as follows:

| *US$ millions* | **Defined benefit schemes** | **Estimated liabilities for employee benefits** | **Consolidated 2008** | **Consolidated 2007** |
|---|---|---|---|---|
| Present value of defined benefit obligations | (18.5) | (125.8) | (144.3) | (154.9) |
| Fair value of plan assets | 11.0 | – | 11.0 | 6.3 |
| **Liability in the Balance Sheet** | (7.5) | (125.8) | (133.3) | (148.6) |

(II) The changes in the present value of the defined benefit obligations during the year are as follows:

| *US$ millions* | **Defined benefit schemes** | **Estimated liabilities for employee benefits** | **Consolidated 2008** | **Consolidated 2007** |
|---|---|---|---|---|
| At 1 January | (11.0) | (143.9) | (154.9) | (67.2) |
| Exchange translation | 2.1 | 20.4 | 22.5 | 3.1 |
| Current service cost | (1.8) | (10.5) | (12.3) | (8.1) |
| Interest cost on obligation | (1.0) | (17.8) | (18.8) | (8.8) |
| Actuarial gains/(losses) | 4.2 | 22.0 | 26.2 | (41.3) |
| Acquisition of subsidiary companies | (12.8) | (5.3) | (18.1) | (37.2) |
| Benefit paid | 1.8 | 9.3 | 11.1 | 4.6 |
| **At 31 December** | (18.5) | (125.8) | (144.3) | (154.9) |

(III) The changes in the fair value of plan assets under defined benefit schemes during the year are as follows:

| *US$ millions* | **Consolidated 2008** | **2007** |
|---|---|---|
| At 1 January | 6.3 | 6.8 |
| Exchange translation | (1.4) | (0.2) |
| Expected return | 0.5 | 0.9 |
| Actuarial losses | (0.6) | – |
| Assets distributed on settlements | (0.8) | – |
| Contributions by employer | 1.8 | 0.1 |
| Acquisition of subsidiary companies | 7.0 | – |
| Benefit paid | (1.8) | (1.3) |
| **At 31 December** | 11.0 | 6.3 |

The overall expected rate of return on assets is determined based on the market prices prevailing on that date applicable to the period over which the obligation is to be settled.

(IV) The major categories of plan assets as a percentage of the fair value of the total plan assets under defined benefit schemes are as follows:

| | Consolidated | |
|---|---|---|
| | **2008** | **2007** |
| Philippines equities | 52% | 1% |
| Indonesian equities | 48% | 99% |

(V) Amounts for the current and previous four years for defined benefit schemes are as follows:

| | | | Consolidated | | |
|---|---|---|---|---|---|
| *US$ millions* | **2008** | **2007** | **2006** | **2005** | **2004** |
| Defined benefit obligations | (18.5) | (11.0) | (10.5) | (11.0) | (9.0) |
| Plan assets | 11.0 | 6.3 | 6.8 | 6.2 | 6.4 |
| Deficit | (7.5) | (4.7) | (3.7) | (4.8) | (2.6) |
| Experience adjustments on plan liabilities | (4.1) | (0.7) | (0.1) | (2.3) | (1.0) |
| Experience adjustments on plan assets | (0.6) | – | – | – | – |

(VI) The amount recognized in the profit and loss statement is analyzed as follows:

| *US$ millions* | **Defined benefit schemes** | **Estimated liabilities for employee benefits** | **Consolidated 2008** | **Consolidated 2007** |
|---|---|---|---|---|
| Current service cost | 1.8 | 10.5 | 12.3 | 8.1 |
| Interest cost on obligation | 1.0 | 17.8 | 18.8 | 8.8 |
| Expected return on plan assets | (0.5) | – | (0.5) | (0.9) |
| Net actuarial (gains)/losses recognized in the year | (3.6) | (22.0) | (25.6) | 41.3 |
| **Total**[(i)] | (1.3) | 6.3 | 5.0 | 57.3 |
| **Actual Return on Plan Assets** | | | 7% | 13% |

(i) Included in cost of sales, distribution costs, administrative expenses and other operating expenses, net

(VII) Principal actuarial assumptions (weighted average) at 31 December are as follows:

| | Consolidated | |
|---|---|---|
| | **2008** | **2007** |
| Discount rate | 11% | 9% |
| Expected return on plan assets | 8% | 8% |
| Future salary increases | 9% | 9% |
| Future pension increases | 9% | 9% |
| Average remaining working lives of employees (years) | 17.8 | 18.9 |

(VIII) The Group expects to contribute US$2.0 million (2007: US$1.8 million) to its defined benefit pension plans in the next year.

**(C) Loans to Officers**

During 2008 and 2007, there were no loans made by the Group to officers which require disclosure pursuant to Section 161B of the Hong Kong Companies Ordinance.

## 37. DIRECTORS' AND SENIOR EXECUTIVES' REMUNERATION

### (A) Directors' Remuneration

The table below shows the remuneration of Directors on an individual basis.

**Directors' Remuneration – 2008**

| | Non-performance based | | | Performance | Equity-settled | | | |
|---|---|---|---|---|---|---|---|---|
| | | Other | Pension | based | share option | | | 2008 |
| *US$'000* | Salaries | benefits | contributions | payments[i] | expense | Fees[ii] | Emoluments[iii] | Total |
| **Chairman** | | | | | | | | |
| Anthoni Salim | 1,152 | – | – | – | – | 30 | – | 1,182 |
| **Executive Directors** | | | | | | | | |
| Manuel V. Pangilinan *Managing Director and Chief Executive Officer* | 2,080 | 460 | 142 | 1,559 | 4,028 | – | – | 8,269 |
| Edward A. Tortorici | 1,242 | 135 | 1,595 | 120 | 2,499 | – | – | 5,591 |
| Robert C. Nicholson | 892 | 23 | 2 | 446 | 2,117 | – | – | 3,480 |
| **Non-executive Directors** | | | | | | | | |
| Ambassador Albert F. del Rosario | – | – | – | – | 720 | 160 | – | 880 |
| Sutanto Djuhar | – | – | – | – | – | – | – | – |
| Tedy Djuhar | – | – | – | – | – | 40 | – | 40 |
| Ibrahim Risjad | – | – | – | – | – | – | – | – |
| Benny S. Santoso | – | – | – | – | 720 | 89 | – | 809 |
| Napoleon L. Nazareno | 244 | 119 | 19 | 146 | – | 91 | – | 619 |
| **Independent Non-executive Directors** | | | | | | | | |
| Graham L. Pickles | – | – | – | – | 720 | 115 | – | 835 |
| Prof. Edward K.Y. Chen, *GBS, CBE, JP* | – | – | – | – | 720 | 90 | – | 810 |
| Sir David W.C. Tang, *KBE* | – | – | – | – | 720 | 45 | 77 | 842 |
| **Total** | 5,610 | 737 | 1,758 | 2,271 | 12,244 | 660 | 77 | 23,357 |

**Directors' Remuneration – 2007**

| US$'000 | Non-performance based Salaries | Other benefits | Pension contributions | Performance based payments[i] | Equity-settled share option expense | Fees[ii] | Emoluments[iii] | 2007 Total |
|---|---|---|---|---|---|---|---|---|
| **Chairman** | | | | | | | | |
| Anthoni Salim | 464 | – | – | – | – | – | – | 464 |
| **Executive Directors** | | | | | | | | |
| Manuel V. Pangilinan *Managing Director and Chief Executive Officer* | 1,610 | 419 | 96 | 2,018 | 1,854 | – | – | 5,997 |
| Edward A. Tortorici | 1,035 | 149 | 1,073 | – | 1,284 | – | – | 3,541 |
| Robert C. Nicholson | 947 | 21 | 2 | 756 | 1,062 | – | – | 2,788 |
| **Non-executive Directors** | | | | | | | | |
| Ambassador Albert F. del Rosario | – | – | – | – | 342 | 125 | – | 467 |
| Sutanto Djuhar | – | – | – | – | – | – | – | – |
| Tedy Djuhar | – | – | – | – | – | – | – | – |
| Ibrahim Risjad | – | – | – | – | – | – | – | – |
| Benny S. Santoso | – | – | – | – | 342 | 31 | – | 373 |
| **Independent Non-executive Directors** | | | | | | | | |
| Graham L. Pickles | – | – | – | – | 342 | 115 | – | 457 |
| Prof. Edward K.Y. Chen, *GBS, CBE, JP* | – | – | – | – | 342 | 120 | – | 462 |
| Sir David W.C. Tang, *KBE* | – | – | – | – | 342 | 75 | 77 | 494 |
| **Total** | 4,056 | 589 | 1,171 | 2,774 | 5,910 | 466 | 77 | 15,043 |

(i) Performance based payments comprise performance bonuses and long-term monetary incentive awards

(ii) For meetings attended

(iii) For consultancy services provided to the Company

Included within the total Directors' remuneration is an amount of US$1.3 million (2007: US$1.2 million) paid by PLDT, an associated company, in respect of the services of the Managing Director and Chief Executive Officer.

**(B) Senior Executives' Remuneration**

As similar remuneration schemes operate for the senior executives of the Group, their remuneration may exceed those of the Company's Directors. Two (2007: Two) senior executives were among the Group's five highest earning employees. The remaining three (2007: three) of the five highest earning employees, are the Company's Directors.

| *US$ millions* | **2008** | **2007** |
|---|---|---|
| Non-performance based | | |
| – Salaries and benefits | 0.8 | 0.7 |
| Performance based | | |
| – Bonuses and long-term monetary incentive awards | 0.2 | 0.3 |
| Equity-settled share option expense | 2.1 | 1.1 |
| **Total** | 3.1 | 2.1 |

The table below shows the remuneration of the two (2007: two) senior executives who were among the Group's five highest earning employees in 2008.

| **Remuneration bands** | **2008** *Number* | **2007** *Number* |
|---|---|---|
| US$893,001 – US$957,000 | – | 1 |
| US$1,149,001 – US$1,213,000 | – | 1 |
| US$1,469,001 – US$1,533,000 | 1 | – |
| US$1,597,001 – US$1,661,000 | 1 | – |
| **Total** | 2 | 2 |

**(C) Key Management Personnel Compensation**

| | **Consolidated** | |
|---|---|---|
| *US$ millions* | **2008** | **2007** |
| Non-performance based | | |
| – Salaries and benefits | 22.5 | 15.8 |
| – Pension contributions | 1.9 | 2.0 |
| Performance based | | |
| – Bonuses and long-term monetary incentive awards | 9.1 | 7.4 |
| Equity-settled share option expense | 18.0 | 8.7 |
| Fees | 0.6 | 0.5 |
| **Total** | 52.1 | 34.4 |

**(D) Share Options**

Particulars of the share options of the Company and its subsidiary company granted to the Directors and senior executives of the Company and its subsidiary company at 31 December 2008 are set out below.

*(a) Particulars of the Company's Share Option Scheme*

| | Share options held at 1 January 2008 | Share options exercised during the year | Share option held at 31 December 2008 | Share options exercise price *(HK$)* | Market price at the date of grant *(HK$)* | Market price during the period of exercise *(HK$)* | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | | | | |
| Manuel V. Pangilinan | 31,800,000 | – | 31,800,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 30,200,000 | – | 30,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Edward A. Tortorici | 10,620,000 | (7,060,000) | 3,560,000 | 1.76 | 1.76 | 5.72 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 18,200,000 | – | 18,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Robert C. Nicholson | 14,000,000 | – | 14,000,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 15,500,000 | – | 15,500,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Non-Executive Directors** | | | | | | | | | | |
| Ambassador Albert F. del Rosario | 2,840,000 | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Benny S. Santoso | 2,840,000 | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Independent Non-Executive Directors** | | | | | | | | | | |
| Graham L. Pickles | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Prof. Edward K.Y. Chen, *GBS, CBE, JP* | 1,340,000 | – | 1,340,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Sir David W. C. Tang, *KBE* | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Senior Executives** | 29,032,000 | – | 29,032,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 4,500,000 | – | 4,500,000 | 3.275 | 3.25 | – | 7 June 2006 | December 2010 | June 2007 | June 2016 |
| | 42,220,000 | – | 42,220,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Total** | 218,892,000 | (7,060,000) | 211,832,000 | | | | | | | |

| | Share options held at 1 January 2007 | Share options granted during the year | Share options exercised during the year | Share options held at 31 December 2007 | Share option exercise price *(HK$)* | Market price at date of grant *(HK$)* | Market price during the period of exercise *(HK$)* | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | | | | | |
| Manuel V. Pangilinan | 31,800,000 | – | – | 31,800,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | – | 30,200,000 | – | 30,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Edward A. Tortorici | 17,680,000 | – | (7,060,000) | 10,620,000 | 1.76 | 1.76 | 5.72 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | – | 18,200,000 | – | 18,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Robert C. Nicholson | 24,500,000 | – | (10,500,000) | 14,000,000 | 1.76 | 1.76 | 5.80-6.00 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | – | 15,500,000 | – | 15,500,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Non-Executive Directors** | | | | | | | | | | | |
| Ambassador Albert | 2,840,000 | – | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| F. del Rosario | – | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Benny S. Santoso | 2,840,000 | – | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | – | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Independent Non-Executive Directors** | | | | | | | | | | | |
| Graham L. Pickles | 1,000,000 | – | (1,000,000) | – | 1.76 | 1.76 | 5.18-5.39 | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | – | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Prof. Edward K.Y. Chen | 2,840,000 | – | (1,500,000) | 1,340,000 | 1.76 | 1.76 | 5.60-5.96 | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| *GBS, CBE, JP* | – | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Sir David W. C. Tang, *KBE* | – | 3,160,000 | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Senior Executives** | 32,286,000 | – | (3,254,000) | 29,032,000 | 1.76 | 1.76 | 4.42-6.05 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 4,500,000 | – | – | 4,500,000 | 3.275 | 3.25 | – | 7 June 2006 | December 2010 | June 2007 | June 2016 |
| | – | 42,220,000 | – | 42,220,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Total** | 120,286,000 | 121,920,000 | (23,314,000) | 218,892,000 | | | | | | | |

At the AGM held on 24 May 2004, the Company's shareholders approved a share option scheme (Scheme) under which the Directors may, at their discretion, at any time during the period of the Scheme, grant Directors and executives of the Company's share options as part of the Company's long-term incentive program. The Scheme, which complies with the provisions set out in Chapter 17 of the Listing Rules, became effective on 24 May 2004. The Scheme will be valid for 10 years and will expire on 23 May 2014.

The maximum number of shares on which options may be granted may not exceed 10% of the Company's issued share capital, excluding any shares issued on the exercise of options at any time. The maximum number of shares in respect of which options may be granted under the Scheme to any one participant in any 12-month period is limited to 1% of the aggregate number of shares of the Company in issue at the time of the proposed grant of options to such participant.

The exercise price in relation to each share option offer shall be determined by the Directors at their absolute discretion, but in any event shall not be less than the highest of (i) the closing price of the Company's shares as stated in the daily quotation sheet of the SEHK on the date of grant; (ii) the average closing price of the Company's shares as stated in the daily quotation sheets of the SEHK for the five trading days immediately preceding the date of grant; and (iii) the nominal value of a Company's share on the date of grant. The terms of the Scheme provide that subject to any other restrictions on vesting imposed by the Directors, share options may be exercised under the Scheme at any time from the date of acceptance until the date of expiry. All options presently outstanding under the Scheme are subject to certain restrictions on exercise including a prohibition on exercise at any time during the period commencing one year after the date on which any option is accepted. Options which lapse or are cancelled prior to their expiry date are deleted from the register of options.

On 1 June 2004, 134,586,000 share options under the Company's Scheme were granted. The average fair value of options granted as calculated by Watson Wyatt Hong Kong Limited, based on the binomial model, was HK$0.849 or an aggregate value of US$14.6 million for all options granted. The assumptions used were as follows:

| | |
|---|---|
| Share price at the date of grant | HK$1.76 |
| Exercise price | HK$1.76 |
| Expected volatility (based on historical volatility of the Company's shares commensurate with the average expected life of the options granted) | 55% |
| Option life | 10 years |
| Expected dividend yield | 1% per annum |
| Average risk-free interest rate (based on the Hong Kong Exchange Fund Notes) | 4.06% per annum |

Taking into account the expected turnover rate of the Directors and senior executives and the early exercise behavior, the average expected life of the options granted was estimated to be 6.61 years. The early exercise behavior assumes that option holders will exercise the options when the share price is at least 75% higher than the exercise price.

On 1 June 2006, 4,500,000 share options under the Scheme were granted. The average fair value of options granted as calculated by Watson Wyatt Hong Kong Limited, based on the binomial model, was HK$1.554 or an aggregate value of US$0.9 million for all options granted. The assumptions used were as follows:

| | |
|---|---|
| Share price at the date of grant | HK$3.25 |
| Exercise price | HK$3.275 |
| Expected volatility (based on historical volatility of the Company's shares commensurate with the average expected life of the options granted) | 50% |
| Option life | 10 years |
| Expected dividend yield | 1% per annum |
| Average risk-free interest rate (based on the Hong Kong Exchange Fund Notes) | 4.71% per annum |

Taking into account the expected turnover rate of the senior executives and the early exercise behavior, the average expected life of the options granted was estimated to be 6.79 years. The early exercise behavior assumes that option holders will exercise the options when the share price is at least 100% higher than the exercise price.

On 5 September 2007, 121,920,000 share options under the Scheme were granted. The average fair value of options granted as calculated by Watson Wyatt Hong Kong Limited, based on the binomial model, was HK$2.596 or an aggregate value of US$40.6 million for all options granted. The assumptions used were as follows:

| | |
|---|---|
| Share price at the date of grant | HK$5.33 |
| Exercise price | HK$5.33 |
| Expected volatility (based on historical volatility of the Company's shares commensurate with the average expected life of the options granted) | 45% |
| Option life | 10 years |
| Expected dividend yield | 1% per annum |
| Average risk-free interest rate (based on the Hong Kong Exchange Fund Notes) | 4.40% per annum |

Taking into account the expected turnover rate of the Directors and senior executives and the early exercise behavior, the average expected life of the options granted was estimated to be 7.60 years. The early exercise behavior assumes that option holders will exercise the options when the share price is at least 150% higher than the exercise price.

The binomial model, applied for determining the estimated values of the share options granted under the Scheme, was developed for use in estimating the fair value of the traded options that are fully transferable. Such an option pricing model requires input of highly subjective assumptions, including the expected stock price volatility. As the Company's share options have characteristics significantly different from those of the traded options, changes in the subjective input assumptions can materially affect the estimated value of the options granted.

Details of the Group's accounting policy in respect of the share options granted are set out in Note 2(D)(r)(III) to the Financial Statements.

*(b) Particulars of MPIC's Share Option Scheme*

On 14 June 2007, the shareholders of MPIC approved a share option scheme under which MPIC's directors may, at their discretion, invite executives of MPIC upon the regularization of employment of eligible executives, to take up share options of MPIC to obtain an ownership interest in MPIC and for the purpose of long-term employment motivation. The scheme became effective on 14 June 2007 and is valid for 10 years.

The maximum number of shares on which options may be granted under the scheme may not exceed 10% of the issued share capital of MPIC as at the date on which the MPIC's share option scheme is adopted. The aggregate number of shares which may be issued upon exercise of the options granted and to be granted to any eligible participant (whether or not already an option holder) in any 12-month period shall not exceed 1% of the shares in issue at the relevant time.

The exercise price in relation to each option granted under the scheme shall be determined by MPIC's directors at their absolute discretion, but in any event shall not be less than (i) the closing price of MPIC's shares for one or more board lots of such MPIC's shares on the Philippine Stock Exchange (PSE) on the option grant date; (ii) the average closing price of MPIC's share for one or more board lots of such MPIC's shares on the PSE for the five business days on which dealings in the MPIC's shares are made immediately preceding the option grant date; or (iii) the par value of the MPIC's shares, whichever is higher.

At a special shareholders' meetings of MPIC held on 20 February 2009, MPIC's shareholders approved the amendments to MPIC's share options scheme which include (i) a refreshment of the number of MPIC options that may be granted to take into account of the increase in the capital stock of MPIC or other changes to its capital structure which has either been approved by the shareholders, implemented, in process, or which may potentially be approved or implemented in the future and (ii) the inclusion in MPIC's share option plan of a requirement for MPIC to comply with relevant corporate requirements and regulations applicable to MPIC's parent company.

Up to 25 March 2009, no share options have been granted under the scheme.

**38. RELATED PARTY TRANSACTIONS**

Significant related party transactions entered into by the Group during the year are disclosed as follows:

(A) In January 2007, the Company (i) advanced US$76.0 million to DMWC and (ii) subscribed for US$20.0 million convertible notes issued by DMWC for the purpose of funding DMWC's acquisition of Maynilad. The convertible notes issued by DMWC have a maturity period of three years and can be converted into DMWC's common shares at their par value of Peso 1 per DMWC's common share during the terms of the notes. In May 2008, DMWC repaid the US$76.0 million advance, together with interest.

(B) On 28 July 2008, SIMP, a subsidiary company of Indofood, completed its subscription of a 60.0% interest in LPI, a company originally owned by the Chairman of the Company, for a total consideration of Rupiah 375 billion (US$41.0 million). Details of the subscription are set out in Note 34(A) to the Financial Statements.

(C) ALBV has a technical assistance agreement with Smart for ALBV to provide Smart with technical support services and assistance in the operations and maintenance of cellular mobile telecommunication services for a period of four years from 23 February 2004, subject to renewal upon mutual agreement between the parties. The agreement expired on 23 February 2008 and was renewed for a period of four years to 23 February 2012. The agreement provides for payments of technical service fees equivalent to 1% (2007: 1%) of the consolidated net revenue of Smart.

The fee under the above arrangement amounted to Pesos 630 million (US$14.1 million) for the year ended 31 December 2008 (2007: Pesos 656 million or US$13.7 million). At 31 December 2008, the outstanding prepaid technical service fee amounted to Pesos 8 million (US$0.2 million) (2007: Pesos 87 million or US$1.7 million).

(D) In November 2008, SIMP entered into two agreements with Lyminton Pte. Ltd and PT Mulia Abadi Lestari to acquire the remaining minority shareholding of approximately 30% of PT Sarana Inti Pramata and PT Mitra Inti Sejati Plantation for the consideration of US$16.4 million and Rupiah 28.5 billion (approximately US$2.3 million), respectively. These transactions also constitute connected transactions as defined in Chapter 14A of the Listing Rules.

(E) In the ordinary course of business, Indofood has engaged in trade transactions with certain of its associated companies, joint ventures and affiliated companies, the majority of which are related to the Salim Family either through direct and/or common share ownership and common management. Mr. Anthoni Salim is the Chairman and a substantial shareholder of the Company and is the President Director and Chief Executive Officer of Indofood.

All significant transactions with related parties, whether or not conducted under normal terms and conditions similar to those with non-related parties, are disclosed as follows:

| **Nature of transactions** | **Consolidated** | |
|---|---|---|
| **For the year ended 31 December** | **2008** | **2007** |
| *US$ millions* | | |
| **Profit and Loss Items** | | |
| Sales of finished goods | | |
| – to associated companies and joint ventures | 24.5 | 28.1 |
| – to affiliated companies | 60.8 | 48.6 |
| Purchases of raw materials | | |
| – from associated companies and joint ventures | 41.5 | 43.2 |
| – from affiliated companies | 14.0 | 8.8 |
| Management and technical services fee income and royalty income | | |
| – from associated companies and joint ventures | 0.9 | 0.9 |
| – from affiliated companies | 7.5 | 4.6 |
| Insurance expenses | | |
| – to affiliated companies | 2.8 | 2.7 |
| Rental expenses | | |
| – to affiliated companies | 1.2 | 1.3 |
| Transportation and pump services expenses | | |
| – to affiliated companies | 0.4 | 0.3 |

Approximately 2% (2007: 3%) of Indofood's sales and 2% (2007: 3%) of its purchases were transacted with these related companies.

| **Nature of balance** | **Consolidated** | |
|---|---|---|
| **At 31 December** | **2008** | **2007** |
| *US$ million* | | |
| **Balance Sheet Items** | | |
| Accounts receivable – trade | | |
| – from associated companies and joint ventures | 2.6 | 3.4 |
| – from affiliated companies | 13.3 | 8.7 |
| Accounts receivable – non-trade | | |
| – from associated companies and joint ventures | 0.4 | 0.2 |
| – from affiliated companies | 8.3 | 8.8 |
| Accounts payable – trade | | |
| – to associated companies and joint ventures | 3.6 | 6.3 |
| – to affiliated companies | 2.3 | 1.2 |
| Accounts payable – non-trade | | |
| – to affiliated companies | 19.2 | 5.9 |
| Other payables – non-trade | | |
| – to affiliated companies | – | 5.8 |

Certain of the above Indofood's related party transactions also constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

(F) Maynilad has entered into various construction contracts with DMCI group for the amounts totaling US$21.9 million for the latter's construction of water infrastructure for Maynilad. These related party transactions also constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

**39. FINANCIAL INSTRUMENTS BY CATEGORY**

The carrying amount of each of the categories of financial instruments as at the balance sheet date are as follows:

| | Consolidated | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2008 | | | 2007 | | | |
| *US$ millions* | Loans sale and receivables | Available-for-sale financial assets | Total | Financial assets at fair value through profit or loss | Loans and receivables | Available-for-financial assets | Total |
| Loans to associated companies and a joint venture | – | – | – | – | 102.2 | – | 102.2 |
| Accounts and other receivables (Non-current) | 3.0 | – | 3.0 | – | 37.0 | – | 37.0 |
| Available-for-sale assets (Non-current) | – | 1.7 | 1.7 | – | – | 6.0 | 6.0 |
| Financial assets at fair value through profit or loss | – | – | – | 79.8 | – | – | 79.8 |
| Other non-current assets | 60.6 | – | 60.6 | – | 36.8 | – | 36.8 |
| Cash and cash equivalents | 625.9 | – | 625.9 | – | 600.8 | – | 600.8 |
| Pledged deposits | 12.0 | – | 12.0 | – | – | – | – |
| Available-for-sale assets (Current) | – | 56.9 | 56.9 | – | – | 24.1 | 24.1 |
| Accounts and other receivables (Current) | 375.7 | – | 375.7 | – | 327.1 | – | 327.1 |
| **Total** | 1,077.2 | 58.6 | 1,135.8 | 79.8 | 1,103.9 | 30.1 | 1,213.8 |

| | Consolidated | | | |
|---|---|---|---|---|
| | 2008 | 2007 | | |
| *US$ millions* | Financial liabilities at amortized cost | Financial liabilities at amortized cost | Financial liabilities at fair value | Total |
| Accounts payable, other payables and accruals | 667.4 | 485.6 | – | 485.6 |
| Short-term borrowings | 1,207.0 | 1,000.1 | – | 1,000.1 |
| Current portion of deferred liabilities and provisions | 18.9 | – | – | – |
| Long-term borrowings | 1,951.7 | 1,044.5 | – | 1,044.5 |
| Deferred liabilities and provisions | 140.3 | – | – | – |
| Derivative liability | – | – | 6.3 | 6.3 |
| **Total** | 3,985.3 | 2,530.2 | 6.3 | 2,536.5 |

| | Company | |
|---|---|---|
| | 2008 | 2007 |
| *US$ millions* | Loans and receivables | Loans and receivables |
| Loans to a joint venture | – | 104.3 |
| Cash and cash equivalents | 45.9 | 106.3 |
| Amounts due from subsidiary companies | 1,889.5 | 1,781.8 |
| Other receivables (Current) | 0.1 | 0.2 |
| **Total** | 1,935.5 | 1,992.6 |

| *US$ millions* | Company 2008 Financial liabilities at amortized cost | 2007 Financial liabilities at amortized cost |
|---|---|---|
| Amounts due to subsidiary companies | 832.6 | 814.5 |
| Other payables and accruals | 0.6 | 0.6 |
| Loans from subsidiary companies | 540.2 | 540.9 |
| **Total** | 1,373.4 | 1,356.0 |

**40. CAPITAL AND FINANCIAL RISK MANAGEMENT**

**(A) Capital Management**

The primary objectives of the Group's capital management is to safeguard the Group's ability to continue as a going concern and ensure that it maintains an optimal capital structure for supporting the stability and growth of its business and maximizing shareholder value.

The Group manages its capital structure, and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2008 and 31 December 2007.

The Group monitors capital using a gearing ratio, which is net debt divided by total equity. The Group's policy is to keep the gearing ratio at an optimal level which supports its business. The Group includes within net debt, short-term borrowings and long-term borrowings, less cash and cash equivalents and pledged deposits. The total equity includes equity attributable to equity holders of the parent and minority interest.

| *US$ millions* | Consolidated 2008 | 2007 (Restated) |
|---|---|---|
| Short-term borrowings | 1,207.0 | 1,000.1 |
| Long-term borrowings | 1,951.7 | 1,044.5 |
| Less cash and cash equivalents | (625.9) | (600.8) |
| Less pledged deposits | (12.0) | – |
| Net debt | 2,520.8 | 1,443.8 |
| Equity attributable to equity holders of the parent | 1,130.1 | 1,131.3 |
| Minority interest | 1,245.1 | 991.7 |
| Total equity | 2,375.2 | 2,123.0 |
| Gearing ratio (times) | 1.06 | 0.68 |

**(B) Financial Risk Management**

The Group's principal financial instruments include the various financial assets (which comprise accounts receivables, other receivables and prepayments, available-for-sale assets, cash and cash equivalents, pledged deposits and financial assets at fair value through profit or loss) and financial liabilities (which comprise accounts payable, other payables and accruals, short-term borrowings, long-term borrowings, deferred liabilities and provisions and derivative liability). The main purpose of the cash and cash equivalents, and short-term and long-term borrowings is to finance the Group's operations. The other financial assets and liabilities, such as accounts receivable and accounts payable, mainly arise directly from its operations.

The Group also enters into derivative transactions, including principally foreign exchange contracts and interest rate swap. The purpose is to manage the currency and interest rate risks arising from the Group's sources of finance and its operations.

It is, and has been, throughout the year, the Group's policy that no trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are market risk (including currency risk and price risk), credit risk, liquidity risk and fair value and cash flow interest rate risk. The Company's Board of Directors reviews and agrees policies for managing each of these risks and they are summarized below. The Group's accounting policies in relation to derivatives are set out in Note 2(D)(u) to the Financial Statements.

*(a) Market Risk*

(I) Currency Risk

To manage the Group's foreign exchange risk arising from future commercial transactions, recognized assets and liabilities, and improve investment and cash flow planning, in addition to natural hedges, the Group enters into and engages in foreign exchange contracts for the purpose of managing its foreign exchange rate exposures emanating from business, transaction specific, as well as currency translation risks and reducing and/or managing the adverse impact of changes in foreign exchange rates on the Group's operating results and cash flows. However, some of the aforementioned derivative instruments of the Group do not qualify as effective hedges and therefore are not designated as cash flow hedges for accounting purposes in accordance with the provisions of HKAS 39.

The following table demonstrates the sensitivity arising from the Group's financial assets and liabilities at the balance sheet date to a reasonably possible change in the exchange rates of Rupiah and Peso, with all other variables held constant, of the Group's profit attributable to equity holders of the parent and retained earnings (due mainly to foreign exchange gains/losses on translation of the U.S. dollar denominated financial assets and liabilities). There is no significant impact on the other components of the Group's equity.

| | 2008 | | 2007 | |
|---|---|---|---|---|
| *US$ millions* | Depreciation against the U.S. dollar (%) | Effect on profit attributable to equity holders of the parent and retained earnings | Depreciation against the U.S. dollar (%) | Effect on profit attributable to equity holders of the parent and retained earnings |
| Rupiah | (5.4) | (11.4) | (0.9) | (0.3) |
| Peso | (4.0) | (2.4) | (3.0) | – |

(II) Price Risk

The Group's price risk principally relates to the changes in the market value of its equity investments.

(b) *Credit Risk*

For the consumer food products business, the Group has credit risk arising from the credit given to the customers, but it has policies in place to ensure that wholesales of products are made to creditworthy customers with an appropriate credit history. The Group has policies that limit the amount of credit exposure to any particular customer, such as requiring sub-distributors to provide bank guarantees. For the water business, the Group allows 60 days of credit to its customers. For the toll road business, the Group collects its toll fees through TMC by cash, prepaid and reloadable electronic toll collection devices and through credit card payments. In addition, receivable balances are monitored on an ongoing basis to reduce the Group's exposure to bad debts.

With respect to credit risk arising from the Group's other financial assets, which include cash and cash equivalents and certain investments in debt securities classified as available-for-sale assets, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amounts of these instruments and the unrealized losses on available-for-sale assets charged directly to the Group's equity.

The Group has no significant concentrations of credit risk.

(c) *Liquidity Risk*

The Group manages its liquidity profile to be able to finance its capital expenditure and service its maturing debts by maintaining sufficient cash and marketable securities, and the availability of funding through an adequate amount of committed credit facilities.

The Group regularly evaluates its projected and actual cash flow information and continuously assesses conditions in the financial markets for opportunities to pursue fund-raising initiatives. These initiatives may include bank loans, and debt capital and equity capital issues.

The maturity profile of the Group's financial liabilities at 31 December 2008 based on contractual undiscounted payments, including future interest payments, is as follows.

| | Accounts payable, other payables and accruals | | Borrowings | | Deferred liabilities and provisions | | Derivative liability | | Consolidated | |
|---|---|---|---|---|---|---|---|---|---|---|
| *US$ millions* | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| Not exceeding one year | 667.4 | 485.6 | 1,509.4 | 1,195.6 | 30.0 | – | – | – | 2,206.8 | 1,681.2 |
| More than one year but not exceeding two years | – | – | 298.9 | 270.2 | 24.5 | – | – | – | 323.4 | 270.2 |
| More than two years but not exceeding five years | – | – | 1,851.5 | 1,086.8 | 58.0 | – | – | 6.3 | 1,909.5 | 1,093.1 |
| More than five years | – | – | 692.2 | 56.9 | 77.1 | – | – | – | 769.3 | 56.9 |
| **Total** | 667.4 | 485.6 | 4,352.0 | 2,609.5 | 189.6 | – | – | 6.3 | 5,209.0 | 3,101.4 |

(d) *Fair Value and Cash Flow Interest Rate Risks*

The Group's interest rate risk arises from interest-bearing borrowings, cash and cash equivalents and pledged deposits. Borrowings and cash and cash equivalents with variable interest rate terms expose the Group to cash flow interest rate risk. Borrowings and cash and cash equivalents with fixed interest rate terms expose the Group to fair value interest rate risk. At 31 December 2008, 21.5% (2007: 24.1%) of the Group's borrowings were at fixed rates.

The following table demonstrates the sensitivity arising from the Group's financial assets and liabilities at the balance sheet date to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit attributable to equity holders of the parent and retained earnings (through the impact on variable rate borrowings and cash and cash equivalents). There is no significant impact on the other components of the Group's equity.

| *US$ millions* | **2008** Increase/ (decrease) (Basis points) | **2008** Effect on profit attributable to equity holders of the parent and retained earnings | **2007** Increase/ (decrease) (Basis points) | **2007** Effect on profit attributable to equity holders of the parent and retained earnings |
|---|---|---|---|---|
| Interest rates for | | | | |
| – U.S. dollar | 50 | (4.8) | (300) | 16.6 |
| – Rupiah | (300) | 0.4 | (50) | 0.6 |
| – Peso | (300) | 5.1 | 100 | (0.2) |

## 41. COMPARATIVE AMOUNTS

As explained in Note 2(B) to the Financial Statements, due to the adoption of HK(IFRIC)-Int 12 during the year, the accounting treatment and presentation of certain items and balances have been revised to comply with such changes. During the year, the Group also changed its classification of the changes in fair value of plantations from cost of sales to other operating expenses/income to better reflect the non-operational nature of such an item. Accordingly, certain comparative amounts have been reclassified and restated to conform with the current year's presentation and accounting treatments. In addition, the comparative profit and loss statement has been re-presented as if the operation discontinued during the current year had been discontinued at the beginning of the comparative year (Note 8).

## 42. APPROVAL OF THE FINANCIAL STATEMENTS

The Financial Statements were approved and authorized for issue by the Board of Directors on 25 March 2009.

## SUMMARY OF PRINCIPAL INVESTMENTS

**Philippine Long Distance Telephone Company**

**PLDT (PSE: TEL; NYSE: PHI)** is the leading telecommunications service provider in the Philippines. It has common shares listed on the Philippine Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. It has one of the largest market capitalizations among Philippine listed companies. Through its three principal business groups, PLDT offers a wide range of telecommunications services: Wireless (principally through wholly-owned subsidiary company, Smart Communications, Inc.); Fixed Line (principally through PLDT); and Information and Communications Technology (principally through wholly-owned subsidiary company, ePLDT). PLDT has developed the Philippines' most extensive fiber optic backbone, cellular, fixed line and satellite networks.

| | | |
|---|---|---|
| Sector | : | Telecommunications |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 187.5 million |
| Particulars of issued shares held | : | Common shares of Pesos 5 par value |
| Economic interest | : | 26.4% |

Further information on PLDT can be found at www.pldt.com

**Metro Pacific Investments Corporation**

**MPIC (PSE: MPI)** is a publicly-listed investment and management company based in the Philippines with holdings in infrastructure, utilities and healthcare enterprises.

| | | |
|---|---|---|
| Sector | : | Infrastructure, Utilities and Healthcare |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 7.0 billion |
| Particulars of issued shares held | : | Common shares of Peso 1 par value |
| Economic interest | : | 97.3% |

Further information on MPIC can be found at www.mpic.com.ph

**PT Indofood Sukses Makmur Tbk**

**Indofood (IDX: INDF)** is a "Total Food Solutions" company engaged in food manufacturing, processing, marketing and distribution. It is based in Jakarta and is listed on the Indonesia Stock Exchange. Through its four complementary strategic business groups, Indofood offers and distributes a wide range of food products throughout Indonesia: Consumer Branded Products (noodles, dairy, food seasonings, snack foods and nutrition and special foods), Bogasari (flour and pasta), Agribusiness (oil palm, rubber, sugar cane, cocoa and tea plantations, cooking oils, margarine and shortening) and Distribution. Indofood is one of the world's largest instant noodle manufacturers by volume, plantation companies by hectarage and the largest flour miller in Indonesia. Indofood's flourmill in Jakarta is one of the largest in the world in terms of production capacity in one location. It also has an extensive distribution network in Indonesia.

| | | |
|---|---|---|
| Sector | : | Consumer Food Products |
| Place of incorporation/business area | : | Indonesia |
| Issued number of shares | : | 8.8 billion |
| Particulars of issued shares held | : | Shares of Rupiah 100 par value |
| Economic interest | : | 50.1% |

Further information on Indofood can be found at www.indofood.co.id

**Philex Mining Corporation**

**Philex (PSE: PX)** is a Philippine listed company engaged in exploration, development and utilization of mineral resources.

| | | |
|---|---|---|
| Sector | : | Natural Resources |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 3.9 billion |
| Particulars of issued shares held | : | Common shares of Peso 1 par value |
| Economic interest | : | 20.1% |

Further information on Philex can be found at www.philexmining.com.ph

## 3. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF THE GROUP

The following are the unaudited condensed consolidated financial statements of the Group for the six months ended 30 June 2009 together with the accompanying notes as extracted from the interim report of the Company for the six months ended 30 June 2009.

**Condensed Consolidated Income Statement**

| **For the six months ended 30 June** | | **(Unaudited)** | |
|---|---|---|---|
| *US$ millions* | *Notes* | **2009** | **2008** (Restated)[(i)] |
| **Turnover** | 2 | 1,809.1 | 2,044.8 |
| Cost of sales | | (1,279.8) | (1,503.6) |
| **Gross Profit** | | 529.3 | 541.2 |
| Gain on divestments and dilutions | | – | 9.8 |
| Distribution costs | | (137.8) | (165.7) |
| Administrative expenses | | (138.5) | (113.0) |
| Other operating income, net | | 96.9 | 81.2 |
| Net borrowing costs | 3 | (110.7) | (60.6) |
| Share of profits less losses of associated companies and joint ventures | | 114.1 | 113.6 |
| **Profit Before Taxation** | 4 | 353.3 | 406.5 |
| Taxation | 5 | (52.7) | (103.3) |
| **Profit for the Period from Continuing Operations** | | 300.6 | 303.2 |
| Profit for the period from a discontinued operation | 6 | 2.7 | 2.3 |
| **Profit for the Period** | | 303.3 | 305.5 |
| **Attributable to:** | | | |
| Owners of the parent | 7 | 164.3 | 156.8 |
| Minority interest | | 139.0 | 148.7 |
| | | 303.3 | 305.5 |
| **Ordinary Share Dividend** | 8 | | |
| U.S. 0.51 cent (2008: U.S. 0.38 cent) per share | | 16.5 | 12.3 |
| **Earnings Per Share Attributable to Owners of the Parent** (U.S. cents) | 9 | | |
| Basic | | | |
| – For profit from continuing operations | | 5.01 | 4.81 |
| – For profit from a discontinued operation | | 0.10 | 0.05 |
| – For profit for the period | | 5.11 | 4.86 |
| Diluted | | | |
| – For profit from continuing operations | | 4.95 | 4.62 |
| – For profit from a discontinued operation | | 0.10 | 0.04 |
| – For profit for the period | | 5.05 | 4.66 |

*(i) Refer to Note 21*

The accompanying notes form an integral part of these Condensed Interim Financial Statements.

**Condensed Consolidated Statement of Comprehensive Income**

| For the six months ended 30 June<br>*US$ millions* | (Unaudited)<br>2009 | 2008 |
|---|---|---|
| **Profit for the Period** | 303.3 | 305.5 |
| **Other Comprehensive Income/(Loss)** | | |
| Exchange differences on translating foreign operations | 89.6 | (35.5) |
| Realized exchange reserve upon divestment and dilution of interest in an associated company | – | (0.3) |
| Unrealized gains/(losses) on available-for-sale assets | 28.3 | (5.6) |
| Realized gains on available-for-sale assets | – | (0.1) |
| Realized losses on cash flow hedges | 0.7 | – |
| Unrealized losses on cash flow hedges | (2.1) | (7.5) |
| Income tax related to cash flow hedges | 0.1 | – |
| Share of revaluation increment of an associated company's assets | 5.0 | – |
| Other comprehensive income/(loss) for the period, net of tax | 121.6 | (49.0) |
| **Total Comprehensive Income for the Period** | 424.9 | 256.5 |
| **Attributable to:** | | |
| Owners of the parent | 214.0 | 94.5 |
| Minority interest | 210.9 | 162.0 |
| | 424.9 | 256.5 |

The accompanying notes form an integral part of these Condensed Interim Financial Statements.

**Condensed Consolidated Statement of Financial Position**

| *US$ millions* | *Notes* | **(Unaudited) At 30 June 2009** | **(Audited) At 31 December 2008** |
|---|---|---|---|
| **Non-current Assets** | | | |
| Property, plant and equipment | 10 | 934.5 | 808.4 |
| Plantations | | 889.4 | 744.5 |
| Associated companies and joint ventures | 11 | 1,184.8 | 1,202.3 |
| Goodwill | | 718.5 | 675.6 |
| Other intangible assets | 12 | 1,546.7 | 1,538.5 |
| Accounts receivable, other receivables and prepayments | | 4.3 | 3.0 |
| Prepaid land premiums | | 160.7 | 153.2 |
| Available-for-sale assets | | 91.5 | 1.7 |
| Deferred tax assets | | 46.2 | 38.7 |
| Other non-current assets | | 270.2 | 217.1 |
| | | 5,846.8 | 5,383.0 |
| **Current Assets** | | | |
| Cash and cash equivalents | | 616.5 | 625.9 |
| Pledged deposits and restricted cash | 13 | 30.8 | 12.0 |
| Available-for-sale assets | | 55.7 | 56.9 |
| Accounts receivable, other receivables and prepayments | 14 | 408.3 | 435.5 |
| Inventories | | 602.9 | 557.4 |
| Assets held for sale | | 8.4 | – |
| | | 1,722.6 | 1,687.7 |
| Assets of a disposal group classified as held for sale | 6 | – | 128.3 |
| | | 1,722.6 | 1,816.0 |

| *US$ millions* | *Notes* | **(Unaudited) At 30 June 2009** | **(Audited) At 31 December 2008** |
|---|---|---|---|
| **Current Liabilities** | | | |
| Accounts payable, other payables and accruals | 15 | 631.5 | 667.4 |
| Short-term borrowings | | 1,068.2 | 1,207.0 |
| Provision for taxation | | 23.4 | 55.8 |
| Current portion of deferred liabilities and provisions | 16 | 81.6 | 39.4 |
| | | 1,804.7 | 1,969.6 |
| Liabilities directly associated with the assets classified as held for sale | 6 | – | 106.1 |
| | | 1,804.7 | 2,075.7 |
| **Net Current Liabilities** | | (82.1) | (259.7) |
| **Total Assets Less Current Liabilities** | | 5,764.7 | 5,123.3 |
| **Equity** | | | |
| Issued share capital | | 32.2 | 32.1 |
| Retained earnings | | 335.6 | 196.0 |
| Other components of equity | | 959.2 | 902.0 |
| Equity attributable to owners of the parent | | 1,327.0 | 1,130.1 |
| Minority interest | | 1,410.1 | 1,245.1 |
| **Total Equity** | | 2,737.1 | 2,375.2 |
| **Non-current Liabilities** | | | |
| Long-term borrowings | | 2,256.5 | 1,951.7 |
| Deferred liabilities and provisions | 16 | 405.1 | 432.4 |
| Deferred tax liabilities | | 366.0 | 364.0 |
| | | 3,027.6 | 2,748.1 |
| | | 5,764.7 | 5,123.3 |

The accompanying notes form an integral part of these Condensed Interim Financial Statements.

On behalf of the Board of Directors

**MANUEL V. PANGILINAN**
*Managing Director and Cheif Executive Officer*

4 September 2009

## Condensed Consolidated Statement of Changes in Equity

| | Equity attributable to owners of the parent | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *US$ millions* | Issued share capital | Share premium | Share options issued | Exchange reserve | Unrealized gains/ (losses) on available-for -sale assets | Unrealized gains/ (losses) on cash flow hedges | Income tax related to cash flow hedges | Capital and other reserves | Retained earnings | Total | Minority interest | (Unaudited) Total equity |
| Balance at 1 January 2008 | 32.2 | 971.7 | 17.6 | 44.1 | 10.3 | 11.0 | (3.7) | (2.3) | 55.6 | 1,136.5 | 992.6 | 2,129.1 |
| Total comprehensive income for the period | – | – | – | (51.8) | (3.0) | (11.1) | 3.6 | – | 156.8 | 94.5 | 162.0 | 256.5 |
| Issue of shares upon | | | | | | | | | | | | |
| the exercise of share options | 0.1 | 2.4 | (0.9) | – | – | – | – | – | – | 1.6 | – | 1.6 |
| Repurchase and cancellation of shares | (0.1) | – | – | – | – | – | – | 0.1 | (4.3) | (4.3) | – | (4.3) |
| Equity-settled share option arrangements | – | – | 11.1 | – | – | – | – | – | – | 11.1 | – | 11.1 |
| 2007 special and final dividends paid | – | – | – | – | – | – | – | – | (32.9) | (32.9) | – | (32.9) |
| Dividends declared to minority shareholders | – | – | – | – | – | – | – | – | – | – | (19.2) | (19.2) |
| Balance at 30 June 2008 | 32.2 | 974.1 | 27.8 | (7.7) | 7.3 | (0.1) | (0.1) | (2.2) | 175.2 | 1,206.5 | 1,135.4 | 2,341.9 |
| Balance at 1 January 2009 | 32.1 | 974.1 | 34.7 | (116.0) | 11.7 | 2.1 | (0.2) | (4.4) | 196.0 | 1,130.1 | 1,245.1 | 2,375.2 |
| Total comprehensive income for the period | – | – | – | 16.5 | 29.4 | (1.3) | 0.1 | 5.0 | 164.3 | 214.0 | 210.9 | 424.9 |
| Issue of shares upon | | | | | | | | | | | | |
| the exercise of share options | 0.1 | 1.2 | (0.4) | – | – | – | – | – | – | 0.9 | – | 0.9 |
| Equity-settled share option arrangements | – | – | 6.8 | – | – | – | – | – | – | 6.8 | – | 6.8 |
| 2008 final dividend paid | – | – | – | – | – | – | – | – | (24.7) | (24.7) | – | (24.7) |
| Dividends declared and paid to | | | | | | | | | | | | |
| minority shareholders | – | – | – | – | – | – | – | – | – | – | (32.9) | (32.9) |
| Acquisition of minority interest | – | – | – | – | – | – | – | – | – | – | (6.6) | (6.6) |
| Disposal of a disposal group | | | | | | | | | | | | |
| classified as held for sale | – | – | – | – | – | – | – | (0.1) | – | (0.1) | (6.4) | (6.5) |
| **Balance at 30 June 2009** | 32.2 | 975.3 | 41.1 | (99.5) | 41.1 | 0.8 | (0.1) | 0.5 | 335.6 | 1,327.0 | 1,410.1 | 2,737.1 |

The accompanying notes form an integral part of these Condensed Interim Financial Statements.

**Condensed Consolidated Statement of Cash Flows**

| **For the six months ended 30 June** | | **(Unaudited)** | |
|---|---|---|---|
| *US$ millions* | *Notes* | **2009** | **2008** (Restated)[i] |
| **Profit Before Taxation** | | | |
| From continuing operations | | 353.3 | 406.5 |
| From a discontinued operation | | 1.7 | 2.8 |
| Adjustments for: | | | |
| Interest expenses | 3 | 123.3 | 79.4 |
| Amortization of other intangible assets | 4 | 44.1 | – |
| Depreciation | 4 | 40.8 | 42.2 |
| Equity-settled share option expense | | 5.7 | 11.1 |
| Recognition of prepaid land premiums | 4 | 2.8 | 3.2 |
| Share of profits less losses of associated companies and joint ventures | | (114.1) | (113.6) |
| Gain on changes in fair value of plantations | 4 | (53.8) | (69.8) |
| Foreign exchange and derivative (gains)/losses, net | 4 | (32.0) | 1.1 |
| Increase in other non-current assets | | (30.5) | (14.1) |
| Interest income | 3 | (12.6) | (18.8) |
| Increase in accounts receivables, other receivables and prepayment (Non-current) | | (1.1) | (0.1) |
| Gain on sale of property, plant and equipment | 4 | (0.3) | (0.5) |
| Gain on divestment and dilution of interest in an associated company | 4 | – | (9.8) |
| Others | | 7.2 | 5.5 |
| | | 334.5 | 325.1 |
| Increase in working capital[ii] | | (141.1) | (153.7) |
| Net cash generated from operations | | 193.4 | 171.4 |
| Interest received | | 9.0 | 17.2 |
| Interest paid | | (110.1) | (88.2) |
| Tax paid | | (100.9) | (79.1) |
| **Net Cash (Outflow)/Inflow from Operating Activities** | | (8.6) | 21.3 |

| **For the six months ended 30 June** | | **(Unaudited)** | |
|---|---|---|---|
| *US$ millions* | *Notes* | **2009** | **2008** (Restated)[(i)] |
| Dividend received from associated companies | | 127.3 | 140.1 |
| Proceeds from sale of property, plant and equipment | | 1.4 | 3.9 |
| Purchase of property, plant and equipment | | (111.6) | (55.8) |
| Acquisition of available-for-sale assets | | (59.3) | (36.1) |
| Investments in other intangible assets | | (43.7) | – |
| Investments in plantations | | (32.6) | (38.2) |
| Investments in associated companies | | (15.5) | (11.8) |
| Increased investments in subsidiary companies | | (8.1) | – |
| (Advances to)/repayment from associated companies, net | | (0.1) | 1.9 |
| Proceeds from disposal of available-for-sale assets | | – | 7.2 |
| Loans to a joint venture, net | | – | (19.0) |
| Deposit for acquisition of a subsidiary company | | – | (4.1) |
| **Net Cash Outflow from Investing Activities** | | (142.2) | (11.9) |
| Net borrowings raised | | 187.4 | 200.6 |
| Proceeds from the exercise of share options | | 0.9 | 1.6 |
| Increase in time deposits with original maturity of more than three months | | (61.3) | – |
| Dividends paid to shareholders | | (24.7) | (32.9) |
| Increase in restricted cash | | (18.8) | – |
| Dividends paid to minority shareholders by subsidiary companies | | (14.2) | – |
| Share issue expenses of a subsidiary company | | (0.3) | – |
| Repurchase of shares | | – | (4.3) |
| **Net Cash Inflow from Financing Activities** | | 69.0 | 165.0 |
| **Net (Decrease)/Increase in Cash and Cash Equivalents** | | (81.8) | 174.4 |
| Cash and cash equivalents at 1 January | | 625.9 | 600.8 |
| Exchange translation | | 11.1 | 4.7 |
| **Cash and Cash Equivalents at 30 June** | | 555.2 | 779.9 |
| **Representing** | | | |
| Cash and cash equivalents | | 616.5 | 779.9 |
| Less time deposits with original maturity of more than three months | | (61.3) | – |
| **Cash and Cash Equivalents at 30 June** | | 555.2 | 779.9 |

*(i) Refer to Note 21*

*(ii) Changes in working capital are stated excluding movements due to acquisition and disposal of subsidiary companies.*

The accompanying notes form an integral part of these Condensed Interim Financial Statements.

## Notes to the Condensed Interim Financial Statements

### 1. BASIS OF PREPARATION AND IMPACT OF NEW AND REVISED HKFRSs

**(A) Basis of Preparation**

The Condensed Interim Financial Statements have been prepared in accordance with HKAS 34 "Interim Financial Reporting" issued by the HKICPA and the disclosure requirements of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the Listing Rules) issued by The Stock Exchange of Hong Kong Limited (SEHK). The Condensed Interim Financial Statements have been prepared on a basis consistent with the accounting policies adopted in the Group's 2008 audited financial statements.

**(B) Impact of New and Revised HKFRSs**

Certain changes to Hong Kong GAAP have been implemented during 2009 as a consequence of the following new and revised Hong Kong Financial Reporting Standards (HKFRSs) (which include all HKFRSs, HKASs and Interpretations) issued by the HKICPA:

| | |
|---|---|
| HKAS 1 (Revised) | "Presentation of Financial Statements"(i) |
| HKAS 23 (Revised) | "Borrowing Costs"(i) |
| HKAS 32 and HKAS 1 Amendments | "Puttable Financial Instruments and Obligations Arising on Liquidation"(i) |
| HKAS 39 Amendments | "Eligible Hedged Items"(ii) |
| HKFRS 1 and HKAS 27 Amendments | "Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate"(i) |
| HKFRS 2 Amendments | "Share-based Payment – Vesting Conditions and Cancellations"(i) |
| HKFRS 7 Amendments | "Financial Instruments: Disclosures"(i) |
| HKFRS 8 | "Operating Segments"(i) |
| HK(IFRIC)-Int 9 and HKAS39 Amendments | "Reassessment of Embedded Derivatives"(iii) |
| HK(IFRIC)-Int 13 | "Customer Loyalty Programmes"(iv) |
| HK(IFRIC)-Int 15 | "Agreements for the Construction of Real Estate"(i) |
| HK(IFRIC)-Int 16 | "Hedges of a Net Investment in a Foreign Operation"(v) |
| Annual Improvements to HKFRSs | "Improvements to HKFRSs"(vi) |
| | "Improvements to HKFRSs 2009"(vii) |

(i) Effective for annual periods commencing on or after 1 January 2009
(ii) Effective for annual periods commencing on or after 1 July 2009
(iii) Effective for annual periods ending on or after 30 June 2009
(iv) Effective for annual periods commencing on or after 1 July 2008
(v) Effective for annual periods commencing on or after 1 October 2008
(vi) Generally effective for annual periods commencing on or after 1 January 2009, unless otherwise stated in the specific HKFRSs
(vii) Generally effective for annual periods commencing on or after 1 January 2010, unless otherwise stated in the specific HKFRSs

The adoption of the above pronouncements has had no effect on both the profit attributable to owners of the parent for the periods ended 30 June 2009 and 30 June 2008 and equity attributable to owners of the parent at 30 June 2009 and 31 December 2008, but only results in certain changes in the financial statements presentation and disclosures.

**2. TURNOVER AND SEGMENTAL INFORMATION**

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008**<br>(Restated) |
|---|---|---|
| **Turnover** | | |
| Sale of goods | 1,624.3 | 2,003.8 |
| Rendering of services | 184.8 | 41.0 |
| **Total** | 1,809.1 | 2,044.8 |

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the Group), whose operating results is regularly reviewed by the Group's chief operating decision maker who makes decisions about how resources are to be allocated to the segment and assesses its performance, and for which discrete financial information is available to him.

The Board of Directors considers the business from both product or service and geographical perspective. From a product or service perspective, the Group business interests are divided into four main segments, which are telecommunications, infrastructure, consumer food products and natural resources. Geographically, the Board of Directors considers the businesses of the Group are operating in the Philippines and Indonesia, respectively. Details of the Group's principal investments are provided on pages 129 to 130.

The Board of Directors assesses the performance of the operating segments based on a measure of recurring profit. This measurement basis measures the profit attributable to owners of the parent excluding the effects of foreign exchange and derivative gains/losses, gain/loss on changes in fair value of plantations and non-recurring items. Non-recurring items represent certain items, through occurrence or size, which are not considered as usual operating items.

The revenue, results, total assets, total liabilities and other information regarding the Group's reportable businesses for the six months ended 30 June 2009 and 2008 and at 30 June 2009 and 31 December 2008 are as follows.

**By Principal Business Activity – 2009**

| | The Philippines | | | Indonesia | | |
|---|---|---|---|---|---|---|
| **For the six months ended/at 30 June** *US$ millions* | **Telecom-munications** | **Infrastructure** | **Natural Resources** | **Consumer Food Products** | **Head Office** | **2009 Total** |
| **Revenue** | | | | | | |
| Turnover | – | 156.2 | – | 1,652.9 | – | 1,809.1 |
| **Results** | | | | | | |
| Recurring profit | 102.9 | 14.6 | 2.1 | 31.8 | (23.9) | 127.5 |
| **Assets and Liabilities** | | | | | | |
| Associated companies and joint ventures | 1,007.0 | 54.9 | 116.1 | 3.1 | 3.7 | 1,184.8 |
| Other assets | – | 1,765.2 | – | 4,450.1 | 169.3 | 6,384.6 |
| Total assets | 1,007.0 | 1,820.1 | 116.1 | 4,453.2 | 173.0 | 7,569.4 |
| Borrowings | – | 672.3 | – | 1,872.0 | 780.4 | 3,324.7 |
| Other liabilities | – | 534.8 | – | 876.7 | 96.1 | 1,507.6 |
| Total liabilities | – | 1,207.1 | – | 2,748.7 | 876.5 | 4,832.3 |
| **Other Information** | | | | | | |
| Depreciation and amortization | – | (37.3) | – | (47.4) | (0.2) | (84.9) |
| Interest income | – | 5.4 | – | 6.4 | 0.8 | 12.6 |
| Interest expenses | – | (38.9) | – | (72.0) | (12.4) | (123.3) |
| Share of profits less losses of associated companies and joint ventures | 107.1 | 3.1 | 3.9 | – | – | 114.1 |
| Taxation | – | 23.2 | – | (69.5) | (6.4) | (52.7) |
| Additions to non-current assets (other than financial instruments and deferred tax assets) | – | 53.5 | – | 186.8 | – | 240.3 |

**By Principal Business Activity – 2008**

| For the six months ended at 30 June/ at 31 December | The Philippines | | | Indonesia | | |
|---|---|---|---|---|---|---|
| *US$ millions* | Telecom-munications | Infrastructure | Natural Resources | Consumer Food Products | Head Office | 2008 (Restated) Total |
| **Revenue** | | | | | | |
| Turnover | – | – | – | 2,044.8 | – | 2,044.8 |
| **Results** | | | | | | |
| Recurring profit | 106.9 | 1.1 | – | 50.6 | (32.1) | 126.5 |
| **Assets and Liabilities** | | | | | | |
| Associated companies and joint ventures | 1,040.5 | 48.0 | 95.1 | 15.4 | 3.3 | 1,202.3 |
| Other assets | – | 1,940.6 | – | 4,039.9 | 16.2 | 5,996.7 |
| Total assets | 1,040.5 | 1,988.6 | 95.1 | 4,055.3 | 19.5 | 7,199.0 |
| Borrowings | – | 677.7 | – | 1,696.6 | 784.4 | 3,158.7 |
| Other liabilities | – | 745.0 | – | 862.7 | 57.4 | 1,665.1 |
| Total liabilities | – | 1,422.7 | – | 2,559.3 | 841.8 | 4,823.8 |
| **Other Information** | | | | | | |
| Depreciation and amortization | – | (0.5) | – | (41.4) | (0.3) | (42.2) |
| Interest income | – | 4.6 | – | 8.0 | 6.2 | 18.8 |
| Interest expenses | – | (4.6) | – | (54.8) | (20.0) | (79.4) |
| Share of profits less losses of associated companies and joint ventures | 117.8 | (3.9) | – | (0.3) | – | 113.6 |
| Taxation | – | 3.1 | – | (101.3) | (5.1) | (103.3) |
| Additions to non-current assets (other than financial instruments and deferred tax assets) | – | 1.0 | – | 108.7 | – | 109.7 |

A reconciliation between profit before taxation as shown in the condensed consolidated income statement and recurring profit is as follows.

| **For the six months ended 30 June** | **2009** | **2008** |
|---|---|---|
| *US$ millions* | | (Restated) |
| Profit before taxation | | |
| – Continuing operations | 353.3 | 406.5 |
| – A discontinued operation | 1.7 | 2.8 |
| Exclusion of: | | |
| – Foreign exchange and derivative (gains)/losses *(Note 7)* | (23.2) | 2.4 |
| – Gain on changes in fair value of plantations *(Note 4)* | (53.8) | (69.8) |
| – Non-recurring items | (14.9) | (17.5) |
| Deduction of attributable taxation and minority interest | (135.6) | (197.9) |
| **Recurring profit** | 127.5 | 126.5 |

## 3. NET BORROWING COSTS

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008**<br>(Restated) |
|---|---|---|
| Bank loans and other loans | | |
| – Wholly repayable within five years | 99.2 | 76.8 |
| – Not wholly repayable within five years | 24.3 | 2.6 |
| Less borrowing costs capitalized in other intangible assets | (0.2) | – |
| **Total Borrowing Costs** | 123.3 | 79.4 |
| Less interest income | (12.6) | (18.8) |
| **Net Borrowing Costs** | 110.7 | 60.6 |

## 4. PROFIT BEFORE TAXATION

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| **Profit Before Taxation is Stated after (Charging)/Crediting** (i) | | |
| Cost of inventories sold | (750.8) | (1,212.6) |
| Employee remuneration | (182.7) | (182.0) |
| Cost of services rendered | (94.1) | (19.7) |
| Amortization of other intangible assets | (44.1) | – |
| Depreciation *(Note 10)* | (40.8) | (42.2) |
| Impairment losses for accounts receivable (ii) | (3.9) | (4.6) |
| Recognition of prepaid land premiums | (2.8) | (3.2) |
| Gain on changes in fair value of plantations | 53.8 | 69.8 |
| Foreign exchange and derivative gains/(losses), net *(Note 7)* | 32.0 | (1.1) |
| Gain on sale of property, plant and equipment | 0.3 | 0.5 |
| Gain on divestment and dilution of interest in an associated company | – | 9.8 |
| Realized gains on sale of available-for-sale assets | – | 0.1 |

*(i) Include amounts (charged)/credited in respect of a discontinued operation*
*(ii) Included in distribution costs*

## 5. TAXATION

No Hong Kong profits tax (2008: Nil) has been provided as the Group had no estimated assessable profits (2008: Nil) in Hong Kong for the period. Taxation on assessable profits generated outside Hong Kong has been provided at the rates of taxation prevailing in the countries in which the Company's subsidiary companies operate.

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008**<br>(Restated) |
|---|---|---|
| **Subsidiary Companies – Overseas** | | |
| Current taxation | 61.0 | 87.6 |
| Deferred taxation | (8.3) | 15.7 |
| **Total** | 52.7 | 103.3 |

Included within share of profits less losses of associated companies and joint ventures is taxation of US$45.5 million (2008: US$77.1 million) and which is analyzed as follows.

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| **Associated Companies and Joint Ventures – Overseas** | | |
| Current taxation | 42.2 | 46.5 |
| Deferred taxation | 3.3 | 30.6 |
| **Total** | 45.5 | 77.1 |

## 6. A DISCONTINUED OPERATION

Following a strategic review of MPIC's businesses which focus on core infrastructure, MPIC's directors decided in late 2008 to divest part of its interest in the property business, Landco Pacific Corporation (Landco), which was operated by MPIC. As at 31 December 2008, the Group's investment in Landco was classified as a disposal group held for sale. In June 2009, MPIC disposed 17.0% interest in Landco for Pesos 203 million (US$4.2 million), thereby reducing its interest in Landco from 51.0% to 34.0%. Following this transaction, the Group's remaining 34.0% interest in Landco was classified as non-current assets held for sale.

## 7. PROFIT ATTRIBUTABLE TO OWNERS OF THE PARENT

The profit attributable to owners of the parent includes US$3.3 million of net foreign exchange and derivative gains (2008: losses of US$4.8 million) on foreign exchange translation differences on the Group's unhedged foreign currency denominated borrowings and payables and the changes in the fair values of derivatives, US$8.4 million (2008: US$12.7 million) of gain on changes in fair value of plantations and US$25.1 million (2008: US$22.4 million) of net non-recurring gains.

**Analysis of Foreign Exchange and Derivative Gains/(Losses)**

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| Foreign exchange and derivative gains/(losses) | | |
| – Subsidiary companies *(Note 4)* | 32.0 | (1.1) |
| – Associated companies and joint ventures | (8.8) | (1.3) |
| Subtotal | 23.2 | (2.4) |
| Attributable to taxation and minority interest | (19.9) | (2.4) |
| **Total** | 3.3 | (4.8) |

The non-recurring gains of US$25.1 million for 2009 mainly represent Maynilad's reversal of provision for deferred credits following a resolution of new tariff rates with the regulator. The non-recurring gains of US$22.4 million for 2008 mainly comprise a gain on divestment and dilution of the Group's interest in PLDT of US$9.8 million.

## 8. ORDINARY SHARE DIVIDEND

At a meeting held on 4 September 2009, the Directors declared an interim cash dividend of U.S. 0.51 cent (2008: U.S. 0.38 cent) per ordinary share.

### 9. EARNINGS PER SHARE ATTRIBUTABLE TO OWNERS OF THE PARENT

The calculation of basic earnings per share is based on the profit for the period attributable to owners of the parent of US$164.3 million (2008: US$156.8 million), and the weighted average number of ordinary shares of 3,214.3 million (2008: 3,226.4 million) in issue during the period.

The calculation of diluted earnings per share is based on: (i) the profit for the period attributable to owners of the parent of US$164.3 million (2008: US$156.8 million) reduced by the dilutive impact of (a) US$0.1 million (2008: US$0.1 million) in respect of the exercise of share options issued by its associated companies and (b) nil (2008: US$3.4 million) in respect of the convertible notes issued by its previous joint venture DMWC (which became a subsidiary company since July 2008) and (ii) a share base equal to the aggregate of the weighted average number of ordinary shares of 3,214.3 million (2008: 3,226.4 million) in issue during the period (as used in the basic earnings per share calculation) and the weighted average number of ordinary shares of 37.6 million (2008: 59.9 million) assumed to have been issued at no consideration on the deemed exercise of all share options of the Company during the period.

The impact upon full conversion of the MPIC's share options has not been taken into account in calculating the diluted earnings per share because their anti-dilutive effect on the basic earnings per share for the period would actually increase the earnings per share.

### 10. PROPERTY, PLANT AND EQUIPMENT

The movements in property, plant and equipment are set out below.

| *US$ millions* | **2009** | **2008** |
|---|---|---|
| At 1 January | 808.4 | 784.1 |
| Exchange translation | 56.3 | 15.8 |
| Additions | 111.6 | 55.8 |
| Depreciation *(Note 4)* | (40.8) | (42.2) |
| Disposals | (1.0) | (3.4) |
| **At 30 June** | 934.5 | 810.1 |

### 11. ASSOCIATED COMPANIES AND JOINT VENTURES

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| PLDT | 1,007.0 | 1,040.5 |
| Philex | 116.1 | 95.1 |
| MPIC | 54.9 | 48.0 |
| Others | 6.8 | 18.7 |
| **Total** | 1,184.8 | 1,202.3 |

## 12. OTHER INTANGIBLE ASSETS

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| Concession assets-Water | 840.3 | 837.9 |
| Concession assets-Tollroad | 345.4 | 354.6 |
| Brands | 361.0 | 346.0 |
| **Total** | 1,546.7 | 1,538.5 |

Concession assets-Water represent the concession held by Maynilad for its exclusive right granted by Metropolitan Waterworks and Sewerage System (MWSS) on behalf of the Philippine government to provide water and sewerage services and charge users for the services provided in the area of West Metro Manila during its concession period. Concession assets-Tollroad represent the concession held by Manila North Tollways Corporation (MNTC) for its right, interests and privileges to finance, design, construct, operate and maintain toll roads, toll facilities and other facilities generating toll-related and non-toll related income in respect of the Manila North Expressway (also known as North Luzon Expressway (NLEX)) during its concession period. Brands represent the brands held by PT Indolakto for its various milk-related products.

## 13. PLEDGED DEPOSITS AND RESTRICTED CASH

At 30 June 2009, the Group had US$12.0 million (31 December 2008: US$12.0 million) of pledged bank deposits and US$18.8 million (31 December 2008: Nil) of cash which was restricted as to use.

## 14. ACCOUNTS RECEIVABLE, OTHER RECEIVABLES AND PREPAYMENTS

Included in accounts receivable, other receivables and prepayments are trade receivables of US$259.5 million (31 December 2008: US$258.1 million) with an ageing profile as below.

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| 0 to 30 days | 209.8 | 204.3 |
| 31 to 60 days | 10.0 | 12.0 |
| 61 to 90 days | 5.7 | 6.7 |
| Over 90 days | 34.0 | 35.1 |
| **Total** | 259.5 | 258.1 |

Indofood allows export customers 60 days of credit and local customers an average of 30 days of credit. MPIC (a) allows 60 days for credit for its water service customers, (b) collects toll fees through its associated company, Tollways Management Corporation (TMC), by cash, the users' prepaid and reloadable electronic toll collection devices and credit card payment arrangements.

## 15. ACCOUNTS PAYABLE, OTHER PAYABLES AND ACCRUALS

Included in accounts payable, other payables and accruals are trade payables of US$195.3 million (31 December 2008: US$233.4 million) with an ageing profile as below.

| *US$ millions* | At 30 June 2009 | At 31 December 2008 |
|---|---|---|
| 0 to 30 days | 163.9 | 220.7 |
| 31 to 60 days | 5.8 | 8.5 |
| 61 to 90 days | 1.0 | 2.6 |
| Over 90 days | 24.6 | 1.6 |
| **Total** | 195.3 | 233.4 |

## 16. DEFERRED LIABILITIES AND PROVISIONS

| *US$ millions* | Long-term liabilities | Pension | Others | 2009 Total | 2008 Total |
|---|---|---|---|---|---|
| At 1 January | 259.7 | 137.7 | 74.4 | 471.8 | 197.9 |
| Exchange translation | (2.4) | 9.7 | (0.7) | 6.6 | 3.2 |
| Additions | 55.0 | 16.3 | 4.3 | 75.6 | 21.9 |
| Payment and utilization | (47.5) | (4.9) | (14.9) | (67.3) | (0.7) |
| **At 30 June** | 264.8 | 158.8 | 63.1 | 486.7 | 222.3 |
| **Presented as:** | | | | | |
| **Current Portion** | 64.2 | – | 17.4 | 81.6 | 17.3 |
| **Non-current Portion** | 200.6 | 158.8 | 45.7 | 405.1 | 205.0 |
| **Total** | 264.8 | 158.8 | 63.1 | 486.7 | 222.3 |

The long-term liabilities mainly relate to Maynilad's concession fees payable to MWSS and deferred credits (which represent foreign exchange gains and other payables which will be refunded to the customers and foreign exchange differences arising from retranslation of the portion of Maynilad's foreign currency denominated concession fees payable and loans) and Indofood's accrued liabilities for dismantlement, removal or restoration in relation to property, plant and equipment.

The pension relates to accrued liabilities in relation to retirement schemes and long service payments.

The others mainly relate to MNTC's provision for value added taxes and a restructuring provision. The restructuring provision relates to the restructuring of the Group's shareholding structure in PLDT. The amount of the provision for the restructuring is estimated based on the anticipated transaction costs required to complete the restructuring. The estimation basis is reviewed on an ongoing basis and revised as appropriate.

**17. COMMITMENTS AND CONTINGENT LIABILITIES**

**(A) Capital Expenditure**

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| Commitments in respect of subsidiary companies: | | |
| Authorized, but not contracted for | 207.8 | 548.2 |
| Contracted, but not provided for | 171.7 | 6.3 |
| **Total** | 379.5 | 554.5 |

The Group's capital expenditure commitments principally relate to Indofood's purchase of property, plant and equipment, investments in plantations, and Maynilad's and MNTC's construction of water and toll road infrastructure.

**(B) Contingent Liabilities**

At 30 June 2009, except for US$56.9 million (31 December 2008: US$53.7 million) guarantees given by Indofood for loan facilities obtained by certain plantation farmers in relation to arrangements for those farmers' production and sale of fresh fruit bunches to Indofood, neither the Group nor the Company had any significant contingent liabilities (31 December 2008: Nil).

## 18. SHARE OPTIONS

Particulars of the share options of the Company and its subsidiary company granted to the Directors and senior executives of the Company and its subsidiary company at 30 June 2009 are set out below.

### (A) Particulars of the Company's Share Option Scheme

| | Share options held at 1 January 2009 | Share options granted during the period | Share options exercised during the period | Share options held at 30 June 2009 | Share options exercise price *(HK$)* | Market price at date of grant *(HK$)* | Market price during the period of exercise *(HK$)* | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | | | | | |
| Manuel V. Pangilinan | 31,800,000 | – | – | 31,800,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 30,200,000 | – | – | 30,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Edward A. Tortorici | 3,560,000 | – | (3,560,000) | – | 1.76 | 1.76 | 3.77 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 18,200,000 | – | – | 18,200,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Robert C. Nicholson | 14,000,000 | – | – | 14,000,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 15,500,000 | – | – | 15,500,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Non-Executive Directors** | | | | | | | | | | | |
| Ambassador Albert F. del Rosario | 2,840,000 | – | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Benny S. Santoso | 2,840,000 | – | – | 2,840,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Independent Non-Executive Directors** | | | | | | | | | | | |
| Graham L. Pickles | 3,160,000 | – | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Prof. Edward K.Y. Chen *GBS, CBE, JP* | 1,340,000 | – | – | 1,340,000 | 1.76 | 1.76 | – | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,160,000 | – | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Sir David W. C. Tang, *KBE* | 3,160,000 | – | – | 3,160,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| **Senior Executives** | 29,032,000 | – | – | 29,032,000 | 1.76 | 1.76 | – | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 4,500,000 | – | – | 4,500,000 | 3.275 | 3.25 | – | 7 June 2006 | December 2010 | June 2007 | June 2016 |
| | 42,220,000 | – | – | 42,220,000 | 5.33 | 5.33 | – | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Total** | 211,832,000 | – | (3,560,000) | 208,272,000 | | | | | | | |

Further information regarding the Company's share option scheme has been set out on pages 147 and 148 of the Company's 2008 Annual Report.

**(B) Particulars of MPIC's Share Option Scheme**

| | Share options held at 1 January 2009 | Share options granted during the period | Share options exercised during the period | Share options held at 30 June 2009 | Share options exercise price *(Peso)* | Market price at date of grant *(Peso)* | Market price during the period of exercise *(Peso)* | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | | | | | |
| Manuel V. Pangilinan | 7,500,000 | – | – | 7,500,000 | 2.12 | 2.10 | – | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | – | 7,500,000 | – | 7,500,000 | 2.73 | 2.65 | – | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| Edward A. Tortorici | 5,000,000 | – | – | 5,000,000 | 2.12 | 2.10 | – | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | – | 5,000,000 | – | 5,000,000 | 2.73 | 2.65 | – | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| Ambassador Albert F. del Rosario | 2,500,000 | – | – | 2,500,000 | 2.12 | 2.10 | – | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | – | 2,500,000 | – | 2,500,000 | 2.73 | 2.65 | – | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| **Senior Executives** | 46,000,000 | – | (2,250,000) | 43,750,000 | 2.12 | 2.10 | 5.60 | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | – | 47,925,245 | (1,250,000) | 46,675,245 | 2.73 | 2.65 | 5.60 | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| **Total** | 61,000,000 | 62,925,245 | (3,500,000) | 120,425,245 | | | | | | | |

At the annual general meeting held on 1 June 2007, the Company's shareholders approved a share option scheme under which MPIC's directors may, at their discretion, invite executives of MPIC upon the regularization of employment of eligible executives, to take up share options of MPIC to obtain an ownership interest in MPIC and for the purpose of long-term employment motivation. The scheme was subsequently approved by MPIC's shareholders and became effective on 14 June 2007 and would be valid for 10 years.

The maximum number of shares on which options may be granted under the scheme may not exceed 10% of the issued share capital of MPIC as 1 June 2007, at the date on which the MPIC's share option scheme was approved by the Company's shareholders on the annual general meeting held on 1 June 2007. The aggregate number of shares which may be issued upon exercise of the options granted and to be granted to any eligible participant (whether or not already an option holder) in any 12-month period shall not exceed 1% of the shares in issue at the relevant time.

The exercise price in relation to each option granted under the scheme shall be determined by MPIC's directors at their absolute discretion, but in any event shall not be less than (i) the closing price of MPIC's shares for one or more board lots of such MPIC's shares on the Philippine Stock Exchange (PSE) on the option grant date; (ii) the average closing price of MPIC's shares for one or more board lots of such MPIC's shares on the PSE for the five business days on which dealings in the MPIC's shares are made immediately preceding the option grant date; or (iii) the par value of the MPIC's shares, whichever is higher.

On 9 December 2008, 61,000,000 share options under MPIC's scheme were granted. The average fair value of options granted, as calculated based on the Black-Scholes option pricing model, was Peso 0.37 or an aggregate value of Pesos 22.8 million (US$0.5 million) for all options granted. The assumptions used were as follows:

| | |
|---|---|
| Share price at the date of grant | Pesos 2.10 |
| Exercise price | Pesos 2.12 |
| Expected volatility (based on historical volatility of the MPIC's share commensurate with the average expected life of the options granted) | 76% |
| Option life | 4 years |
| Average risk-free interest rate (based on the Philippine government zero coupon bond) | 6.26% per annum |

On 10 March 2009, 62,925,245 share options under MPIC's scheme were granted. The average fair value of options granted, as calculated based on Black-Scholes option pricing model, was Peso 0.51 or an aggregate value of Pesos 31.8 million (US$0.7 million) for all options granted. The assumptions used were as follows:

| | |
|---|---|
| Share price at the date of grant | Pesos 2.65 |
| Exercise price | Pesos 2.73 |
| Expected volatility (based on historical volatility of the MPIC's share commensurate with the average expected life of the options granted) | 64% |
| Option life | 4 years |
| Average risk-free interest rate (based on the Philippine government zero coupon bond) | 4.53% per annum |

The Black-Scholes option pricing model, applied for determining the estimated values of the share options granted under MPIC's scheme, requires input of higher subjective assumptions, including the expected stock price volatility. Changes in the subjective input assumptions can materially affect the estimated value of the options granted.

Details of the Group's accounting policy in respect of the share options granted are set out in Note 2D(r)(III) to the Company's 2008 audited financial statements set out on pages 103 and 104 of the Company's 2008 Annual Report.

At a special shareholders' meetings of MPIC held on 20 February 2009, MPIC's shareholders approved the amendments to MPIC's share options scheme which include (i) a refreshment of the number of MPIC options that may be granted to take into account of the increase in the capital stock of MPIC or other changes to its capital structure which have either been approved by the shareholders, implemented, in process, or which may potentially be approved or implemented in the future; and (ii) the inclusion in MPIC's share option plan of a requirement for MPIC to comply with relevant corporate requirements and regulations applicable to MPIC's parent company. The amendments were subsequently approved by the Company's shareholders in the annual general meeting held on 3 June 2009.

**19. RELATED PARTY TRANSACTIONS**

Significant related party transactions entered into by the Group during the period are disclosed as follows:

(A) In June 2009, MPIC entered into a sale and purchase agreement with AB Holdings Corporation (ABHC), Alfred Xerex-Burgos, Jr. (AXB) (together the 49.0% shareholder of Landco) and Landco pursuant to which MPIC sold 1.3 million common shares of Landco (representing 17.0% interest in Landco) for a consideration of Pesos 203 million (approximately US$4.2 million) to ABHC. This transaction also constituted a connected transaction as defined in Chapter 14A of the Listing Rules.

(B) Asia Link B.V. (ALBV), a wholly-owned subsidiary company of the Company, has a technical assistance agreement with Smart Communications, Inc. (Smart), a wholly-owned subsidiary company of PLDT, for ALBV to provide Smart with technical support services and assistance in the operations and maintenance of cellular mobile telecommunications services for a period of four years from 23 February 2008, subject to renewal upon mutual agreement between the parties. The agreement provides for payments of technical service fees equivalent to 1% (2008: 1%) of the consolidated net revenue of Smart.

The fee under the above arrangement amounted to Pesos 322 million (US$6.7 million) for the period ended 30 June 2009 (30 June 2008: Pesos 303 million or US$7.2 million). At 30 June 2009, the outstanding technical service fee payable amounted to Pesos 214 million (US$4.5 million) (31 December 2008: outstanding prepaid technical service fee of Pesos 8 million or US$0.2 million).

(C) In the ordinary course of business, Indofood has engaged in trade transactions with certain of its associated companies, joint ventures and affiliated companies, the majority of which are related to the Salim Family either through direct and/or common share ownership and common management. Mr. Anthoni Salim is the Chairman and a substantial shareholder of the Company and is the President Director and Chief Executive Officer of Indofood.

All significant transactions with related parties, whether or not conducted under normal terms and conditions similar to those with non-related parties, are disclosed as follows:

**Nature of transactions**

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| **Income Statement Items** | | |
| Sales of finished goods | | |
| – to associated companies and joint ventures | 14.0 | 12.7 |
| – to affiliated companies | 25.1 | 28.1 |
| Purchases of raw materials | | |
| – from associated companies and joint ventures | 19.4 | 22.9 |
| – from affiliated companies | 5.7 | 5.5 |
| Management and technical services fee income and royalty income | | |
| – from associated companies and joint ventures | 0.5 | 0.5 |
| – from affiliated companies | 2.5 | 1.8 |
| Insurance expenses | | |
| – to affiliated companies | 1.4 | 1.3 |
| Rental expenses | | |
| – to affiliated companies | 0.5 | 0.6 |
| Transportation and pump services expenses | | |
| – to affiliated companies | 0.2 | 0.2 |

Approximately 2% (2008: 2%) of Indofood's sales and 2% (2008: 2%) of its purchases were transacted with these related parties.

**Nature of balances**

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| **Statement of Financial Position Items** | | |
| Accounts receivable – trade | | |
| – from associated companies and joint ventures | 4.5 | 2.6 |
| – from affiliated companies | 11.8 | 13.3 |
| Accounts receivable – non-trade | | |
| – from associated companies and joint ventures | 0.2 | 0.4 |
| – from affiliated companies | 10.4 | 8.3 |
| Accounts payable – trade | | |
| – to associated companies and joint ventures | 4.9 | 3.6 |
| – to affiliated companies | 3.5 | 2.3 |
| Accounts payable – non-trade | | |
| – to affiliated companies | 21.8 | 19.2 |

(D) During the period ended 30 June 2009, MPIC's subsidiary company, Maynilad, entered into certain construction contracts with DMCI Holdings Inc. (DMCI) (a 44.6% shareholder of DMWC, Maynilad's parent company) for the latter's construction of water infrastructure for Maynilad. On 23 March 2009, Maynilad entered into (i) a framework agreement with D.M. Consunji, Inc. (Consunji), a subsidiary company of DMCI, in relation to the provision of engineering, procurement and/or construction services by Consunji to Maynilad for the period from 23 March 2009 to 31 December 2011 and (ii) a lease agreement with DMCI Project Developers, Inc. (DMCIPD), a subsidiary company of DMCI, for the renting of certain premises in the Makati City by DMCIPD to Maynilad for the period from 1 February 2009 to 31 January 2012. These related party transactions also constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

All significant transactions with DMCI group, whether or not conducted under normal terms and conditions similar to those with non-related parties, are disclosed as follows:

**Nature of transactions**

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| **Income Statement Items** | | |
| Rental expenses | 0.1 | – |
| **Capital Expenditure Items** | | |
| Construction services for water infrastructure obtained | 21.2 | – |

**Nature of balances**

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| **Statement of Financial Position Items** | | |
| Accounts receivable – trade | 5.4 | – |
| Accounts payable – trade | 0.1 | 3.0 |

(E) During the period ended 30 June 2009, MPIC's subsidiary company, MNTC, collected toll fees through TMC, MPIC's associated company.

All significant transactions with TMC, whether or not conducted under normal terms and conditions similar to those with non-related parties, are disclosed as follows:

**Nature of transactions**

| **For the six months ended 30 June**<br>*US$ millions* | **2009** | **2008** |
|---|---|---|
| **Income Statement Items** | | |
| Operator's fee | 14.3 | – |
| Management income | 0.1 | – |
| Guarantee income | 0.2 | – |
| Interest income | 0.2 | – |

**Nature of balances**

| *US$ millions* | **At 30 June 2009** | **At 31 December 2008** |
|---|---|---|
| **Statement of Financial Position Items** | | |
| Accounts receivable – trade | 7.7 | 7.3 |
| Accounts payable – trade | 6.2 | 5.6 |

**20. SUBSEQUENT EVENTS**

(A) On 10 July 2009, LAWL Pte. Ltd (LAWL) completed the subscription of 791.1 million of new common shares issued by MPIC for Pesos 2.0 billion (approximately US$41.6 million), which reduced the Group's economic interest in MPIC from approximately 97.9% to approximately 90.3%. The Group is expected to record a dilution gain of approximately US$10 million from this transaction.

(B) On 14 July 2009, Pilipino Telephone Corporation (Piltel), a subsidiary company of PLDT, completed the acquisition of 223.0 million common shares of Manila Electric Company (Meralco) from First Philippine Utilities Corporation at a total consideration of Pesos 20.1 billion (approximately US$418.8 million).

On 17 July 2009 (the Reference Date), MPIC entered into two separate preliminary agreements (term sheets) with (a) Beneficial Trust Fund of PLDT (BTF Term Sheet) and (b) Crogan Limited (Crogan), a wholly-owned subsidiary company of the Company, and Metro Pacific Holdings, Inc. (MPHI), a Philippine affiliate of the Company (MPHI Term Sheet), respectively. The BTF Term Sheet contemplates that MPIC will purchase 113.3 million common shares of Meralco (representing an approximately 10.17% interest in Meralco) from BTF at a total consideration of Pesos 14.3 billion (approximately US$297.4 million), which will be partly funded by the cash proceeds from BTF's subscription of 2.7 billion new common shares of MPIC, at a price of Pesos 3.5 (US$0.073) per share, for a total subscription price of Pesos 9.5 billion (approximately US$197.4 million). The MPHI Term Sheet contemplates that MPIC will purchase 31.1 million common shares of Meralco (representing approximately 2.79% interest in Meralco) from Crogan at a total consideration of Pesos 3.9 billion (approximately US$81.6 million), which will be partly funded by the cash proceeds from MPHI's subscription of 742.5 million new common shares of MPIC, at a price of Pesos 3.5 (US$0.073) per share, at a total consideration of Pesos 2.6 billion (approximately US$54.1 million). In addition, according to the MPHI Term Sheet, Crogan has the option to (a) apply the remaining amount of consideration payable by MPIC to Crogan of Pesos 1.3 billion (approximately US$27.5 million) for the purchase of Meralco common shares in subscribing for more common shares of MPIC at the price of Pesos 3.5 (US$0.073) per share and (b) assign to MPHI its right to receive the said total consideration for the sale of Meralco common shares to MPIC.

Upon completion of the above transactions, the Group's economic interest in MPIC will be reduced from approximately 90.3% to either 73.0% or 73.7%, and the Group is expected to record a dilution gain of either US$40 million or US$42 million, depending on whether Crogan exercises the right to subscribe for more MPIC common shares (as mentioned above).

In addition, MPIC has undertaken in the BTF Term Sheet that, subject to favourable market conditions as determined by its board of directors, MPIC will conduct a fund raising exercise (a "Re-launch" of its listed shares) to broaden its current investor base, which will be effected by way of a public offering or placement of MPIC's shares to independent investors and result in an offering to public shareholders of a minimum of the lower of (a) 15% of MPIC's fully diluted equity and (b) US$100 million in value of shares valued at the Re-launch issue price. MPIC agreed that it would not, within a period of 90 days from the Reference Date, issue shares or other securities at a price less than the Pesos 3.5 (US$0.073) per share and in the alternative, that if MPIC do so, MPIC will compensate BTF and MPHI for the difference between the aggregate subscription price paid by BTF and MPHI for the above-mentioned subscriptions and the value of those shares at the Re-launch issue price in the form of additional MPIC common shares, to be issued at the Re-launch issue price.

**21. COMPARATIVE AMOUNTS**

As explained in Note 1(B) to the Condensed Interim Financial Statements, due to the adoption of HKAS 1 (Revised) and HKFRS 8 during the period, the presentation of certain items and balances has been revised to comply with such changes. Accordingly, certain comparative amounts have been reclassified to conform with the current period's accounting presentation. In addition, the comparative income statement has been restated as if a discontinued operation had been discontinued at the beginning of the comparative period.

**SUMMARY OF PRINCIPAL INVESTMENTS**
**At 30 June 2009**

**Philippine Long Distance Telephone Company**
**PLDT (PSE: TEL; NYSE: PHI)** is the leading telecommunications service provider in the Philippines. It has common shares listed on the Philippine Stock Exchange and American Depositary Receipts (ADRs) listed on the New York Stock Exchange. It has one of the largest market capitalizations among Philippine listed companies. Through its three principal business groups, PLDT offers a wide range of telecommunications services: Wireless (principally through wholly-owned subsidiary company, Smart Communications, Inc.); Fixed Line (principally through PLDT); and Information and Communications Technology (principally through wholly-owned subsidiary company, ePLDT). PLDT has developed the Philippines' most extensive fiber optic backbone, cellular, fixed line and satellite networks.

| | | |
|---|---|---|
| Sector | : | Telecommunications |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 186.8 million |
| Particulars of issued shares held | : | Common shares of Pesos 5 par value |
| Economic interest | : | 26.5% |

Further information on PLDT can be found at www.pldt.com

**Metro Pacific Investments Corporation**
**MPIC (PSE: MPI)** is a publicly-listed investment and management company based in the Philippines with holdings in infrastructure, utilities and healthcare enterprises.

| | | |
|---|---|---|
| Sector | : | Infrastructure, Utilities and Healthcare |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 9.4 billion |
| Particulars of issued shares held | : | Common shares of Peso 1 par value |
| Economic interest | : | 97.9% |

Further information on MPIC can be found at www.mpic.com.ph

**PT Indofood Sukses Makmur Tbk**

**Indofood (IDX: INDF)** is a "Total Food Solutions" company engaged in food manufacturing, processing, marketing and distribution. Indofood is based in Jakarta and is listed on the Indonesia Stock Exchange and its Agribusiness subsidiaries, Indofood Agri Resources Ltd and PT PP London Sumatra Indonesia Tbk are listed on the Singapore and Indonesia Stock Exchanges. Through its four complementary strategic business groups, Indofood offers and distributes a wide range of food products throughout Indonesia: Consumer Branded Products (noodles, dairy, food seasonings, snack foods and nutrition and special foods), Bogasari (flour and pasta), Agribusiness (oil palm, rubber, sugar cane, cocoa and tea plantations, cooking oils, margarine and shortening) and Distribution. Indofood is one of the world's largest instant noodle manufacturers by volume, plantation companies by hectarage and the largest flour miller in Indonesia. Indofood's flourmill in Jakarta is one of the largest in the world in terms of production capacity in one location. It also has an extensive distribution network in Indonesia.

| | | |
|---|---|---|
| Sector | : | Consumer Food Products |
| Place of incorporation/business area | : | Indonesia |
| Issued number of shares | : | 8.8 billion |
| Particulars of issued shares held | : | Shares of Rupiah 100 par value |
| Economic interest | : | 50.1% |

Further information on Indofood can be found at www.indofood.co.id

**Philex Mining Corporation**

**Philex (PSE: PX)** is a Philippine listed company engaged in exploration, development and utilization of mineral resources.

| | | |
|---|---|---|
| Sector | : | Natural Resources |
| Place of incorporation/business area | : | The Philippines |
| Issued number of shares | : | 4.9 billion |
| Particulars of issued shares held | : | Common shares of Peso 1 par value |
| Economic interest | : | 23.1% |

Further information on Philex can be found at www.philexmining.com.ph

## 4. INDEBTEDNESS

As at 31 January 2010, the Group had outstanding borrowings of approximately US$3,771.8 million (equivalent to approximately HK$29,420.0 million). The borrowings comprised secured bank loans of US$1,915.7 million (equivalent to approximately HK$14,942.4 million), unsecured bank loans of US$1,192.7 million (equivalent to approximately HK$9,303.1 million), secured other loans of US$45.9 million (equivalent to approximately HK$358.0 million) and unsecured other loans of US$617.5 million (equivalent to approximately HK$4,816.5 million).

The secured bank loans were secured by certain of the Group's property, plant and equipment, plantations, other intangible assets, other non-current assets, cash and cash equivalents, inventories and the Group's interest of approximately 24.3% in PLDT, approximately 7.9% in Philex Mining Corporation, approximately 99.8% in Metro Pacific Tollways Corporation, approximately 16.5% in DMCI-MPIC Water Company, Inc., approximately 9.9% in Maynilad Water Services, Inc. and approximately 10.5% in Meralco.

The other loans comprised unsecured bonds of US$460.5 million (equivalent to approximately HK$3,591.9 million) (as described below), unsecured trust receipt loans of US$38.1 million (equivalent to approximately HK$297.2 million) and others. The bonds issued by the Group as at 31 January 2010 comprise the following:

(a) Rupiah 2.0 trillion (equivalent to approximately US$212.7 million or HK$1,659.1 million) Rupiah bonds issued by PT Indofood Sukses Makmur Tbk ("Indofood"), with a coupon rate of 10.0%, payable quarterly, and which mature in May 2012;

(b) Rupiah 1.6 trillion (equivalent to approximately US$170.8 million or HK$1,332.2 million) Rupiah bonds issued by Indofood, with a coupon rate of 13.2%, payable quarterly, and which mature in June 2014;

(c) Rupiah 452 billion (equivalent to approximately US$47.7 million or HK$372.1 million) 5-year Rupiah bonds issued by PT Salim Ivomas Pratama ("SIMP"), with a coupon rate of 11.65%, payable quarterly, and which mature in November 2014; and

(d) Rupiah 278 billion (equivalent to approximately US$29.3 million or HK$228.5 million) 5-year Islamic Lease-based bonds issued by SIMP, with a coupon rate of 11.65%, payable quarterly, and which mature in November 2014.

As at 31 January 2010, except for US$61.8 million (equivalent to approximately HK$482.0 million) guarantees given by Indofood for loan facilities obtained by certain plantation farmers in relation to arrangements for those farmers' production and sale of fruit bunches to Indofood, the Group did not have any material contingent liabilities.

Save as aforesaid, and apart from intra-group liabilities, the Group did not have outstanding at the close of business on 31 January 2010 any loan capital issued and outstanding or agreed to be issued, bank overdrafts, loans or other similar indebtedness, liabilities under acceptances or acceptance credits, debentures, mortgages, charges, finance leases or hire purchase commitments, guarantees or other contingent liabilities.

Except for (i) a PhP18 billion (equivalent to approximately US$389.6 million or HK$2,039.0 million) new loan facility to be obtained by Beacon Electric in connection with the possible exercise of the Call Option by Beacon Electric, and (ii) the early repayment of a PhP11.2 billion (equivalent to approximately US$242.4 million or HK$1,890.9 million) bank loan by MPIC, with the proceeds from a loan receivable from FPHC, there is no material change in the Group's outstanding indebtedness and contingent liabilities from 31 January 2010 to the Latest Practicable Date.

## 5. WORKING CAPITAL

As at the Latest Practicable Date, the Directors are of the opinion that the Group will have sufficient working capital for its present requirements for the twelve months from the date of this Circular, after the completion of the Piltel Investment and the possible exercise of the Call Option.

## 6. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors are not aware of any material adverse change in the financial or trading position of the Group since 31 December 2008, the date to which the latest published audited financial statements of the Group were made up.

## 7. GENERAL BUSINESS TRENDS AND FINANCIAL AND TRADING PROSPECTS OF THE GROUP

The Group's principal investments have the following developments since 31 December 2008.

In September and October 2009, MPIC completed the re-launch of its shares by way of a public offering to raise PhP14.3 billion (equivalent to approximately US$309.5 million or HK$2,414.3 million) through an old for new shares arrangement. The public offering diluted the Group's attributable economic interest in MPIC from approximately 90.2% to approximately 61.5%. The Group is expected to record a dilution gain of approximately US$47.5 million (equivalent to approximately HK$370.5 million) as a result of the public offering of MPIC's shares.

On 6 October 2009, MPIC completed the acquisition of an approximately 12.8% interest in Meralco for a consideration of Php18.2 billion (equivalent to approximately US$393.9 million or HK$3,072.7 million). Since part of the consideration was settled through the issuance of new MPIC common shares, the Group's attributable economic interest in MPIC was further diluted to approximately 54.1%. A dilution gain of approximately US$25 million (equivalent to approximately HK$195.0 million) will be recorded by the Group as a result of the issuance of MPIC common shares as part of the consideration for the acquisition of the approximately 12.8% interest in Meralco. Together with the approximately 1.7% Meralco interest acquired from the open market, MPIC's effective interest in Meralco totaled approximately 14.5%. In addition, Piltel completed an acquisition of approximately 19.8% interest in Meralco in July 2009.

On 8 October 2009, the Philippine Port Authority awarded a 25-year licence to a joint venture company owned by MPIC and Harbour Centre Port Terminal Inc for the development, management, operation and maintenance of the Manila North Harbor which covers an area of up to 70 hectares. The joint venture has undertaken to invest up to PhP14.5 billion (equivalent to approximately US$313.9 million or HK$2,448.1 million).

On 5 November 2009, MPIC entered into an agreement with FPHC regarding (i) the provision of a loan in the amount of approximately PhP11.2 billion (equivalent to approximately US$242.4 million or HK$1,890.9 million) by MPIC to FPHC; and (ii) the agreement to grant a call option relating to 74.7 million common shares of Meralco (approximately 6.6% interest in Meralco) by FPHC to MPIC. The exercise price of the call option is PhP300 (equivalent to approximately US$6.5 or HK$50.6) per share.

In December 2009, the Group capitalized its approximately PhP2.0 billion (equivalent to approximately US$43.3 million or HK$337.9 million) of advances into additional equity in MPIC which increased the Group's attributable economic interest in MPIC to approximately 55.6%.

Following the acquisition of an approximately 20% interest in Philex Mining Corporation ("Philex") on 28 November 2008, the Group acquired an additional approximately 11.6% interest in Philex from the open market for a consideration of approximately US$105 million (equivalent to approximately HK$819.0 million) during 2009. Therefore, the Group has approximately 31.5% economic interest in Philex as of 31 December 2009.

In addition, the Company's Philippine affiliate, Two Rivers Pacific Holdings Corporation ("Two Rivers"), acquired approximately 9.2% interest in Philex from third parties for a consideration of PhP9.5 billion (equivalent to approximately US$205.6 million or HK$1,603.9 million) in December 2009. Two Rivers further acquired approximately 5.9% interest in Philex from Government Service Insurance System, a state pension of the Philippine government, in January 2010, for a total consideration of approximately PhP6 billion (equivalent to approximately US$129.9 million or HK$1,013.0 million). The economic interest in Philex held by Two Rivers increased to approximately 15.1%.

In December 2009, the Company raised approximately HK$2,187.5 million (equivalent to approximately US$280.5 million), by way of a fully underwritten rights issue by offering its Shareholders 1 new ordinary share for every 5 ordinary shares held at a subscription price of HK$3.40 per new ordinary share. The funds are to be used to increase the Group's investment in Philex and Meralco. As a result of the rights issue, the total number of issued ordinary shares of the Company increased to approximately 3,860 million from approximately 3,216 million.

During 2009 and January 2010, Indofood completed an internal reorganization of its consumer branded product business under a separate legal entity, PT Indofood CBP Sukses Makmur ("Indofood CBP"). On 9 February 2010, Indofood announced the proposal to spin off Indofood CBP through an initial public offering on the Indonesia Stock Exchange. As at the Latest Practicable Date, the terms of such have not been finalized and no agreements or understandings have been reached.

The Group's performance during the year ended 31 December 2009 has been strong with the following key factors influencing performance:

- growth in mobile subscribers and take up of further broadband customers in the PLDT telecommunications business in the Philippines. This business has continued to generate strong cash flows and will payout 100% of core net income as dividend for the financial year ended 31 December 2009. This dividend income is a key component of the Company's liquidity.

- Whilst the competitive environment in both the Philippines impacting the telecommunications business and in the Indonesian market impacting the consumer branded businesses has remained strong their respective marketing strategies have enabled the businesses to maintain market share and in the case of the branded consumer goods business to increase margins. The improvement in crude palm oil prices compared to the financial year 2008 has also benefited this business.

- The mining business in the Philippines has benefited from increased gold and copper prices when compared with financial year 2008 however this has been offset by lower production volumes given mine and milling challenges.

- The infrastructure businesses comprising MPIC have performed extremely well with strong growth in the water distribution business; growth in the number of connections and in the delivery of a higher volume of water to those customers. The tollways business has seen revenue growth as traffic has responded to lower fuel prices and marketing initiatives to encourage travel.

The Group's liquidity remains strong given the inherent cash flows being generated from the operating businesses.

The Company will see strong dividend income in 2010 in respect of 2009 earnings from PLDT and Indofood and has managed its cash flows prudently since 31 December 2008.

The Company's gearing ratio will show an improvement on that of 31 December 2008 and 30 June 2009. Gearing is calculated by reference to the net borrowings as a factor of total equity.

The share values of each of the Group's listed investments in PLDT, MPIC, Indofood and Philex have increased since 31 December 2008.

## 8. MANAGEMENT DISCUSSION AND ANALYSIS

(a) Beacon Electric is a single purpose investment vehicle. Its activity is restricted to the holding of the Group's investment in Meralco. The investment in Meralco held by Beacon Electric will initially be approximately 14.5%, and subject to approvals being obtained by Piltel the effective holding will increase to approximately 28.2% and should Beacon Electric exercise the Call Option in respect of the Option Shares, its total shareholding will amount to approximately 34.8%.

(b) Meralco is the leading electricity distribution company in the Philippines and accounts for approximately 60% of electricity sales in the Philippines with its franchise of 25 years (granted in June 2003) being anchored in Luzon and incorporating Metro Manila.

The franchise area covers approximately 9,400 sq kilometers which is home to approximately 25% of the country's population and accounts for 50% of the country's gross domestic product.

Meralco currently delivers over 27,500 Giga Watt Hours ("Gwh") of electricity to over 4.7 million customers.

(c) As referred to in point (a) above, after the completion of the proposed transactions, the Group together with Piltel will have an attributable economic interest in shares representing approximately 40.9% (34.8% held through Beacon Electric while the other 6.1% held through Piltel) of the total issued common shares in Meralco; and the Group together with Piltel will have hold a voting trust arrangement with the Lopez group which enables it to exercise or control the exercise of approximately 47.5% of the voting power at general meetings of Meralco. The period over which this voting trust arrangement is until November 2012.

(d) Meralco's results are equity accounted for in the accounts of the Group for the period ended 31 December 2009 given that Piltel completed its approximately 19.8% interest in July 2009 and MPIC completed its approximately 14.5% interest in October 2009.

As at 31 December 2009, the Group had an approximately 26.5% interest in PLDT, through which Piltel is 99.5% owned, and an approximately 55.6% interest in MPIC. Therefore, the Group's effective equity accounting for Meralco is 13.3%.

By reference to the Meralco announcement of its full year 2009 results of approximately PhP6.0 billion net income (equivalent to approximately US$129.9 million and HK$1,013.0 million) published on 22 February 2010; the Group's share of Meralco earnings would be PhP1.1 billion (equivalent US$23.8 million and HK$185.6 million).

As at the Latest Practicable Date there has been no dividend declared in respect of 2009 earnings by Meralco, however the board of Meralco has formalized a dividend policy for the company to pay out regular dividends equivalent to 50% of core earnings which may be supplemented by special dividends on a look back basis.

Meralco is a successful company and will be making a significant contribution to the Group's profit. The future revenue growth of Meralco is likely to come as the Philippine economy develops with the asset itself being synonymous with the economic development of the country and from increased efficiency of operations and managed system losses.

The Group will also be able to benefit from potential synergies; these include establishment of long term pole rental, cross utilization of assets and various marketing opportunities arising from the respective customer bases available.

Meralco has a strong and stable cash generating capability and has a very manageable level of debt with a gearing ratio of 0.06 times at 31 December 2009.

For the year ended 31 December 2009:

- The consolidated core net income has increased 169% to Pesos 7 billion (equivalent to approximately US$146.4 million and HK$1,142.0 million) from Pesos 2.6 billion (equivalent to approximately US$58.2 million and HK$453.9 million) (restated) in 2008.

- The consolidated EBITDA amounted to Pesos 13.3 billion (equivalent to approximately US$278.2 million and HK$2,169.8 million), an increase of 20% compared to 2008 with EBITDA margin increasing to 7.17% from 5.75% in 2008.

- The consolidated free cash flow improved to Pesos 18.8 billion (equivalent to approximately US$393.2 million and HK$3,067.1 million) compared to Pesos 0.5 billion (equivalent to approximately US$10.5 million and HK$81.6 million) in 2008.

- The consolidated revenues and consolidated costs and expenses were lower by 3.6% and 5.9% at Pesos 184.9 billion (equivalent to approximately US$3,867.4 million and HK$30,165.7 million) and Pesos 175.6 billion (equivalent to approximately US$3,930.2 million and HK$30,655.3 million) respectively than in 2008. The revenue decrease was largely due to the impact of lower generation and transmission charges and lost sales due to typhoon Ondoy partly offset by the Performance Based Regulation ("PBR") rate adjustment and the Energy Regulatory Commission (ERC) approved under recoveries.

The performance for the year ended 31 December 2009 has been due to a 3.1% increase in billed customers to 4.7 million (2008: 4.6 million), a higher volume of energy sold by 1.7% to 27,516 Gwh and an adjustment in distribution rates which took effect in May 2009.

This growth of 3.3% and 3.0% in energy was in the residential and commercial sectors while the industrial sector showed a decline of 1.8% although the volume sold to this sector improved slowly in the course of 2009. Recovery in energy consumption was propelled by sustained remittances, lower inflation and lower electricity prices. The service sector showed robust performance with retail trade and communications growing by 8.7% and 18.3% respectively.

Actual system loss was recorded as 8.61% which for the second consecutive year is below the 9.5% cap imposed by the ERC.

The achievement in system loss management has been due to intensified deterrence drives and apprehensions, relocation of metering facilities from pilferage-prone areas and intensive campaigns.

The company's overall system performance and service delivery to customers, which are among the components of the PBR, are well within the limits mandated by the ERC.

In 2009, under recoveries from prior years were significantly addressed with the ERC authorizing the collection of transmission charge under recoveries amounting to Pesos 5.4 billion (equivalent to approximately US$112.9 million and HK$881.0 million), excluding carrying costs, starting in November. Collection of under recoveries of lifeline and inter-class subsidies began in December.

The company's consolidated debt comprises Pesos 20.7 billion (equivalent to approximately US$448.1 million and HK$3,494.8 million) of interest bearing borrowings; 99.7% of these are in local currency and the average effective interest rates on such are 8.1% for short term and 10.4% for long term. Of these borrowings Pesos 19.3 billion (equivalent to approximately US$417.7 million and HK$3,258.4 million) are classed as long term. The gearing ratio at 31 December 2009 is 0.06 times compared with 0.35 times at 31 December 2008.

The gearing ratio referred to above is calculated by reference to the net debt which comprises total debt less cash and cash equivalents divided by total equity.

The number of employees as at 31 December 2009 was 6,112.

For the year 31 December 2008:

- the consolidated core net income has decreased by 23% to Pesos 3.13 billion (equivalent to approximately US$70.1 million and HK$546.4 million) from Pesos 4.04 billion (equivalent to approximately US$88.1 million and HK$687.1 million) in 2007.

- Revenues from the sale of electricity declined by 5.2% to Pesos 196.2 billion (equivalent to approximately US$4,391.2 million and HK$34,251.6 million) from Pesos 186.5 billion (equivalent to approximately US$4,066.7 million and HK$31,720.5 million) in 2007. This decline in revenues was a result of lower generation power costs which was partly due to the utilization of banked gas.

Actual system loss was recorded at 9.28% slightly below the 9.5% cap imposed by the ERC.

The performance for the year was impacted by increased electricity sales by 3.2% to 27,049 Gwh over 2007. This sales increase was achieved through higher sales of 4.6% and 2.1% to commercial and industrial customers respectively while sales to the residential sector decreased by 0.4%. The result for the year 2008 was not influenced by any rate adjustment. However, the company did recognize a provision of Pesos 6.2 billion (equivalent to approximately US$138.8 million and HK$1,082.4 million) in respect of disallowed recovery of generation costs and transmission charge refunds to customers.

The company's consolidated debt comprised Pesos 25.3 billion (equivalent to approximately US$532.4 million and HK$4,152.8 million) of interest bearing borrowings of which 99.5% were in local currency. Of those borrowings Pesos 13.8 billion (equivalent to approximately US$290.4 million and HK$2,265.2 million) were classed as long term. The gearing ratio at 31 December 2008 was 0.35 times compared with 0.41 times at 31 December 2007.

The gearing ratio referred to above is calculated by reference to the net debt which comprises total debt less cash and cash equivalents divided by total equity.

The number of employees as at 31 December 2008 was 6,050.

For the year 31 December 2007:

- the consolidated core net income decreased by 70.9% to Pesos 4.04 billion (equivalent to approximately US$88.1 million and HK$687.1 million) from Pesos 13.88 billion (equivalent to approximately US$271.3 million and HK$2,116.2 million) in 2006.

  The net income in 2006 was significantly impacted by the reversal of provisions amounting to Pesos 15.7 billion (equivalent to US$306.9 million and HK$2,393.7 million) for probable losses following a favourable ruling of the Supreme Court in respect of the granting of a rate increase to the company by the ERC in 2003.

- Consolidated revenues increased by 5.2% to Pesos 200.7 billion (equivalent to approximately US$4,376.4 million and HK$34,135.6 million) from Pesos 190.8 billion (equivalent to approximately US$3,729.5 million and HK$29,089.9 million) in 2006.

Actual system loss was recorded at 9.99% which was above the 9.5% cap imposed by the ERC.

The performance for the year was impacted by a 4.6% increase in electricity sales to 26,219 Gwh with strong growth of 6.0% and 4.2% from the commercial and industrial customers respectively and a 3.3% increase from residential customers. The performance for the year was not influenced by any rate adjustment.

The company's consolidated debt comprised Pesos 27 billion (equivalent to approximately US$654.1 million and HK$5,101.7 million) of interest bearing borrowings of which 99.3% were in local currency. Of those borrowings Pesos 14.1 billion (equivalent to approximately US$341.6 million and HK$2,664.2 million) were classed as long term. The gearing ratio at 31 December 2007 was 0.41 times.

The gearing ratio referred to above is calculated by reference to the net debt which comprises total debt less cash and cash equivalents divided by total equity.

The number of employees as at 31 December 2007 was 5,990.

Details of the remuneration of employees and share option schemes are detailed in notes 28, 37 and 19 of the accountant's report on Meralco.

Meralco has a compensation committee which is responsible for setting overall remuneration practice. This committee uses its performance management system (a balanced scorecard process), the results therefrom and surveys to establish remuneration practice.

Meralco has a comprehensive training offering with certification programs to cover regulatory awareness and orientation for employees and middle management. There is also a career management programme to support employees competency development.

Details of the charges on group assets are detailed in notes 20 and 8 of the accountant's report on Meralco.

The company's exposure to exchange rates and related hedges are detailed in notes 30 and 31 of the accountant's report on Meralco.

The details of contingent liabilities are contained in note 34 of the accountant's report on Meralco.

**Outlook**

The company will consolidate its achievements referred to above in relation to system loss and continue to drive the service delivery to customers. The company will be challenged from the anticipated generation deficiencies and developments on the transmission side however the business is capable of mitigating the impact on customers through the management of power distribution.

Given the resilience in the commercial and industrial sectors the company is optimistic that growth will be achieved in 2010 and that core net income will show an improvement over 2009.

In December 2009 the ERC approved the Maximum Average Price ("MAP") under the PBR for 2010. However the company manifested before the ERC to voluntarily suspend the adjustment pending resolution of matters raised by an intervenor.

The Directors consider that the prospects of Meralco are promising. As far as the Company is aware, Meralco has no plans for material acquisitions or disposals.

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BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-FR-2

March 13, 2010

The Directors
First Pacific Company Limited
Manila Electric Company

Dear Sirs,

We set out below our report on the financial information (the "Financial Information") of Manila Electric Company ("Meralco" or the "Parent Company") and its subsidiaries (hereinafter collectively referred to as the "Company"), for inclusion in the circular of First Pacific Company Limited ("First Pacific") dated March 13, 2010 (the "Circular") issued in connection with the proposed/possible transactions, including (1) the proposed acquisition by Beacon Electric Asset Holdings, Inc. ("Beacon Electric", a subsidiary of First Pacific as at the date of this report) of shares in Meralco from Pilipino Telephone Corporation ("Piltel", an associate of First Pacific) and the subscription of new shares in Beacon Electric by Piltel; and (2) the possible acquisition of 74,700,000 shares in Meralco by Beacon Electric through the exercise of a call option. The Financial Information comprises the consolidated statements of financial position of the Company and the statements of financial position of the Parent Company as at December 31, 2009, 2008 and 2007, the consolidated statements of income, comprehensive income, changes in equity and cash flows of the Company for the years ended December 31, 2009, 2008 and 2007, and a summary of significant accounting policies and other explanatory notes.

The principal activities of the Company are the distribution and supply of electricity.

The primary and statutory financial statements of the Company for the years ended December 31, 2009, 2008 and 2007 were prepared in accordance with Philippine Financial Reporting Standards and were audited by us.

For the purpose of this report, the directors of Meralco have prepared the financial information of the Company, including the consolidated statements of financial position of the Company and the statements of financial position of the Parent Company as at December 31, 2009, 2008 and 2007 and the consolidated statements of income, comprehensive income, changes in equity and cash flows of the Company for the years ended December 31, 2009, 2008 and 2007, in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board (the "IFRS Financial Statements") which were audited by us in accordance with International Standards on Auditing. The Financial Information set out in this report has been prepared from the IFRS Financial Statements. No adjustments were made to the IFRS Financial Statements for the purpose of the Financial Information included in this report.

The directors of Meralco are responsible for the preparation and the true and fair presentation of the Financial Information in accordance with IFRS. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of the Financial Information that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. The directors of First Pacific are responsible for the content of the Circular in which this report is included.

It is our responsibility to form an independent opinion on the Financial Information and to report our opinion thereon.

For the purpose of this report, we have carried out an independent audit on the Financial Information. We conducted our audit in accordance with International Standards on Auditing and carried out such additional procedures as we considered necessary in accordance with Auditing Guideline 3.340 "Prospectuses and the Reporting Accountant" issued by the Hong Kong Institute of Certified Public Accountants.

In our opinion, the Financial Information gives, for the purpose of this report, a true and fair view of the results and cash flows of the Company for the years ended December 31, 2009, 2008 and 2007 and of the state of affairs of the Company and the Parent Company as at December 31, 2009, 2008 and 2007.

## I. FINANCIAL INFORMATION

### Consolidated Statements of Financial Position

| | December 31 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| **ASSETS** | | | |
| **Non-current Assets** | | | |
| Utility plant and others – net *(Notes 9, 10 and 18)* | ₱98,409 | ₱95,704 | ₱93,696 |
| Construction in progress *(Notes 9 and 10)* | 3,703 | 5,149 | 2,811 |
| Investments in associates and a joint venture *(Note 11)* | 1,182 | 2,036 | 1,608 |
| Investment properties *(Notes 12 and 20)* | 10,893 | 7,963 | 7,807 |
| Deferred pass-through fuel costs *(Notes 13, 26 and 35)* | 3,161 | 3,792 | 4,896 |
| Pension asset *(Note 29)* | 68 | 39 | – |
| Deferred tax assets *(Note 33)* | 8,143 | 8,032 | 6,724 |
| Other non-current assets – net *(Notes 2, 13, 15, 25, 30, 31 and 34)* | 13,362 | 9,993 | 16,213 |
| Total Non-current Assets | 138,921 | 132,708 | 133,755 |
| **Current Assets** | | | |
| Cash and cash equivalents *(Notes 14, 30 and 31)* | 17,068 | 5,402 | 4,876 |
| Trade and other receivables – net *(Notes 2, 13, 15, 26, 28 and 31)* | 21,294 | 37,506 | 33,406 |
| Inventories *(Note 16)* | 1,857 | 1,648 | 1,538 |
| Land and development costs *(Notes 8 and 25)* | 5,558 | 2,832 | 5,927 |
| Other current assets *(Notes 13, 17, 20, 23, 30 and 31)* | 2,470 | 2,265 | 1,970 |
| Total Current Assets | 48,247 | 49,653 | 47,717 |
| Total Assets | ₱187,168 | ₱182,361 | ₱181,472 |

| | December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| **EQUITY AND LIABILITIES** | | | |
| **Equity Attributable to Equity Holders of the Parent** | | | |
| Common stock *(Note 18)* | ₱11,273 | ₱11,038 | ₱11,033 |
| Subscription receivable | (960) | – | – |
| Additional paid-in capital | 4,566 | 2,932 | 2,931 |
| Employee share-based payment *(Notes 18 and 19)* | 115 | 268 | 152 |
| Unrealized fair value gains on available-for-sale investments *(Note 13)* | 71 | 47 | 68 |
| Revaluation increment in utility plant and others *(Note 18)* | 19,178 | 19,833 | 20,203 |
| Share in revaluation increment of an associate *(Notes 11 and 18)* | – | 129 | 298 |
| Share in cumulative translation adjustment of a subsidiary and an associate *(Note 11)* | 683 | 682 | (14) |
| Retained earnings *(Note 18)*: | | | |
| Unappropriated | 19,172 | 14,479 | 15,794 |
| Appropriated | 4,198 | 4,198 | 200 |
| | 58,296 | 53,606 | 50,665 |
| **Minority Interests** | 3,999 | 3,934 | 3,346 |
| Total Equity | 62,295 | 57,540 | 54,011 |

| | December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| **Non-current Liabilities** | | | |
| Interest-bearing loans and other borrowings – net of current portion *(Notes 9, 12, 20, 28 and 31)* | ₱17,234 | ₱13,228 | ₱14,169 |
| Customers' deposits – net of current portion *(Notes 21, 25, 28 and 31)* | 25,063 | 23,443 | 21,423 |
| Deposits from condominium units pre-sold *(Notes 5 and 8)* | 5,330 | 3,806 | 5,679 |
| Deferred tax liabilities *(Note 33)* | 12,663 | 12,793 | 13,560 |
| Pension liability *(Note 29)* | 8,941 | 12,313 | 12,953 |
| Provisions *(Notes 6, 22 and 34)* | 7,492 | 5,743 | 1,396 |
| Customers' refund – net of current portion *(Notes 2, 23 and 31)* | – | 2,680 | 7,866 |
| Liability arising from deferred pass-through fuel costs – net of current portion *(Notes 13, 25 and 26)* | – | – | 692 |
| Currency Exchange Rate Adjustment (CERA) I and II over-recoveries, including carrying charges – net of current portion *(Note 25)* | – | 3,008 | – |
| Other non-current liabilities *(Note 29)* | 5,398 | 1,328 | 1,613 |
| Total Non-current Liabilities | 82,121 | 78,342 | 79,351 |
| **Current Liabilities** | | | |
| Notes payable *(Notes 24, 28 and 31)* | 513 | 9,828 | 10,748 |
| Trade and other payables *(Notes 2, 5, 13, 20, 21, 25, 26, 28 and 31)* | 30,039 | 24,176 | 30,285 |
| Income tax payable | 133 | 2,285 | 51 |
| Customers' refund – current portion *(Notes 2, 23 and 31)* | 9,147 | 7,925 | 4,904 |
| Interest-bearing loans and other borrowings – current portion *(Notes 9, 12, 20, 28, and 31)* | 2,920 | 2,265 | 2,122 |
| Total Current Liabilities | 42,752 | 46,479 | 48,110 |
| Total Liabilities | 124,873 | 124,821 | 127,461 |
| Total Equity and Liabilities | ₱187,168 | ₱182,361 | ₱181,472 |

See accompanying Notes to Financial Information.

**Parent Company Statements of Financial Position**

| | December 31 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| **ASSETS** | | | |
| **Non-current Assets** | | | |
| Utility plant and others – net *(Notes 9, 10 and 18)* | ₱97,059 | ₱93,970 | ₱92,290 |
| Construction in progress *(Notes 9 and 10)* | 3,703 | 3,704 | 2,811 |
| Investments in subsidiaries, associates and joint venture *(Notes 8 and 11)* | 3,120 | 2,238 | 1,776 |
| Investment properties *(Notes 12 and 20)* | 1,691 | 1,074 | 1,074 |
| Deferred pass-through fuel costs *(Note 13)* | 3,161 | 3,792 | 4,896 |
| Deferred tax assets *(Note 33)* | 7,404 | 7,598 | 5,813 |
| Other non-current assets – net *(Notes 2, 13, 17, 25, 30, 31 and 34)* | 12,200 | 9,097 | 15,449 |
| Total Non-current Assets | 128,338 | 121,473 | 124,109 |
| **Current Assets** | | | |
| Cash and cash equivalents *(Notes 14, 30 and 31)* | 15,430 | 4,023 | 4,062 |
| Trade and other receivables – net *(Notes 2, 13, 15, 26, 28, 30 and 31)* | 19,932 | 36,653 | 33,211 |
| Inventories *(Note 16)* | 1,751 | 1,525 | 1,491 |
| Other current assets *(Notes 13, 17, 20, 23, 30 and 31)* | 733 | 996 | 1,361 |
| Total Current Assets | 37,846 | 43,197 | 40,125 |
| Total Assets | ₱166,184 | ₱164,670 | ₱164,234 |

| | December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| **EQUITY AND LIABILITIES** | | | |
| **Equity** | | | |
| Common stock *(Note 18)* | ₱11,273 | ₱11,038 | ₱11,033 |
| Subscription receivable | (960) | – | – |
| Additional paid-in capital | 4,566 | 2,932 | 2,931 |
| Employee share-based payment plan *(Notes 18 and 19)* | 115 | 268 | 152 |
| Unrealized fair value gains on available-for-sale investments *(Note 13)* | 62 | 57 | 57 |
| Revaluation increment in utility plant and others *(Note 18)* | 18,939 | 19,433 | 19,821 |
| Retained earnings *(Note 18)*: | | | |
| Unappropriated | 15,714 | 11,597 | 13,309 |
| Appropriated | 4,198 | 4,198 | 200 |
| Total Equity | 53,907 | 49,523 | 47,503 |
| **Non-current Liabilities** | | | |
| Interest-bearing loans and other borrowings – net of current portion *(Notes 9, 12, 20, 28 and 31)* | ₱15,085 | ₱11,381 | ₱13,028 |
| Customers' deposits – net of current portion *(Notes 21, 25, 28 and 31)* | 24,927 | 23,321 | 21,300 |
| Deferred tax liabilities *(Note 33)* | 11,336 | 11,866 | 12,575 |
| Pension liability *(Note 29)* | 8,897 | 12,280 | 12,908 |
| Provisions *(Notes 6, 22 and 34)* | 7,492 | 5,743 | 1,396 |
| Customers' refund – net of current *(Notes 2, 23 and 31)* | – | 2,680 | 7,866 |
| Liability arising from deferred pass-through fuel costs – net of current portion *(Note 13)* | – | – | 692 |
| Currency Exchange Rate Adjustment (CERA) I and II over-recoveries, including carrying charges – net of current portion *(Note 25)* | – | 3,008 | – |
| Other non-current liabilities *(Notes 25 and 29)* | 5,743 | 1,115 | 1,296 |
| Total Non-current Liabilities | 73,480 | 71,394 | 71,061 |

| | December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| **Current Liabilities** | | | |
| Notes payable *(Notes 24, 28 and 31)* | ₱500 | ₱9,770 | ₱10,500 |
| Trade and other payables *(Notes 13, 20, 21,25, 26, 28 and 31)* | 26,991 | 22,225 | 28,752 |
| Income tax payable | – | 2,197 | – |
| Customers' refund – current portion *(Notes 2, 23 and 31)* | 9,147 | 7,925 | 4,904 |
| Interest-bearing loans and other borrowings – current portion *(Notes 9, 12, 20, 28 and 31)* | 2,159 | 1,636 | 1,514 |
| Total Current Liabilities | 38,797 | 43,753 | 45,670 |
| Total Liabilities | 112,277 | 115,147 | 116,731 |
| Total Equity and Liabilities | ₱166,184 | ₱164,670 | ₱164,234 |

See accompanying Notes to Financial Information.

**Consolidated Statements of Income**

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions, Except Per Share Data)* | | |
| **REVENUES** | | | |
| Sale of electricity *(Notes 2, 13, 25, 26 and 27)* | ₱178,686 | ₱186,999 | ₱196,171 |
| Sale of contracts and services *(Note 8)* | 1,588 | 1,512 | 1,346 |
| Sale of real estate *(Note 8)* | 182 | 6,132 | 60 |
| Others *(Note 12)* | 1,685 | 1,051 | 1,054 |
| | 182,141 | 195,694 | 198,631 |
| **EXPENSES (INCOME)** | | | |
| Purchased power *(Notes 26, 27 and 35)* | 150,928 | 156,872 | 172,837 |
| Operations and maintenance *(Notes 15, 19, 26, 28 and 29)* | 12,803 | 12,033 | 4,412 |
| Depreciation and amortization *(Note 9)* | 4,901 | 4,305 | 4,336 |
| Interest and financial income *(Notes 15, 21, 28 and 31)* | (3,839) | (2,537) | (1,573) |
| Provision for (Reversal of provision for) probable losses from claims – net *(Notes 22 and 34)* | 3,351 | 318 | (328) |
| Interest and financial charges *(Notes 13, 20, 21, 24, 25, 26 and 28)* | 3,328 | 4,135 | 2,999 |
| Cost of contracts and services *(Note 28)* | 1,803 | 1,456 | 1,415 |
| Provision for (Recovery of provision for) probable losses and refund – net *(Notes 6, 22, 25 and 35)* | (1,179) | 6,617 | (646) |
| Present value impact on customers' refund *(Note 23)* | 555 | 846 | 1,096 |
| Foreign exchange gains – net | (266) | (467) | (162) |
| Equity in net earnings of associates and a joint venture *(Note 11)* | (246) | (188) | (327) |
| Guaranteed service levels payout *(Note 2)* | 216 | – | – |
| Gains from change in fair value of investment properties *(Note 12)* | (196) | (108) | (571) |
| Cost of real estate sold *(Note 8)* | 40 | 4,320 | 61 |
| Taxes other than income tax *(Note 33)* | 130 | 217 | 214 |
| | 172,329 | 187,819 | 183,763 |
| **INCOME BEFORE INCOME TAX** | 9,812 | 7,875 | 14,868 |

| | Years Ended December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions, Except Per Share Data)* | | |
| **PROVISION FOR (BENEFIT FROM) INCOME TAX** *(Note 33)* | | | |
| Current | ₱3,303 | ₱5,122 | ₱2,729 |
| Deferred | (258) | (2,041) | 2,379 |
| | 3,045 | 3,081 | 5,108 |
| **NET INCOME** | ₱6,767 | ₱4,794 | ₱9,760 |
| **Attributable To** | | | |
| Equity holders of the parent *(Note 36)* | ₱6,576 | ₱4,100 | ₱9,562 |
| Minority interests | 191 | 694 | 198 |
| | ₱6,767 | ₱4,794 | ₱9,760 |
| **Earnings Per Share Attributable to the Equity Holders of the Parent** *(Note 36)* | | | |
| Basic | ₱5.93 | ₱3.71 | ₱9.02 |
| Diluted | 5.93 | 3.71 | 8.98 |

Details of the dividends payable and proposed for the year are disclosed in Note 18 to the financial information.

See accompanying Notes to Financial Information.

**Consolidated Statements of Comprehensive Income**

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| **NET INCOME FOR THE YEAR** | ₱6,767 | ₱4,794 | ₱9,760 |
| **OTHER COMPREHENSIVE INCOME** | | | |
| Unrealized fair value gains (losses) on available-for-sale investments | 27 | (23) | 28 |
| Income tax effect | (3) | 2 | (3) |
| | 24 | (21) | 25 |
| Revaluation of land and others transferred to investment properties | 54 | 49 | 668 |
| Income tax effect | (16) | (15) | (234) |
| | 38 | 34 | 434 |
| Share in cumulative translation adjustment of a subsidiary and an associate | 1 | 696 | (463) |
| Other comprehensive income – net of tax | 63 | 709 | (4) |
| **TOTAL COMPREHENSIVE INCOME** – Net of Tax | ₱6,830 | ₱5,503 | ₱9,756 |
| **Attributable To** | | | |
| Equity holders of the parent | ₱6,639 | ₱4,793 | ₱9,345 |
| Minority interests | 191 | 710 | 411 |
| | ₱6,830 | ₱5,503 | ₱9,756 |

See accompanying Notes to Financial Information.

## Consolidated Statements of Changes in Equity

| | Attributable to Equity Holders of the Parent | | | | | | | | | | | | Minority Interests | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Common Stock *(Note 18)* | Subscription Receivable *(Note 19)* | Additional Paid-in Capital | Excess of Acquisition Cost Over Carrying Value of Minority Interest Acquired | Employee Share-Based Payment Plan *(Note 19)* | Unrealized Fair Value Gains on Available-for-Sale Investments *(Note 13)* | Revaluation Increment in Utility Plant and Others *(Note 18)* | Share in Revaluation Increment of an Associate *(Notes 11 and 18)* | Share in Cumulative Translation Adjustment of a Subsidiary and an Associate *(Note 11)* | Unappropriated Retained Earnings *(Note 18)* | Appropriated Retained Earnings *(Note 18)* | Total | | |
| | *(In Millions)* | | | | | | | | | | | | | |
| At January 1, 2009, Philippine Financial Reporting Standards | ₱11,038 | ₱– | ₱2,932 | (₱328) | ₱268 | ₱47 | ₱19,926 | ₱129 | ₱682 | ₱14,395 | ₱4,198 | ₱53,287 | ₱3,552 | ₱56,839 |
| Adoption of International Financial Reporting Standards | – | – | – | 328 | – | – | (93) | – | – | 84 | – | 319 | 382 | 701 |
| At January 1, 2009, as remeasured | 11,038 | – | 2,932 | – | 268 | 47 | 19,833 | 129 | 682 | 14,479 | 4,198 | 53,606 | 3,934 | 57,540 |
| Net income | – | – | – | – | – | – | – | – | – | 6,576 | – | 6,576 | 191 | 6,767 |
| Other comprehensive income | – | – | – | – | – | 24 | 38 | – | 1 | – | – | 63 | – | 63 |
| Total comprehensive income | – | – | – | – | – | 24 | 38 | – | 1 | 6,576 | – | 6,639 | 191 | 6,830 |
| Depreciation on revaluation increment transferred to unappropriated retained earnings | – | – | – | – | – | – | (693) | – | – | 693 | – | – | – | – |
| Share in depreciation of revaluation increment of an associate transferred to unappropriated retained earnings | – | – | – | – | – | – | – | (129) | – | 129 | – | – | – | – |
| Issuance of shares | 235 | (960) | 1,481 | – | – | – | – | – | – | – | – | 756 | – | 756 |
| Share-based payment | – | – | 153 | – | (153) | – | – | – | – | – | – | – | – | – |
| Dividends and others | – | – | – | – | – | – | – | – | – | (2,705) | – | (2,705) | (126) | (2,831) |
| | 235 | (960) | 1,634 | – | (153) | 24 | (655) | (129) | 1 | 4,693 | – | 4,690 | 65 | 4,755 |
| At December 31, 2009 | ₱11,273 | (₱960) | ₱4,566 | ₱– | ₱115 | ₱71 | ₱19,178 | ₱– | ₱683 | ₱19,172 | ₱4,198 | ₱58,296 | ₱3,999 | ₱62,295 |
| At January 1, 2008, Philippine Financial Reporting Standards | ₱11,033 | ₱– | ₱2,931 | (₱328) | ₱152 | ₱68 | ₱20,292 | ₱298 | (₱14) | ₱17,032 | ₱200 | ₱51,664 | ₱3,341 | ₱55,005 |
| Adoption of International Financial Reporting Standards | – | – | – | 328 | – | – | (89) | – | – | (1,238) | – | (999) | 5 | (994) |
| At January 1, 2008, as remeasured | 11,033 | – | 2,931 | – | 152 | 68 | 20,203 | 298 | (14) | 15,794 | 200 | 50,665 | 3,346 | 54,011 |
| Net income | – | – | – | – | – | – | – | – | – | 4,100 | – | 4,100 | 694 | 4,794 |
| Other comprehensive income | – | – | – | – | – | (21) | 18 | – | 696 | – | – | 693 | 16 | 709 |
| Total comprehensive income | – | – | – | – | – | (21) | 18 | – | 696 | 4,100 | – | 4,793 | 710 | 5,503 |
| Depreciation on revaluation increment transferred to unappropriated retained earnings | – | – | – | – | – | – | (388) | – | – | 388 | – | – | – | – |
| Share in depreciation of revaluation increment of an associate transferred to unappropriated retained earnings | – | – | – | – | – | – | – | (169) | – | 169 | – | – | – | – |
| Issuance of shares | 5 | – | 1 | – | – | – | – | – | – | – | – | 6 | – | 6 |
| Share-based payment | – | – | – | – | 116 | – | – | – | – | – | – | 116 | – | 116 |
| Dividends and others | – | – | – | – | – | – | – | – | – | (1,974) | – | (1,974) | (122) | (2,096) |
| Appropriations – net of reversal | – | – | – | – | – | – | – | – | – | (3,998) | 3,998 | – | – | – |
| | 5 | – | 1 | – | 116 | (21) | (370) | (169) | 696 | (1,315) | 3,998 | 2,941 | 588 | 3,529 |
| At December 31, 2008 | ₱11,038 | ₱– | ₱2,932 | ₱– | ₱268 | ₱47 | ₱19,833 | ₱129 | ₱682 | ₱14,479 | ₱4,198 | ₱53,606 | ₱3,934 | ₱57,540 |

| | Attributable to Equity Holders of the Parent | | | | | | | | | | | | Minority Interests | Total Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Common Stock *(Note 18)* | Subscription Receivable *(Note 19)* | Additional Paid-in Capital | Excess of Acquisition Cost Over Carrying Value of Minority Interest Acquired | Employee Share-Based Payment Plan *(Note 19)* | Unrealized Fair Value Gains on Available-for-Sale Investments *(Note 13)* | Revaluation Increment in Utility Plant and Others *(Note 18)* | Share in Revaluation Increment of an Associate *(Notes 11 and 18)* | Share in Cumulative Translation Adjustment of a Subsidiary and an Associate *(Note 11)* | Unappropriated Retained Earnings *(Note 18)* | Appropriated Retained Earnings *(Note 18)* | Total | | |
| | *(In Millions)* | | | | | | | | | | | | | |
| At January 1, 2007, Philippine Financial Reporting Standards | ₱9,988 | ₱– | ₱2,918 | (₱328) | ₱79 | ₱43 | ₱20,699 | ₱467 | ₱449 | ₱12,703 | ₱1,200 | ₱48,218 | ₱3,204 | ₱51,422 |
| Adoption of International Financial Reporting Standards | – | – | – | 328 | – | – | (311) | – | – | (7,040) | – | (7,023) | (129) | (7,152) |
| At January 1, 2007, as remeasured | 9,988 | – | 2,918 | – | 79 | 43 | 20,388 | 467 | 449 | 5,663 | 1,200 | 41,195 | 3,075 | 44,270 |
| Other comprehensive income | – | – | – | – | – | 25 | 221 | – | (463) | – | – | (217) | 213 | (4) |
| Net income | – | – | – | – | – | – | – | – | – | 9,562 | – | 9,562 | 198 | 9,760 |
| Total comprehensive income | – | – | – | – | – | 25 | 221 | – | (463) | 9,562 | – | 9,345 | 411 | 9,756 |
| Depreciation on revaluation increment transferred to unappropriated retained earnings | – | – | – | – | – | – | (406) | – | – | 406 | – | – | – | – |
| Share in depreciation of revaluation increment of an associate transferred to unappropriated retained earnings | – | – | – | – | – | – | – | (169) | – | 169 | – | – | – | – |
| Issuance of shares | 1,045 | – | 13 | – | – | – | – | – | – | – | – | 1,058 | – | 1,058 |
| Share-based payment | – | – | – | – | 73 | – | – | – | – | – | – | 73 | – | 73 |
| Dividends and others | – | – | – | – | – | – | – | – | – | (6) | (1,000) | (1,006) | (140) | (1,146) |
| | 1,045 | – | 13 | – | 73 | 25 | (185) | (169) | (463) | 10,131 | (1,000) | 9,470 | 271 | 9,741 |
| At December 31, 2007 | ₱11,033 | ₱– | ₱2,931 | ₱– | ₱152 | ₱68 | ₱20,203 | ₱298 | (₱14) | ₱15,794 | ₱200 | ₱50,665 | ₱3,346 | ₱54,011 |

See accompanying Notes to Financial Information.

**Consolidated Statements of Cash Flows**

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Income before income tax | ₱9,812 | ₱7,875 | ₱14,868 |
| Adjustments for: | | | |
| Provision for (Recovery of provision for) probable losses and refund – net *(Notes 6, 22, 25 and 35)* | (1,179) | 6,617 | (646) |
| Depreciation and amortization *(Notes 9 and 12)* | 4,901 | 4,305 | 4,336 |
| Interest and financial charges *(Note 28)* | 2,127 | 2,085 | 1,864 |
| Interest expense on bill and meter deposits *(Note 28)* | 1,201 | 1,014 | 963 |
| Interest and financial income *(Note 28)* | (3,839) | (1,724) | (1,554) |
| Present value impact on customers' refund *(Note 23)* | 555 | 846 | 1,096 |
| Provision for (Reversal of provision for) probable losses from claims *(Note 22)* | 3,351 | 318 | (328) |
| Equity in net earnings of associates and a joint venture *(Note 11)* | (246) | (188) | (327) |
| Employee share-based benefits expense *(Notes 19 and 28)* | 301 | 116 | 73 |
| Gains from change in fair values of investment properties | (196) | (108) | (571) |
| Operating income before working capital changes | 16,788 | 21,156 | 19,774 |
| Decrease (increase) in: | | | |
| Trade and other receivables | 13,474 | 1,459 | (2,126) |
| Inventories | (209) | (110) | (502) |
| Land and development costs | (2,721) | 3,095 | (3,110) |
| Deferred pass-through fuel costs | 631 | 740 | (1,116) |
| Other current assets | (2,304) | (1,007) | 532 |
| Increase (decrease) in trade and other payables | 3,991 | (8,924) | (5,452) |
| Net cash generated from operations | 29,650 | 16,409 | 8,000 |
| Interest paid | (1,905) | (2,093) | (2,561) |
| Income tax paid | (3,787) | (2,888) | (2,583) |
| Franchise, realty and other taxes paid | (318) | (42) | (235) |
| Net cash flows from operating activities | 23,640 | 11,386 | 2,621 |

| | Years Ended December 31 | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Additions to: | | | |
| Construction in progress *(Note 10)* | (₱8,650) | (₱8,573) | (₱6,469) |
| Utility plant and others *(Note 9)* | (187) | (629) | (326) |
| Investment properties *(Note 12)* | (52) | (48) | (74) |
| Decrease (increase) in: | | | |
| Other non-current assets | (234) | 1,084 | (3,358) |
| Other receivables | 1,102 | (1,048) | (1,047) |
| Acquisition of a subsidiary, net of cash acquired *(Note 8)* | – | – | (75) |
| Interest and dividends received *(Notes 11 and 28)* | 2,924 | 2,032 | 3,385 |
| Net cash flows used in investing activities | (5,097) | (7,182) | (7,964) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from: | | | |
| Notes payable | ₱2,936 | ₱9,650 | ₱12,180 |
| Long-term debt | 12,398 | 1,235 | 644 |
| Issuance of and subscriptions to common stock under employee share-based payment plan | 455 | 5 | – |
| Payments of: | | | |
| Customers' refund | (2,013) | (1,713) | (1,463) |
| Long-term debt | (6,856) | (1,557) | (193) |
| Notes payable | (12,251) | (10,570) | (1,742) |
| Increase (decrease) in: | | | |
| Customers' deposits | 1,177 | 1,259 | 1,515 |
| Other non-current liabilities | 510 | 167 | (6,472) |
| Dividends paid | (2,679) | (1,960) | (1,006) |
| Redemption of preferred stock | (554) | (194) | (85) |
| Net cash flows from (used in) financing activities | (6,877) | (3,678) | 3,378 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | 11,666 | 526 | (1,965) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 5,402 | 4,876 | 6,841 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | ₱17,068 | ₱5,402 | ₱4,876 |

See accompanying Notes to Financial Information.

## I. NOTES TO FINANCIAL INFORMATION

### 1. CORPORATE INFORMATION

In October 1902, the Second Philippine Commission, which had legislative powers to organize the new government, passed on Act No. 484. By the virtue of Act No. 484, the franchise to construct, maintain and operate an electric street railway and to furnish electric current for light, heat and power in the city of Manila and its suburbs, was granted in March 1903, which later on was acquired by Manila Electric Company, or *Meralco*, or the *Parent Company*.

Under its latest amended Articles of Incorporation, Meralco's corporate life was extended for another 50 years through the year 2019. Meralco distributes and supplies electricity in its franchise area and is subject to the rate-making regulations and rigid regulatory policies of the Energy Regulatory Commission (ERC).

The Parent Company holds a congressional franchise under Republic Act or RA No. 9209, which took effect on June 28, 2003, granting the Parent Company a 25-year franchise to construct, operate, and maintain an electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities, and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the ERC granted the Parent Company a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until June 28, 2028, to coincide with the Parent Company's congressional franchise.

*Meralco* is the largest distribution utility in the country. The electric operating segment consists of operations of the *Parent Company* and its subsidiary, Clark Electric Distribution Corporation or CEDC. Through its other operating segments, it develops and sells real estate properties and provides engineering, construction and consulting, information systems and technology services, among others.

CEDC was organized on February 19, 1997 under a joint venture agreement entered into between Clark Development Corporation or CDC and Meralco Industrial Engineering Corporation or Miescor. CEDC, which is also subject to extensive regulation by the CDC, a government-owned corporation created as the implementing arm of the Bases Conversion Development Authority to manage and develop the Clark Economic Zone, in so far as these are consistent with RA No. 9136, otherwise known as the Electric Power Industry Reform Act or EPIRA. The franchise of CEDC is co-terminus with the agreement between CEDC and CDC. The common shares of the *Parent Company* are listed and traded on the Philippine Stock Exchange (PSE).

The registered office address of the *Parent Company* is Lopez Building, Ortigas Avenue, Pasig City, Philippines.

### 2. RATE REGULATIONS

As distribution utilities, *Meralco* and *CEDC* are subject to the rate-making regulations and regulatory policies of the ERC. Billings to customers of the *Parent Company* are itemized or "unbundled" into a number of bill components that reflect the various units incurred in providing electric service. The adjustment of each bill component is governed by mechanisms promulgated and enforced by the ERC, mainly: (i) the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities", which govern the recovery of pass-through costs, including over- or under-recoveries in the following bill components: generation charge, transmission charge, system loss charge, lifeline rate subsidies, local franchise and business taxes; and (ii) the "Rules for the Setting of Distribution Wheeling Rates or RDWR", as modified by ERC Resolution No. 20, Series of 2008, which govern the determination of the *Parent Company's* distribution, supply, and metering charges.

The rate-setting mechanism of CEDC is likewise in compliance with ERC regulations. After the unbundling of its rates in accordance with ERC guidelines, CEDC shall also become an entrant to the Performance – Based Regulation ("PBR"). However, the effective date when CEDC shall be under the PBR scheme depends on when the ERC decides so.

The following is a discussion of matters related to rate-setting of the *Parent Company*.

**I. Rate Applications**

*a. Performance-Based Regulation or PBR Application*

The Parent Company is among the first entrants to the PBR, together with Dagupan Electric Corporation or *DECORP* and Cagayan Electric and Power Company or *CEPALCO*.

Rate-setting under *PBR* is governed by the *RDWR*. Unlike the previous Return on Rate Base or RORB-methodology where utility tariffs were based on historical costs plus a reasonable rate of return, the *PBR* scheme sets tariffs according to forecasts of capital and operating expenditures to meet a predetermined level of operational performance. The PBR also employs a mechanism that will penalizes or rewards a utility company depending on its network and service performance.

Rate filings and setting are done on a regulatory period basis, where one regulatory period consists of four regulatory years. A regulatory year begins in July and ends in June of the following year. As of December 31, 2009, the Parent Company is in the third regulatory year of the second regulatory period. The second regulatory period is from July 1, 2007 to June 30, 2011.

On August 31, 2007, the ERC issued its Final Determination setting forth its evaluation of the *Parent Company's* annual revenue requirement and approved the performance incentive scheme and price control arrangements that will apply to the Parent Company during the Second Regulatory Period. The approved Maximum Average Prices or *MAPs* were ₱1.167 per kWh, ₱1.260 per kWh, ₱1.361 per kWh, and ₱1.471 per kWh for the regulatory years (RY) 2008, 2009, 2010, and 2011, respectively.

A Motion for Reconsideration or *MR* and Clarification was filed with a series of appeals and discussions ensuing, which dealt primarily with the components the *MAP* determination. Thereafter, on January 11 and April 1, 2008, the Parent Company filed separate applications for the approval of its proposed translation of the MAP for RY 2008 and RY 2009 into different rate schedules for the Parent Company's various customer segments. Distribution charge under-recoveries as a result of the delay in the implementation of PBR were partly incorporated in the proposed MAP of ₱1.3607 per kWh for the RY 2009.

On October 17, 2008, the ERC released its Decision on the Parent Company's rate translation applications. To avoid price shocks and mitigate the rate impact on end-users, the ERC subjected the proposed rate to side constraints and approved an MAP for the RY 2009 of ₱1.2280 per kWh. The ERC's Decision also directed the Parent Company to implement its approved distribution, supply and metering charges starting July 1, 2008.

However, the ERC, acting on a motion filed by the National Association of Electricity Consumers for Reforms, Inc. or NASECORE, a group of electricity consumers, deferred the implementation of the approved charges until such time that the ERC can resolve the MR filed by the group. Meralco eventually received a copy of the consumer group's MR, to which Meralco filed an Opposition on November 19, 2008.

On February 16, 2009, the *ERC* approved the Guidelines for the regulatory year 2010 Rate Reset to guide the first entrants to *PBR* in their next rate application which was due on March 20, 2009.

In April 2009, the ERC approved the implementation of the increase in the Parent Company's average distribution rate for RY 2009 to ₱1.2227 per kWh effective for billing periods starting May 2009. This rate is inclusive of ₱12.85 centavos per kWh for the recovery of under-recoveries for the calendar year 2007. Under-recoveries for the period 2008 onwards will be considered in future rate petitions.

On May 28, 2009, NASECORE and other consumer groups filed a Petition with the Court of Appeals or *CA* questioning the Decision and Order of the ERC on the Parent Company's rate translation application. The parties submitted their respective memoranda after which the case will be deemed submitted for decision. As of February 22, 2010, the case is still pending with the CA.

As part of the PBR, the Parent Company implemented payouts to customers for whom the Parent Company failed to meet certain guaranteed service levels of performance or *GSL* (see Note 25).

On August 7, 2009, the Parent Company filed a petition for the verification of the MAP for the RY 2010 and its translation into tariffs by customer category. In accordance with the ERC's "Guidelines for RY 2010 Rate Reset for First Entrant Distribution Utilities ("DUs")", the constrained MAP for RY 2010 was computed to be ₱1.4917 per kWh.

On December 14, 2009, the ERC approved the Parent Company's application for approval of: a) MAP for the RY 2010; and b) translation of the MAP for RY 2010 into a distribution rate structure for its various customer classes. However, because of an MR filed by a consumer group against the said ERC decision, on January 26, 2010, the Parent Company filed a manifestation with the ERC voluntarily suspending the implementation of the ERC's December 14, 2009 Decision. The suspension will be until such time that the regulator resolves the pending MR and addressed all other issues other intervenors may raise.

*b. Supreme Court or SC Decision on Unbundling Rate Case*

On May 30, 2003, the ERC issued an Order approving the Parent Company's unbundled tariffs that resulted in a total increase of ₱0.17 per kWh over May 2003 tariff levels. However, on August 4, 2003, certain consumer and civil society groups filed with the CA a Petition for Review of the ERC's ruling with the CA. On July 22, 2004, the *CA* set aside the ERC's ruling on the Parent Company's rate unbundling and remanded the case back to the ERC. Further, the *CA* opined that the ERC should have asked the Commission on Audit or *COA* to audit the books of the Parent Company. The *ERC* and the *Parent Company* subsequently filed separate motions asking *CA* to reconsider its decision. On January 24, 2005, as a result of the denial by the *CA* of the motions, the *ERC* and the *Parent Company* elevated the case to the Supreme Court of the Philippines or *SC*.

In an En Banc Decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed the *ERC's* authority in rate-fixing, the *SC* also recognized the potential social impact of the matter. Thus, the *SC* directed the *ERC* to request the *COA* to undertake a complete audit of the books, records and accounts of the *Parent Company*. On January 15, 2007, in compliance with the SC's directive, the *ERC* requested the *COA* to conduct an audit of the books, records and accounts of the *Parent Company*. The test periods shall be calendar years 2004 and 2007.

The status of the *COA* audit is discussed in Note 34(b)(6).

**II. Applications for Recoveries**

The Parent Company filed applications with the ERC for recoveries of Advances in Pass-Through costs. These advances consist mainly of unrecovered or differential generation and transmission charges technically referred to as under-recoveries, which are recoverable from the customers, as allowed by law.

*a. 10 Applications for the Recovery of Generation Costs*

During the period in which the Automatic Generation Rate Adjustment or AGRA mechanism was suspended by the *ERC*, the *Parent Company* filed 10 separate applications (ERC Case Nos. 2006-052RC, 2006-062RC, 2006-076RC, 2007-001RC, 2007-038RC, 2007-078RC, 2007-101RC, 2007-120RC, 2007-123RC and 2007-135RC) for the full recovery of generation costs, including value-added tax or *VAT*, incurred for the supply months of August 2006 to May 2007, which resulted in under-recoveries in the total amount of ₱12,679 million for generation charges and ₱1,295 million for system loss charges.

On January 18, 2008, the ERC issued an Order allowing the Parent Company to collect the amount of ₱8,829 million through a ₱0.1662 per kWh charge to customers for the generation cost under-recoveries of ₱12,679 million. The charge was implemented beginning February 2008 and will continue until the ₱8,829 million is fully collected.

On September 3, 2008, the ERC released a Decision dated June 4, 2008 on the remaining ₱3,850 million, representing the balance of the Parent Company's generation charge under-recoveries. In the said Decision, the ERC directed the Parent Company to recover ₱1,149 million in generation cost under-recoveries, plus ₱813 million in carrying costs. The balance of ₱2,701 million which represents the Parent Company's incremental generation cost for energy purchases from the Wholesale Electricity Spot Market (WESM) in excess of 10% of the Parent Company's total requirement (for the period from December 2006 to May 2007) was disallowed. It is the Parent Company's position that its purchases from the WESM are prudent and mandated by law. As such, these costs are just and reasonable pass-through costs recoverable from its customers. On September 18, 2008, the Parent Company filed a Motion for Partial Reconsideration questioning the disallowance of ₱2,701 million. The ERC has yet to decide on the Parent Company's motion.

Of the ₱10,791 million approved for recovery, the Parent Company has billed the amount of ₱9,458 million and ₱4,312 million as of December 31, 2009 and 2008, respectively. The remaining balance of ₱1,333 million will be billed in 2010 and is shown as part of "Trade and other receivables – Unbilled" account (see Note 15).

With respect to the system loss charge under-recoveries of ₱1,295 million, the ERC also ordered the Parent Company to file a separate application for the recovery of system loss adjustments after the ERC confirms the transmission rate to be used in the calculation of the system loss rate in accordance with the system loss rate formula of the AGRA Guidelines.

*b. Generation Rate Adjustment Mechanism or GRAM Case*

In the March 2003 Decision on the Parent Company's rate unbundling application, the ERC directed the Parent Company to discontinue implementing the Purchased Power Adjustment or PPA clause with respect to its tariffs. Instead, subsequent changes in the Parent Company's generation charge would be covered by the ERC's GRAM rules.

In accordance with the GRAM rules, the Parent Company made three filings related to its deferred generation cost accounting beginning November 2004 as well as a final GRAM filing to account for all generation costs prior to November 2004.

The approval by the ERC of the second GRAM filing was questioned before the *SC* by a group of electricity consumers on grounds that the Parent Company and the ERC failed to comply with Sec. 4(e), Rule 3 of *EPIRA* Implementing Rules and Regulations or *IRR*, which required publication, notice, and hearing of application prior to issuance of the second GRAM Order.

The GRAM rules, however, neither require the publication of the application prior to its filing with the ERC, nor the conduct of formal hearings thereon.

On February 2, 2006, the SC ruled that strict compliance to with Sec. 4(e), Rule 3 of the EPIRA IRR is jurisdictional and applies to the GRAM. Accordingly, the ERC's second GRAM Order was declared void and set aside. On February 20, 2006, the ERC and the Parent Company filed separate MRs with the SC.

On August 16, 2006, the SC denied with finality the MRs filed. Accordingly, the Parent Company recognized liability related to GRAM amounting to ₱780 million and began refunding ₱0.1327 per kWh reckoned from when the same was charged and collected.

As of December 31, 2009 and 2008, the Parent Company has refunded ₱746 million with the balance of ₱34 million as of such dates, being shown as part of "Trade and other payables" account in the consolidated and parent company statements of financial position (see Note 25).

Generation costs for the period covered by the GRAM have all been confirmed for recovery from customers. The Parent Company will be filing an application with the ERC for the recovery of the total generation costs refunded under the second GRAM, plus any additional amount that it will still refund to its customers pursuant to SC Resolution dated August 16, 2006, and the corresponding carrying charges.

*c.* *Application for the Recovery of Transmission Costs*

In September 2005, the ERC promulgated the rules related to Transmission Rate Adjustment Mechanism or TRAM.

On October 12, 2009, the ERC authorized the Parent Company to collect transmission under-recoveries of ₱5,348 million, inclusive of ₱1,026 million in carrying costs from its customers. The approval is net of certain disallowances by the ERC, which said it claimed the Parent Company failed to fully substantiate. The Parent Company subsequently filed a Motion for Partial Reconsideration on October 30, 2009, and presented evidences to provide additional explanation and substantiation of the amounts disallowed by the ERC.

Also, on October 12, 2009, the ERC released an Order on a separate application of the Parent Company to offset transmission cost over-recoveries of ₱4,528 million covering the period from August 2007 to April 2009 against the under-recoveries being claimed. The ERC provisionally approved the offsetting proposal and directed the Parent Company to refund over-recoveries amounting to ₱4,917 million and carrying costs of ₱257 million. When offset against the ₱5,348 million approved for collection by the ERC, the net amount to be collected from customers is ₱174 million. The Parent Company has filed a manifestation of its intention to implement the Order, without prejudice to the outcome of the October 30, 2009 Motion for Partial Reconsideration and the hearing on the merits for this offsetting.

The foregoing Decision of the ERC with respect to the offsetting arrangement was implemented by the Parent Company starting the November 2009 billing.

Thereafter, on December 29, 2009, the Parent Company received an Order dated December 14, 2009 granting with modification its Motion for Partial Reconsideration of the Decision dated October 12, 2009. The ERC reconsidered its earlier Decision and confirmed the revised total under-recoveries of Meralco in the transmission charges for the period June 2003 to July 2007 to be ₱6,925 million, with ₱5,418 million in transmission costs and ₱1,507 million in carrying costs. Collection of such amount shall start in January 2010 until such time that the full amount shall have been collected.

d. *Applications for the Recovery of Advances for Other Pass-Through Costs*

i. Inter-Class Cross Subsidy

On November 14, 2007, the Parent Company filed a petition for authority to recover ₱1,054 million of under-recoveries, and a corresponding carrying charge, incurred in implementing the Inter-Class Cross Subsidy system.

On November 27, 2009, the Parent Company received a Decision of the ERC dated November 16, 2009, approving, with modification, the subject Application. The ERC authorized the Parent Company to collect the total inter-class cross subsidy under-recoveries covering the period from June 2003 to October 2006 amounting to ₱1,049 million equivalent to ₱0.0103 per kWh until such time that the said amount shall have been fully recovered.

In December 2009, the Parent Company filed a Motion for Partial Reconsideration praying that it be allowed to incorporate the cross subsidy charge under-recoveries as a line item under the "Subsidies" instead of a separate line item under "Universal Charge." As of February 22, 2010, said Motion is pending before the ERC. In the meantime, billing for inter-class cross subsidy is presented as a separate line item in the customers' monthly statements.)

ii. Lifeline Subsidy

On February 19, 2008, the Parent Company filed an application with the ERC for the collection of the under-recoveries incurred in the implementation of the Lifeline Subsidy system amounting to ₱864 million, with a corresponding carrying cost. Hearings on the petition were completed on May 6, 2008.

On November 27, 2009, the Parent Company received a Decision dated November 16, 2009 approving, with modification, the subject Application. The ERC authorized the Parent Company to recover the total lifeline subsidy under-recoveries covering the period from June 2003 to December 2007 amounting to ₱856 million, equivalent to ₱0.0068 per kWh, until such time that the said amount shall have been fully recovered.

The decisions with respect to inter-class cross subsidy and lifeline subsidy were implemented beginning the December 2009 billing cycle. As of December 31, 2009, the total amounts recovered for the inter-class cross subsidy and lifeline subsidy were₱25 million and ₱16 million, respectively. The balance of ₱1,024 million for inter-class cross subsidy and ₱840 million for lifeline subsidy is expected to be recovered in the next 41 months and 51 months, respectively. The current portion and non-current portion of the balance are presented under "Trade and other receivables" and "Other non-current assets" accounts, respectively, in the consolidated and parent company statements of financial position.

e. *Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities*

On August 12, 2009, the ERC issued Resolution No. 16, series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for DUs". These rules govern the recovery of pass-through costs, including over- or under-recoveries in the following bill components: generation charge, transmission charge, system loss charge, lifeline rate subsidies, local franchise and business taxes.

The rules synchronize the various confirmation and verification processes by the ERC for the foregoing charges. In its decision, the ERC required the DUs in Luzon, to which the Parent Company belongs, to file their consolidated applications to resolve under/over-recoveries accumulated from the start of their rate unbundling until December 2008, not later than October 30, 2009. Subsequent filings will be every three years thereafter. Subsequently, through Resolution No. 23, series of 2009 dated October 12, 2009, such application was deferred indefinitely. The ERC has yet to set the new deadline for the consolidated application.

Meanwhile, on October 8, 2009, the Parent Company filed a petition with the ERC, seeking the amendment to the ERC's Resolution No. 16, series of 2009. Specifically, the Parent Company proposed a modification to the formula used in confirming the system loss charges of DUs from a monthly to an annual reckoning to more fairly reflect the actual system loss performance of DUs. Up to the present, the reckoning of system loss charges by the ERC is still on an annual basis. The petition is currently pending at the ERC.

**III. Others**

a. *Bureau of Trade Regulation and Consumer Protection of the Department of Trade and Industry (BTRCP-DTI) Petition*

On May 19, 2008, the BTRCP-DTI filed a petition asking the ERC to:

i. Expand the coverage or increase the discounts under the lifeline rate within the Meralco area only. Further, the BTRCP-DTI said that the Parent Company should absorb the lifeline discounts;

ii. Direct the Parent Company to buy more from the WESM during off-peak hours;

iii. Direct the Parent Company to extend the preferential treatment to poor households and power-intensive industries in the allocation of transmission charges;

iv. Direct the Parent Company to stop billing system losses to customers and that customers are entitled to a refund; and

v. Direct the Parent Company to charge distribution rates equal to or lower than those of Visayan Electric Company, CEPALCO, or Davao Light and Power Company.

After the conduct of public hearings, the ERC issued its decision on December 10, 2008 denying all of the courses of action proposed by the BTRCP-DTI, except for the increase in discounts under the lifeline rate to be given to those using 20 kWh or less each month, from 50% to 100%, subject only to the payment of a ₱5 per month metering charge. The modification in the lifeline subsidy system, which is revenue neutral to the Parent Company, commenced in February 2009.

One of the intervenors filed an MR with respect to the Decision, which was subsequently denied by the ERC. Thereafter, a Petition for Mandamus was filed before the SC praying that the ERC and the Parent Company be ordered to stop charging customers the cost of system loss and administrative or company use. In its Resolution dated April 15, 2009, the SC denied the aforesaid Petition for being a wrong remedy and a violation of hierarchy of courts.

On May 21, 2009, the Petitioner filed a Petition for Mandamus before the CA with the allegations being mere reproduction of the Petition filed before the SC.

On September 4, 2009, the Parent Company received the CA's Resolution dated September 1, 2009, directing the ERC and the Parent Company, to file their comment within 10 days from notice. As of February 22, the Parent Company and the ERC have filed their respective Comments to the Petition. The matter is still pending final decision by the SEC.

b. *SC Decision on the ₱0.167 per kWh Refund*

Following the SC's final ruling that directed the Parent Company to refund affected customers ₱0.167 per kWh covering the billing period from February 1994 to April 30, 2003, the ERC approved the release of the refund in four phases. The refund is still ongoing (see Note 23).

## 3. BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

The accompanying financial information (consisting of the consolidated financial statements, the parent company statements of financial position and the parent company statements of changes in equity) has been prepared on a historical cost basis, except for derivative financial instruments, available-for-sale (AFS) financial assets and investment properties, which are measured at fair value. Derivative financial instruments are shown as part of "Other current assets," "Other non-current assets," "Trade and other payables" and "Other non-current liabilities" accounts in the consolidated and parent company statement of financial position. AFS financial assets are included as part of "Other non-current assets" account in the consolidated and parent company statement of financial position.

The financial information is presented in Philippine Peso, the Company's functional and presentation currency, and all values are rounded to the nearest millions (₱000,000), except when otherwise indicated.

**Statement of Compliance**

The financial information of the Parent Company and subsidiaries (collectively referred to as "the Company") has been prepared in compliance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the disclosure requirements of the Hong Kong Companies Ordinance. References to IFRS include the application of International Accounting Standards (IAS), interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and interpretations of the Standards Interpretation Committee.

**First-time Adoption and Transition to IFRS**

This is the Company's first financial information prepared in accordance with IFRS. This IFRS financial information has been prepared for inclusion in the Circular of First Pacific Company Limited (First Pacific) to be issued in connection with the proposed/possible transactions, including: (1) the proposed acquisition by Beacon Electric Asset Holdings, Inc. (Beacon Electric) of shares in Meralco from Pilipino Telephone Corporation (Piltel) and the subscription of new shares in Beacon Electric by Piltel; and (2) possible acquisition of 74,700,000 shares in Meralco by Beacon Electric through the exercise of a call option. The Company, being a Philippine entity, prepares its primary and statutory financial statements in accordance with Philippine Financial Reporting Standards (PFRS).

The Company applied IFRS 1, "First-time Adoption of International Financial Reporting Standards," in preparing this financial information, with January 1, 2007 as the date of transition. The Company has prepared financial information which comply with IFRS applicable for annual periods beginning on or after January 1, 2009. The Company applied the accounting policies set forth below to all the years presented. An explanation of how the adoption of IFRS has affected the reported consolidated financial position, financial performance and cash flows of the Company is provided in the succeeding discussions.

The preparation of the IFRS financial information resulted in certain changes to the accounting policies adopted under PFRS. The comparative figures for the 2008 and 2007 financial information were restated to reflect the changes in accounting policies in accordance with IAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors." IFRS 1 allows first-time adopters certain exemptions from the general requirements to apply IFRS effective December 31, 2009 retrospectively. In preparing the first IFRS financial information, the Company applied the following exemptions: (a) IFRS 2, "Share-based Payment," has not been applied to equity instruments that were granted on or before November 7, 2002; (b) IFRS 3, "Business Combinations," has not been applied to acquisitions of subsidiaries or of interests in associates and joint ventures that occurred before date of transition; and (c) the Company elected to use the established deemed cost in accordance with PFRS related to the Parent Company's utility plant and others.

The following tables (Reconciliation Tables) set forth a reconciliation of (i) consolidated equity as at January 1, 2007, December 31, 2007 and December 31, 2008, and (ii) consolidated comprehensive income for the years ended December 31, 2008 and 2007, in each case between IFRS and the reported PFRS financial statements. There are no differences between the consolidated statements of cash flows for the years ended December 31, 2008 and 2007 prepared under IFRS and PFRS.

Reconciliation of consolidated equity under PFRS and IFRS at January 1, 2007, December 31, 2007 and December 31, 2008:

| | Note | **January 1, 2007** | **December 31, 2007** | **December 31, 2008** |
|---|---|---|---|---|
| | | *(Amounts in Millions)* | | |
| Consolidated equity under PFRS | | ₱51,422 | ₱55,005 | ₱56,839 |
| Reconciling adjustments: | | | | |
| Equity attributable to equity holders of the Parent: | | | | |
| Adoption of IFRIC 15, "Agreements for the Construction of Real Estate" | A | (348) | (677) | (422) |
| Defined benefit pension and other post-employment benefits | B | (7,503) | (1,609) | (667) |
| Investment properties | C | 500 | 959 | 1,080 |
| Acquisition of minority interests | D | 328 | 328 | 328 |
| | | (7,023) | (999) | 319 |
| Minority interests | A, B and C | (129) | 5 | 382 |
| | | (7,152) | (994) | 701 |
| Consolidated equity under IFRS | | ₱44,270 | ₱54,011 | ₱57,540 |

Reconciliation between consolidated net income under PFRS and consolidated comprehensive income under IFRS for the years ended December 31, 2008 and 2007:

| | *Note* | **2007** | **2008** |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Consolidated net income for the year under PFRS | | ₱4,036 | ₱3,133 |
| Reconciling adjustments: | | | |
| Net income attributable to equity holders of the Parent: | | | |
| Adoption of IFRIC 15 | A | (329) | 255 |
| Defined benefit pension and other post–employment benefits | B | 5,894 | 942 |
| Investment properties | C | 238 | 103 |
| | | 5,803 | 1,300 |
| Minority interests | | (79) | 361 |
| | | 5,724 | 1,661 |
| Reclassification to other comprehensive income: | | | |
| Unrealized fair value gains (loss) on available-for-sale investments | | 28 | (23) |
| Revaluation of utility plant and others transferred to investment properties | | 668 | 49 |
| Share in cumulative translation adjustment of a subsidiary and an associate | | (463) | 696 |
| Tax relating to other comprehensive income | | (237) | (13) |
| | | (4) | 709 |
| Consolidated comprehensive income for the year under IFRS | | ₱9,756 | ₱5,503 |

The explanation of the effects of the transition to IFRS is as follows:

**A. Adoption of IFRIC 15**

Under PFRS, this interpretation will become effective for the Company on January 1, 2012. The Philippine Financial Reporting Standards Council decided to require mandatory application of this interpretation for Philippine financial reporting purposes in 2012 to allow entities engaged in the real estate business time to prepare for implementation of the interpretation.

Under IFRS, this interpretation was effective on January 1, 2009. This interpretation covers the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The interpretation requires that revenue on the construction of real estate be recognized only upon completion, except when such contract qualifies as a construction contract to be accounted for under IAS 11, "Construction Contracts," or involves the rendering of services in which case revenue is recognized based on stage of completion. Contracts involving the provision of services with construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion. Under PFRS, revenue from sale of land and condominium units is recognized based on percentage of completion while under IFRS, revenue is recognized when the significant risks and rewards of ownership have passed to the buyer, usually upon completion.

As a result of the adoption of IFRIC 15, the following adjustments were made to the 2007 and 2008 financial information. The reconciliation adjustments pertain to: (a) the reversal of revenue from sale of real estate and related costs that were previously recognized based on percentage of completion, and (b) the recognition of such revenue and related costs upon completion of the condominium units. Also, selling costs capitalized under PFRS were charged to the consolidated statement of income as these are incurred under IFRS.

| | Amounts in Millions |
|---|---|
| As of January 1, 2007: | |
| Net increase in deferred tax assets | ₱412 |
| Net increase in current assets | 1,361 |
| Net increase in non-current liabilities | 2,456 |
| Net decrease in minority interests | 335 |
| Net decrease in opening retained earnings | 348 |

| | Amounts in Millions |
|---|---|
| As of and for the year ended December 31, 2007: | |
| Net increase in deferred tax assets | ₱789 |
| Net increase in current assets | 1,152 |
| Net increase in non-current liabilities | 3,268 |
| Net decrease in minority interests | 650 |
| Net decrease in revenue from sale of real estate | 2,062 |
| Net decrease in costs of real estate sold | 1,761 |
| Net increase in operations and maintenance expense | 146 |
| Net decrease in interest income | 574 |
| Net decrease in tax expense | 377 |
| Decrease in share of minority interests in profit after tax | 315 |
| Decrease in share of equity holders of the parent in profit after tax | 329 |

| | Amounts in Millions |
|---|---|
| As of and for the year ended December 31, 2008: | |
| Net increase in deferred tax assets | ₱371 |
| Net increase in current assets | 995 |
| Net increase in non-current liabilities | 3,770 |
| Net decrease in current liabilities | 1,578 |
| Net decrease in minority interests | 404 |
| Net increase in revenue from sale of real estate | 3,919 |
| Net increase in costs of real estate sold | 2,674 |
| Net decrease in operations and maintenance expense | 56 |
| Net decrease in interest income | 382 |
| Net increase in tax expense | 418 |
| Increase in share of minority interests in profit after tax | 246 |
| Increase in share of equity holders of the parent in profit after tax | 255 |

**B. Defined Benefit Pension and Other Post-Employment Benefits**

The Company opted in its PFRS financial statements for the policy of recognizing actuarial gains and losses as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans. In the Company's IFRS financial statements, the Company opted for the policy of recognizing actuarial gains and losses immediately in the consolidated statement of income as and when they occur.

The change increased the Company's consolidated net income attributable to equity holders of the Parent by ₱942 million and ₱5,894 million for the years ended December 31, 2008 and 2007, respectively, increased minority interests by ₱4 million and ₱7 million for the years ended December 31, 2008 and 2007, respectively, and decreased the Company's consolidated equity by ₱7,511 million, ₱1,610 million and ₱664 million as at January 1, 2007, December 31, 2007 and December 31, 2008, respectively. As of December 31, 2007, the change increased pension liability by ₱1,640 million, other non-current liabilities by ₱811 million and deferred tax assets by ₱852 million, and decreased investments in associates by ₱11 million. As of December 31, 2008, the change increased pension liability by ₱436 million, pension asset by ₱11 million, other non-current liabilities by ₱487 million and deferred tax assets by ₱271 million and decreased investments in associates by ₱11 million.

**C. Investment Properties**

The Company opted in its PFRS financial statements for the policy of accounting for investment properties at cost, which is similar to the accounting policy adopted for utility plant and others. In the Company's IFRS financial statements, the Company opted for the policy of presenting and accounting for investment properties at fair value with the changes in fair value recognized in the consolidated statement of income. The reconciliation adjustments pertain to fair market value adjustments and reversal of previously recognized depreciation expense.

The change increased the Company's consolidated net income attributable to the equity holders of the Parent by ₱103 million and ₱238 million for the years ended December 31, 2008 and 2007, respectively, increased minority interests by ₱111 million and ₱229 million for the years ended December 31, 2008 and 2007, respectively, and increased the Company's consolidated equity by ₱714 million, ₱1,615 million and ₱1,863 million as at January 1, 2007, December 31, 2007 and December 31, 2008, respectively. As of December 31, 2007, the change increased investment properties by ₱2,229 million and deferred tax liabilities by ₱614 million. As of December 31, 2008, the change increased investment properties by ₱2,458 million and deferred tax liabilities by ₱595 million.

**D. Acquisition of Minority Interest**

The Company opted in its PFRS financial statements for the policy of accounting for acquisitions of minority interests using the entity concept method, whereby the difference between the fair value of the consideration transferred and the book value of the share in the net assets acquired is treated as an equity transaction and is presented as "Excess of acquisition cost over carrying value of minority interest acquired" account within the equity section of the consolidated statement of financial position. In the Company's IFRS financial statements, the Company opted for the policy of accounting for an acquisition of a minority interest using the parent entity extension method whereby the difference between the consideration and the existing carrying amount of the share of the net assets acquired is recognized as "Goodwill" and is included under "Other non-current assets account." The reconciliation adjustments pertain to reclassification of the "Excess of acquisition cost over carrying value of minority interest acquired" account to "Goodwill" account.

The change increased the Company's consolidated equity and consolidated other non-current assets by ₱328 million as at January 1, 2007, December 31, 2007 and December 31, 2008.

**Basis of Consolidation**

The consolidated financial statements comprise the financial statements of the Parent Company and its subsidiaries as at December 31 of each year, except for MIESCOR and subsidiaries, whose financial reporting date ends at September 30. Adjustments and disclosures are made for the effects of significant transactions or events that occurred between the date of MIESCOR's financial statements and the date of the consolidated financial statements. The consolidated financial statements are prepared using consistent accounting policies for like transactions and other events in similar circumstances.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognized in the consolidated financial statements, are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Parent Company obtains control, and continue to be consolidated until the date that such control ceases.

Minority interests represent the portion of profit or loss and net assets not held by the Company and are presented separately in the consolidated statement of income and within equity in the consolidated statement of financial position, from the amount of equity attributable to the equity holders of the Parent. Acquisitions of minority interests are accounted for using the parent entity extension method, whereby the difference between the consideration and the existing carrying amount of the share of the net assets acquired is recognized as goodwill. Disposals to minority interests result in gains and losses and are recognized in the consolidated statement of income.

The consolidated financial statements include the financial statements of the Parent Company and the following directly-owned subsidiaries as of December 31:

| | Country of Incorporation | Principal Activities | Percentage of Ownership | | |
|---|---|---|---|---|---|
| | | | 2009 | 2008 | 2007 |
| Corporate Information Solutions, Inc. and subsidiaries | Philippines | e-Transactions | 100 | 100 | 100 |
| Meralco Energy, Inc. | Philippines | Energy Systems Management | 100 | 100 | 100 |
| eMeralco Ventures, Inc. | Philippines | e-Business Development | 100 | 100 | 100 |
| Asian Center for Energy Management* | Philippines | Research & Development | 100 | 100 | 100 |
| Financial Services Corporation | Philippines | Financial Services Provider | 100 | 100 | 100 |
| Republic Surety and Insurance Co. (RSIC) | Philippines | Insurance | 100 | 100 | 100 |
| Lighthouse Overseas Insurance Company, Limited (LOIL)** | Bermuda | Insurance | 100 | 100 | – |
| MIESCOR and Subsidiaries | Philippines | Engineering, Construction and Consulting Services | 99 | 97 | 97 |
| Clark Electric Distribution Corporation (CEDC)** | Philippines | Power Distribution | 65 | 65 | – |
| Rockwell Land Corporation (Rockwell) | Philippines | Real Estate | 51 | 51 | 51 |

* *For dissolution*

** *Acquired in 2008 (see Note 8)*

## 4. STANDARDS, INTERPRETATIONS AND AMENDMENTS NOT YET EFFECTIVE

The Company will adopt the following standard, amendments and interpretations enumerated below when these become effective. Except as otherwise indicated, the Company does not expect the adoption of these new and amended IFRS and Interpretations to have any significant impact on its financial information.

**New Standard and Interpretations**

- IFRIC 17, "Distributions of Non-Cash Assets to Owners"

  This interpretation is effective for annual periods beginning on or after July 1, 2009. It provides guidance on how to account for non-cash distributions to owners. The interpretation clarifies when to recognize a liability, how to measure it and the associated assets, and when to derecognize the asset and liability.

- IFRIC 19, "Extinguishing Financial Liabilities with Equity Instruments"

  This interpretation is effective for annual periods beginning on or after July 1, 2010. If application of the interpretation results in a change in accounting policy, it would be applied retrospectively from the beginning of the earliest comparative period presented.

  IFRIC 19 clarifies that equity instruments issued to a creditor to extinguish a financial liability are "consideration paid" in accordance with paragraph 41 of IAS 39. As a result, the financial liability is derecognized and the equity instruments issued are treated as consideration paid to extinguish that financial liability. The interpretation states that equity instruments issued in a debt for equity swap should be measured at the fair value of the equity instruments issued, if this can be determined reliably. If the fair value of the equity instruments issued is not reliably determinable, the equity instruments should be measured by reference to the fair value of the financial liability extinguished as of the date of extinguishment.

  Any difference between the carrying amount of the financial liability that is extinguished and the fair value of the equity instruments issued is recognized immediately in the statement of income. The resulting gain or loss is disclosed separately on the statement of comprehensive income, or the separate statement of income (if presented), or in the notes.

The same principle applies when there is partial extinguishment of the financial liability. In these situations, the issuer would have to determine whether part of the consideration paid relates to a modification of the part of the liability that remains outstanding. If so, the issuer would allocate the consideration paid between the portion of the liability extinguished and the portion of the liability that remains outstanding.

The interpretation also requires an assessment of the terms of the remaining liability to determine whether they are substantially different from those of the original liability when applying the approach set out in IAS 39 paragraph 40. Any consideration allocated to the remaining liability would form part of this assessment. If the terms of the retained liability are substantially different, the entity accounts for the transaction, in accordance with IAS 39, as an extinguishment of the entire original financial liability, the recognition of a new liability (at fair value) and the issue of equity instruments, together with any resulting gain or loss in the statement of income.

- IFRS 9, "Financial Instruments (Phase 1)"

IFRS 9 is the new accounting standard that will eventually replace IAS 39, "Financial Instruments: Recognition and Measurement." In order to expedite the replacement of IAS 39, the IASB divided the project into phases. The main focus of Phase 1 is the classification and measurement of financial assets. The IASB's work on the other phases is currently ongoing, and covers impairment of financial instruments, hedge accounting, financial liabilities and derecognition. The aim is to replace IAS 39 in its entirety by the end of 2010. As each phase is completed, chapters with the new requirements will be added to IFRS 9, and the relevant portions deleted from IAS 39.

Phase 1 of IFRS 9 is applicable to all financial assets within the scope of IAS 39. At initial recognition, all financial assets (including hybrid contracts with a financial asset host) are measured at fair value.

Subsequent to initial recognition, financial assets that are debt instruments are classified at amortized cost or fair value on the bases of both: (a) the entity's business model for managing the financial assets; and (b) the contractual cash flow characteristic of the financial asset. Debt instrument may be subsequently measured at amortized cost if: (a) the asset is held within a business model whose objective is to hold the assets to collect the contractual cash flows; and (b) the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value.

All financial assets that are equity investments are measured at fair value either through other comprehensive income or the consolidated statement of income. This is an irrevocable choice the entity makes by instrument unless the equity investments are held for trading, in which case, they must be measured at fair value through profit or loss (FVPL).

The mandatory effective date for IFRS 9 is on January 1, 2013, with early adoption of Phase 1 permitted for reporting periods ending on or after December 31, 2009. IFRS 9 is required to be applied retrospectively and comparative figures are required to be restated.

**Amendments to Standards and Interpretation**

- Amendment to IAS 39, "Financial Instruments: Recognition and Measurement – Eligible Hedged Items"

The amendment to IAS 39, which is effective for annual periods beginning on or after July 1, 2009, clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item. This also covers the designation of inflation as a hedged risk or portion in particular situations.

- IFRS 3, "Business Combinations (Revised)" and IAS 27, "Consolidated and Separate Financial Statements (Amended)"

  The revised standards are effective for annual periods beginning on or after July 1, 2009. IFRS 3 (Revised) introduces significant changes in the accounting for business combinations occurring after this date. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs and future reported results. IAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes by IFRS 3 (Revised) and IAS 27 (Amended) will affect future acquisitions or loss of control of subsidiaries and transactions with non-controlling interests. IFRS 3 (Revised) will be applied prospectively while IAS 27 (Amended) will be applied retrospectively with a few exceptions. The Company will apply this amended standard in 2010 and will affect future acquisitions and transactions with non-controlling interests.

- Amendments to IFRS 2, "Share-based Payment – Group Cash-settled Share-based Payment Transactions"

  The amendments to IFRS 2, which are effective for annual periods beginning on or after January 1, 2010, clarify the scope and the accounting for group cash-settled share-based payment transactions.

- Amendment to IAS 32, "Financial Instruments: Presentation – Classification of Rights Issues Denominated in a Foreign Currency"

  The amendment is effective for annual periods beginning on or after February 1, 2010 and should be applied retrospectively.

  The amendment alters the definition of a financial liability in IAS 32 to classify rights issues and certain options or warrants (together, here termed rights) as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency.

  By changing the definition of a liability, these rights are no longer considered derivative instruments. Their fair value adjustments will no longer impact the statement of income.

- Amendments to IAS 24, "Related Party Disclosures"

  The amendments become effective for annual periods beginning on or after January 1, 2011 and should be applied retrospectively. The standard has been amended to simplify the identification of related party relationships and re-balance the extent of disclosures of certain transactions between related parties based on the costs to preparers and the benefits to users of the financial statements in having this information available in the financial statements.

- Amendments to IFRIC 14, "Prepayments of a Minimum Funding Requirement"

  The revised interpretation is effective for annual periods beginning on or after January 1, 2011. The IASB aligned the transitional provisions of these amendments with those of the original IFRIC 14. This means that entities have to assess the adjustment resulting from this amendment by going back to the beginning of the earliest comparative period presented in the first financial statements in which the entity applied the original interpretation.

  The amendment was made to remove an unintended consequence when an entity is subject to minimum funding requirements (MFR) and makes an early payment of contributions to cover those requirements.

If a pension asset cannot be recovered by a refund, its carrying value is restricted to the amount recoverable through reduced future contributions. When an entity is subject to MFR for future service, the amount recoverable is currently defined as the present value of:

(a) Future current service costs (net of employee contributions), less

(b) The part of the future MFR that relates to future service (as distinct from the part of the MFR that relates to past service).

It follows that if (b) exceeds (a), then no asset may be recognized. In some jurisdictions, the MFR are set on much more prudent basis than the IAS 19, "Employee Benefits" measure of service cost, with the result that so far no asset is recognized.

The amendment requires entities to treat the benefit of such an early payment as a pension asset. Subsequently, the remaining surplus in the plan, if any, is subject to the same analysis as if no prepayment had been made.

**Improvements to IFRS**

The omnibus amendments to IFRS issued in 2009 were issued primarily with a view to removing inconsistencies and clarifying wording. The amendments are effective for annual periods beginning on or after January 1, 2010 except when otherwise stated. The Company has not yet adopted the following amendments and anticipates that these changes will have no material effect on the financial information.

- IFRS 2, "Share-based Payment," clarifies that the contribution of a business on formation of a joint venture and combinations under common control are not within the scope of IFRS 2 even though they are out of scope of IFRS 3, "Business Combinations (Revised)." The amendment is effective for annual periods beginning on or after July 1, 2009.

- IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations," clarifies that the disclosures required in respect of non-current assets and disposal groups classified as held for sale or discontinued operations are only those set out in IFRS 5. The disclosure requirements of other IFRS only apply if specifically required for such non-current assets or discontinued operations.

- IFRS 8, "Operating Segment," clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker.

- IAS 1, "Presentation of Financial Statements," clarifies that the terms of a liability that could result, at anytime, in its settlement by the issuance of equity instruments at the option of the counterparty do not affect its classification.

- IAS 7, "Statement of Cash Flows," explicitly states that only expenditure that results in a recognized asset can be classified as a cash flow from investing activities.

- IAS 17, "Leases," removes the specific guidance on classifying land as a lease. Prior to the amendment, leases of land were classified as operating leases. The amendment now requires that leases of land are classified as either "finance" or "operating" in accordance with the general principles of IAS 17. The amendments will be applied retrospectively.

- IAS 36, "Impairment of Assets," clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for financial reporting purposes.

- IAS 38, "Intangible Assets," clarifies that if an intangible asset acquired in a business combination is identifiable only with another intangible asset, the acquirer may recognize the group of intangible assets as a single asset provided the individual assets have similar useful lives. It also clarifies that the valuation techniques presented for determining the fair value of intangible assets acquired in a business combination that are not traded in active markets are only examples and are not restrictive on the methods that can be used.

- IAS 39, "Financial Instruments: Recognition and Measurement," clarifies the following:
  - that a prepayment option is considered closely related to the host contract when the exercise price of a prepayment option reimburses the lender up to the approximate present value of lost interest for the remaining term of the host contract.
  - that the scope exemption for contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date applies only to binding forward contracts, and not derivative contracts where further actions by either party are still to be taken.
  - that gains or losses on cash flow hedges of a forecast transaction that subsequently results in the recognition of a financial instrument or on cash flow hedges of recognized financial instruments should be reclassified in the period that the hedged forecast cash flows affect profit or loss.
- IFRIC 9, "Reassessment of Embedded Derivatives," clarifies that it does not apply to possible reassessment, at the date of acquisition, embedded derivatives in contracts acquired in a business combination between entities or businesses under common control or the formation of joint venture.
- IFRIC 16, "Hedge of a Net Investment in a Foreign Operation," states that, in a hedge of a net investment in a foreign operation, qualifying hedging instruments may be held by any entity or entities within the group, including the foreign operation itself, as long as the designation, documentation and effectiveness requirements of IAS 39 that relate to a net investment hedge are satisfied.

## 5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in preparing the financial information of the Company are as follows:

### Utility Plant and Others

Utility plant and others, except land, are stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any impairment loss. Such costs include the cost of replacing part of such utility plant and other equipment when that cost is incurred if the recognition criteria are met. The cost of each major inspection is recognized in the carrying amount of the utility plant and others as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognized as incurred in the statement of income. The present value of the expected cost for the decommissioning of the asset after its use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Land is stated at cost less any impairment in value.

Utility plant and others of the Parent Company as of January 1, 2007 are stated at deemed cost. The Parent Company elected to use the deemed cost established under IFRS (see Note 18b).

Depreciation of utility plant and others of the Company is computed using the straight-line method (except for certain subtransmission and distribution assets which use straight-line functional group method) over the following estimated useful lives:

| **Asset Type** | **Estimated Useful Lives** |
|---|---|
| Subtransmission and distribution | 10–50 years, depending on the significant parts involved |
| Others: | |
| Buildings and improvements | 15–40 years |
| Communication equipment | 10 years |
| Office furniture, fixtures and other equipment | 5 years |
| Transportation equipment | 5–10 years |
| Others | 5–20 years |

An item of utility plant and others is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of income in the year the asset is derecognized.

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted prospectively if appropriate, at each reporting date.

**Construction in Progress**

Construction in progress of subtransmission and distribution substations and buildings is stated at cost which includes cost of construction, plant and equipment, borrowing costs and other direct costs. Construction in progress is not depreciated until such time that the relevant assets are completed and available for operational use.

**Borrowing Costs**

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset, an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, are capitalized as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred, and ceases when the assets are ready for their intended use.

**Investment Properties**

Investment properties are initially measured at cost including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day to day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the end of each reporting date and have been determined based on latest valuations performed by an independent firm of appraisers. Gains or losses arising from changes in the fair values of investment properties are included in the statement of income in the year in which they arise.

Investment properties are derecognized when they have been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment property is recognized in the statement of income in the year of retirement or disposal.

Transfers are made to or from investment property only when there is a change in use. For a transfer from investment property to owner-occupied property, the deemed cost for subsequent accounting is the fair value at the date of change in use. When the use of a property changes from owner-occupied to investment property, the property is remeasured to fair value and reclassified as investment property. Any gain arising on remeasurement is recognized in the statement of income to the extent the gain reverses a previous impairment loss on the specific property, with any remaining gain recognized in other comprehensive income and presented in the "Revaluation increment in utility plant and others" account in equity. Any loss is recognized in other comprehensive income and presented in the "Revaluation increment in utility plant and others" account in equity to the extent that an amount had previously been included in the "Revaluation increment in utility plant and others" account relating to the specific property, with any remaining loss recognized immediately in the statement of income.

Property that is being constructed for future use as investment property is accounted for at fair value.

**Investments in Associates**

The Company's investments in associates are accounted for using the equity method of accounting in the consolidated financial statements. An associate is an entity over which the Company has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in associate is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the Company's share of net assets of the associate, less any impairment in value. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. The consolidated statement of income reflects the Company's share of the results of operations of the associates. Where there has been a change recognized directly in the equity of the associate, the Company recognizes its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Profits and losses resulting from transactions between the Company and the associate are eliminated to the extent of the interest in the associate.

The reporting dates of the associates and the Company are identical and the associates' accounting policies conform to those used by the Company for like transactions and events in similar circumstances.

In the parent company financial statements, the Parent Company's investments in subsidiaries (entities over which the Parent Company controls) and associates (entities over which the Parent Company has significant influence and which are neither subsidiaries nor joint ventures) are accounted for under the cost method of accounting in the parent company financial statements. These are carried in the parent company statement of financial position at cost less any impairment in value. The Parent Company recognizes income from the investment only to the extent that the Parent Company receives distributions from accumulated profits of the subsidiaries arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

**Interest in a Joint Venture**

The Company's interest in joint venture is accounted for using the equity method of accounting in the consolidated financial statements. The interest in joint venture is carried at cost plus post-acquisition changes in the Company's share of the net assets of the joint venture, less any impairment in value. The Company's share of the results of operations of the joint venture is recognized in the consolidated statement of income.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest. The financial statements of the joint venture are prepared for the same reporting year as the Company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

When the Company contributes or sells assets to the joint venture, any share in the gain or loss from the transaction is recognized based on the substance of the transaction. When the Company purchases assets from the joint venture, the Company does not recognize its share of the profit of the joint venture from the transaction until it resells the assets to an independent party.

In the parent company financial statements, the Company's investment in joint venture is accounted for using the cost method of accounting. The interest in joint venture is carried at cost less any impairment in value.

**Deferred Pass-Through Fuel Costs**

Deferred pass through fuel costs are accounted as prepayments and are initially recorded based on the billings received. The account is reduced for fuel consumption above the required annual volume based on historical costs and is tested for impairment at each reporting date. Key factors in the impairment test of the deferred pass through costs are the ability of First Gas' plants to consume the banked gas within the prescriptive period and the exchange rate at which the Parent Company can convert the historical US dollar price to bill its customers for the power generated from the withdrawn banked gas.

**Business Combinations and Goodwill**

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities but excluding future restructuring) of the acquired business at fair value.

Goodwill acquired in a business combination is initially measured at cost, such cost being the excess of the cost of the business combination over the Company's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment loss. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether the other assets or liabilities of the Company are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated represents the lowest level within the Company at which the goodwill is monitored for internal management purposes; and, is not larger than a segment based on either the primary or secondary reporting format determined in accordance with IFRS 8.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in such circumstance is measured based on relative values of the operation disposed of and the portion of the cash-generating unit retained.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation differences and goodwill is recognized in the consolidated statement of income.

**Impairment of Non-financial Assets**

The Company assesses at each reporting date whether there is an indication that the following non-financial assets may be impaired:

- Utility plant and others
- Construction in progress
- Investments in associates and a joint venture
- Deferred pass-through fuel cost

The Company also performs annual impairment testing for goodwill.

If any such indication exists (such as obsolescence, physical damage, significant changes to the manner in which the asset is used, worse than expected economic performance, a drop in revenues or other external indicators), or when annual impairment testing for an asset is required (in the case of goodwill), the Company makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The fair value less cost to sell is the amount obtainable from the sale of the asset in an arm's-length transaction. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicy traded subsidiaries or other available fair value indicators.

Impairment losses are recognized in the statement of income in those expense categories consistent with the function of the impaired asset, except for assets previously revalued where the revaluation was taken to equity. In this case, the impairment is also recognized in equity up to the amount of any previous revaluation.

For assets, excluding goodwill, an assessment is also made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's or cash-generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation (in case of utility plant and others and investment properties), had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

The following criteria are also applied in assessing impairment of specific assets:

*Goodwill*. Goodwill is reviewed for impairment annually or more frequently if event or changes in circumstances indicate the carrying value maybe impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating units to which the goodwill relates. Where the recoverable amount of the cash-generating units is less than their carrying amount, an impairment loss is recognized. Impairment loss relating to goodwill cannot be reversed in future periods.

*Associates and a Joint Venture*. After application of equity method, the Company determines whether it is necessary to recognize an additional impairment loss of the Company's investments in its associates and joint venture. The Company determines at each reporting date whether there is objective evidence that the investments in associates and a joint venture is impaired. The entire carrying amount of the investment is tested for impairment, by comparing its recoverable amount, which is the higher of value in use and fair value less costs to sell, with its carrying amount. In determining the value in use of the investment, the Company estimates its share of the present value of the estimated future cash flows expected to be generated by the associate and joint venture, including the cash flows from the operations of the associate and joint venture and the proceeds on the ultimate disposal of the investment; or the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal. The recoverable amount of an investment in an associate or a joint venture is assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

**Inventories**

Materials and supplies are stated at the lower of cost or net realizable value. Costs incurred in bringing materials and supplies to their present location and condition are determined on the moving average method. Net realizable value is the current replacement cost of the asset.

Condominium units for sale of Rockwell are stated at the lower of cost or net realizable value. Cost includes the cost of the land, expenditures for the construction of the condominium units and borrowing costs incurred during the construction of the units. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

**Land and Development Costs**

Subdivided and unsubdivided land of Rockwell are stated at the lower of cost and net realizable value less allowance for probable losses. Expenditures for development are capitalized as part of the cost of the land. Borrowing costs are capitalized while development is in progress. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

**Financial Instruments**

*Initial Recognition*. Financial assets and financial liabilities are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at FVPL.

The Company recognizes a financial asset or a financial liability in the statement of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using trade date accounting.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. A financial instrument is classified as liability if it provided for a contractual obligation to (a) deliver cash or another financial asset to another entity; or (b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or (c) satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own shares. If the Company does not have the unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity, net of any related income tax benefits.

*Determination of Fair Value*. The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business at the reporting date. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's-length market transactions, reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis and option pricing models.

**"Day 1" Profit/Loss**

Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Company recognizes the difference between the transaction price and fair value (a "Day 1" profit/loss) in the statement of income, unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Company determines the appropriate method of recognizing the "Day 1" profit/loss amount.

**Financial Assets**

Financial assets are categorized as either financial assets at FVPL, loans and receivables, held-to-maturity (HTM) investments or AFS investments, as appropriate. The Company determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates this designation at each reporting date.

The Company has no HTM investments.

*Financial Assets at FVPL*. Financial assets at FVPL include financial assets held for trading purposes, derivative financial instruments and those designated upon initial recognition as at FVPL.

Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term.

Derivatives, including separated embedded derivatives, are also classified under this category unless they are designated as effective hedging instruments.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains or losses arising from changes in fair value recognized in the consolidated statement of income (shown as part of "Interest and financial income – Mark-to-market gains (losses) from derivative instruments" account). Reassessment of embedded derivatives is only done when there are changes in the contract that significantly modifies the cash flows.

Financial assets may be designated at initial recognition as at FVPL if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis; or (ii) the assets or liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

The Company's derivative financial instruments including embedded derivatives that are not accounted for as accounting hedges are classified under this category as of December 31, 2009, 2008 and 2007 (see Note 31).

*Loans and Receivables*. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortized cost using the effective interest method less any allowance for impairment. Gains and losses are recognized in consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are included in current assets if maturity is within 12 months from the reporting date. Otherwise, these are classified as non-current assets.

This category includes cash and cash equivalents, trade and other receivables and refundable deposits (see Note 32).

*AFS Investments*. AFS investments are those non-derivative financial assets that are designated as AFS or are not classified in any of the other three categories. After initial recognition, AFS are measured at fair value with gains and losses being recognized in the "Unrealized fair value gains (losses) on AFS investments" account under other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is removed and recognized in the consolidated statement of income.

AFS investments also include unquoted equity investments, which are carried at cost, less any accumulated impairment in value. The fair value of these instruments is not reasonably determinable due to the unpredictable nature of future cash flows and the lack of other suitable methods for arriving at a fair value.

The Company's AFS investments include investments in club shares and ordinary common shares (see Note 13).

**Financial Liabilities**

Financial liabilities are categorized as financial liabilities at FVPL or other financial liabilities at amortized cost. The Company does not have financial liabilities at FVPL.

*Other Financial Liabilities at Amortized Cost*. Other financial liabilities at amortized cost pertain to issued financial instruments or their components that are not classified or designated at FVPL and contain contractual obligations to deliver cash or another financial asset to the holder or to settle the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

This category mainly includes interest-bearing loans and other borrowings, customers' deposits, customers' refund, notes payable and trade and other payables which are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and other borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of effective interest rate. The effective interest rate amortization is included in "interest and financial expenses" account in the consolidated statement of income.

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment or reduction. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

**Offsetting Financial Instruments**

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented at gross amounts in the statement of financial position.

**Impairment of Financial Assets**

The Company assesses at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

*Assets Carried at Amortized Cost*. For assets carried at amortized cost, the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment based on historical loss experience. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. Specifically for the Company, it considers termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset is impaired. For Rockwell, it considers breach of contract, such as default or delinquency in interest on principal payments as objective evidence that a financial asset or group of assets is impaired. For both specific and collective assessment, any collateral and credit enhancement is considered in determining the amount of impairment loss.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through the use of an allowance account and the amount of the loss shall be recognized in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with associated allowance are written off when there is no realistic prospect of future recovery and all collateral or deposits have been realized or have been transferred to the Company.

If in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is recognized in the consolidated statement of income. Any subsequent reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

The estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate.

*Assets Carried at Cost*. If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

*AFS Investments*. For AFS investments, the Company assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as AFS investments, objective evidence would include a significant or prolonged decline in the fair value of an investment below its cost. "Significant" is evaluated against the original cost of the investment and "prolonged" against the period in which the fair value has been below its original cost. Where there is evidence of impairment, the cumulative loss which is measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the consolidated statement of income, is removed from other comprehensive income and recognized in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in their fair value after impairment are recognized directly in other comprehensive income.

In the case of debt instruments classified as AFS investments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the fair value, less any impairment loss on the investment previously recognized in the consolidated statement of income. Future interest income continues to be accrued based on the reduced carrying amount of the asset and is accrued using the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. The interest income is recorded as part of "Interest and financial income" account in the consolidated statement of income. If, in subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

**Derecognition of Financial Instruments**

*Financial Assets*. A financial asset (or, when applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Company has transferred its right to receive cash flows from the asset or has assumed an obligation to receive cash flows in full without material delay to a third party under a "pass-through" arrangement; and either the Company (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Company has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, a new asset is recognized to the extent of the Company's continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

*Financial Liabilities*. A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of income.

**Derivative Financial Instruments**

Derivative instruments (including bifurcated embedded derivatives) are initially recognized at fair value on the date in which a derivative transaction is entered into or bifurcated, and are subsequently re-measured at fair value. Changes in fair value of derivative instruments not accounted as hedges are recognized immediately in the consolidated statement of income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Derivative financial instruments also include bifurcated embedded derivatives. An embedded derivative is separated from the hybrid or combined contract if all the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid instrument is not recognized at FVPL.

Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

The Parent Company has bifurcated embedded currency forwards and call options (see Note 31).

Rockwell enters into derivative instruments such as forward currency contracts to manage its currency exposure (see Note 31). The fair values of freestanding forward currency transactions are calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

**Provisions**

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

**Pension and Other Post-Employment Benefits**

The Company has funded, non-contributory defined benefit retirement plans covering substantially all of its permanent employees. The Company also provides additional post-employment benefits upon retirement. The cost of providing benefits under the defined benefit plan is determined using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognized immediately in the consolidated statement of income.

The past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a pension plan, past service cost is recognized immediately.

In addition to its defined benefit retirement plan, MIESCOR also has a defined contribution retirement plan. The amount of MIESCOR's contribution to the retirement plan is recognized as expense in the period incurred.

**Share-Based Payment Transactions**

The Company has a share based payment plan for its employees and retirees to purchase a fixed number of shares of stock at a stated price. When the grants vest, the capital stock transactions are recorded at the fair value of the awards on grant date as described below. The regular terms of the plan include, among others, a two to three-year holding period of the purchased shares and cancellation of the purchase prior to full payment of the purchase price.

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined using the Black-Scholes Option Pricing Model. In valuing equity-settled transactions, no account is taken of any performance conditions.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The charge or credit in the consolidated statement of income represents the movement in cumulative expense recognized as at the beginning and end of that period. The cost of equity settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled. The cumulative expense recognized for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The charge or credit in the consolidated statement of income represents the movement of cumulative expense recognized as at the beginning and end of that period.

No expense is recognized for awards that do not ultimately vest.

The dilutive effect of outstanding awards is reflected as additional share dilution in the computation of earnings per share (see Note 36).

**Revenue**

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at fair value of the consideration received, excluding discounts, rebates and sales taxes or duty. The Company assesses its revenue arrangement against specific criteria in order to determine if it is acting as principal or agent. The Company has concluded that it is acting as a principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

*Sale of Electricity*. Revenues are recognized upon supply of power to the customers. The Uniform Filing Requirements on the rate unbundling released by the ERC on October 30, 2001 specified the following bill components: Generation Charge, Transmission Charge, System Loss Charge, Distribution Charge, Supply Charge, Metering Charge, the CERA I and II and Interclass and Lifeline Subsidies. National and Local Franchise Taxes, the Power Act Reduction (for Residential Customers) and the Universal Charge are also separately indicated in the customers' billing statements. National and Local Franchise Taxes and Universal Charges, which are billed and collected merely on behalf of the national and local government, do not form part of the Company's revenue.

*Sale of Real Estate*. Revenue from sale of land and condominium units is recognized when the significant risks and rewards of ownership of the land and condominium units have passed to the buyer, usually upon delivery or at completion.

The Company accounts for cash received as "Deposits from pre-selling of condominium units" when the construction is not yet completed.

All selling costs are charged to expense in the period these are incurred.

For income tax purposes, full revenue recognition is applied when at least 25% of the selling price has been collected in the year of sale; otherwise, the installment method is applied.

*Sale of Contracts and Services*. Revenues from construction contracts are recognized and measured using the percentage of completion method of accounting for the physical portion of the contract work, determined based on the actual costs incurred in relation to the total estimated costs of the contract. Revenue from contracts to manage, supervise or coordinate construction activity for others and contracts where materials and services are supplied by contract owners are recognized only to the extent of the contracted fees.

Contract costs principally include subcontracted costs related to contract performance. Expected losses on contracts are recognized immediately when it is probable that the total contract costs will exceed total contract revenues. The amount of such loss is determined irrespective of whether or not work has commenced on the contract; the stage of completion of contract activity; or the amount of profits expected to arise on other contracts which are not treated as a single construction contract. Changes in contract performance, contract conditions and estimated profitability, including those arising from contract penalty provisions, and final contract settlements which may result in revisions to estimated costs and gross margins are recognized in the year in which the changes are determined.

Service fees are recognized when the service is rendered.

Consultancy fees are recognized when services are rendered.

*Interest Income*. Revenue is recognized as interest accrues (using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

*Dividends*. Revenue from non-equitized holdings is recognized when the Company's right to receive the payment is established.

*Lease Income*. Lease income (shown as part of "Revenue – Others" account in the consolidated statement of income) arising from investment properties and poles is accounted for on a straight-line basis over the lease terms on ongoing leases.

Lease income from condominium units held for lease and mall operations (shown as part of "Revenue – Others" account in the consolidated statement of income) is accounted for on a straight-line basis over the lease terms.

**Leases**

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or the arrangement conveys a right to use the asset.

*Company as Lessee*. Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease terms.

*Company as Lessor*. Leases where the Company does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same bases as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

**Foreign Currency-Denominated Transactions and Translation**

The financial information is presented in the Philippine Peso, which is the Company's functional and presentation currency. Each entity in the Company determines its own functional currency.

Transactions in foreign currencies are initially recorded by the Company entities at their respective functional currency rates prevailing at the date of the transactions.

Monetary assets and liabilities denominated in foreign currencies are re-translated at the exchange rate as of the reporting date.

All differences are taken to the consolidated statement of income with the exception of all monetary items that provide an effective hedge for a net investment in a foreign operation. These are recognized in other comprehensive income until the disposal of the net investment, at which time they are recognized in the consolidated statement of income. Tax charges and credits attributable to exchange differences on those monetary items are also recorded in equity.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

As at the reporting date, the statement of financial position of an associate is translated into the presentation currency of the Company (the Philippine Peso) at the rate of exchange ruling at the reporting date and, the statement of income is translated at the monthly weighted average exchange rates for the year. The exchange differences arising on the translation are recognized in other comprehensive income and accumulated in a separate component of equity. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognized in the consolidated statement of income.

**Taxes**

*Current Income Tax*. Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authority. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted as at the reporting date.

*Deferred Income Tax*. Deferred income tax is provided using the balance sheet liability method on temporary differences as at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carryforward benefit of unused tax credits from excess minimum corporate income tax (MCIT) and net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefit of MCIT and NOLCO can be utilized except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and associates. With respect to investments in other subsidiaries and associates, deferred income tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to offset current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same tax authority.

Income tax relating to items recognized directly in equity and other comprehensive income is recognized in equity and other comprehensive income and not in the consolidated statement of income.

**Earnings per Share**

Basic earnings per share is calculated by dividing the net income for the year attributable to equity holders of the parent by the weighted average number of common shares outstanding during the year.

For the purpose of calculating diluted earnings per share, the net income attributable to equity holders of the parent and the weighted average number of shares outstanding are adjusted for the effects of all dilutive potential common shares.

**Contingencies**

Contingent liabilities are not recognized in the financial statements. They are disclosed in the notes to financial information unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized unless the realization of the assets is virtually certain. They are disclosed in the notes to financial information when an inflow of economic benefits is probable.

**Events After the Reporting Period**

Post year-end events that provide additional information about the Company's financial position at the reporting date (adjusting events) are reflected in the financial statements. Post year-end events that are not adjusting events are disclosed in the notes to financial information when material.

## 6. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the financial information requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that would require a material adjustment to the carrying amount of the asset or liability affected in the future periods.

### I. Judgments

In the process of applying the Company's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the financial information.

*a. National Power Corporation (NPC) Settlement Agreement*

As discussed in Note 34(b)(4), the effectivity of the Settlement Agreement of the Parent Company with NPC is dependent on the approval by the ERC. The approval of the ERC is vital since the amount to be settled shall form part of generation cost that is recoverable from the customers. Thus, this amount will be recognized as a liability by the Parent Company only if the ERC or the Court, as the case may be, finally approves the Settlement Agreement and allows the pass-through of the said amount to the customers. Upon approval by the ERC of the Settlement Agreement, the amount of liability to NPC shall be recognized with a corresponding recognition of receivable from the customers. In the event that the Settlement Agreement is disapproved, NPC and the Parent Company (Parties) shall revert to their respective positions before the mediation. If this happens, the remedy available to both Parties, pursuant to their Contract for the Sale of Electricity (CSE), is arbitration. In such a case, the Parent Company will continue to dispute any liability to NPC arising from the CSE, including the amount subject of the Settlement Agreement.

*b. Advances for Pass-Through Costs*

As discussed in Note 2(II), the Parent Company has advances for pass-through costs that have been the subject of various applications for recovery with the ERC. If these advances are not recovered through existing ERC-approved recovery mechanisms or orders, they remain unbilled to customers.

The following is the breakdown of the Parent Company's total advances for pass-through costs presented as unbilled receivables under "Trade and other receivables" and "Other non-current assets" accounts in the consolidated and parent company statement of financial position and disclosed as contingent assets in the financial information as of December 31, 2009.

| | Unbilled Receivables | Contingent Assets | Contingent Liabilities | Total |
|---|---|---|---|---|
| | | *(Amounts in Millions)* | | |
| Generation costs net under-recoveries | ₱560 | ₱– | ₱– | ₱560 |
| Generation net under-recoveries (10 cases)* | 881 | – | – | 881 |
| Deferred PPA for refund | (405) | – | – | (405) |
| System loss under-recoveries | 3,614 | 805 | – | 4,419 |
| SC GRAM case refund amount | 780 | – | – | 780 |
| Transmission cost over-recoveries* | (4,447) | 8 | – | (4,439) |
| Transmission cost under-recoveries* | 4,661 | – | – | 4,661 |
| Lifeline rate under-recoveries | 840 | – | (73) | 767 |
| Inter-class subsidy removal under-recoveries | 1,024 | – | (21) | 1,003 |
| | ₱7,508 | ₱813 | (₱94) | ₱8,227 |

* *Exclusive of carrying charges.*

c. *Unbilled Receivables*

Unbilled receivables represent pass-through costs incurred by the Parent Company and the estimated distribution revenues earned but not yet billed or recovered from the customers. Following is the breakdown of unbilled receivables:

(1) Generation Cost Net Under-recoveries

This includes under-recoveries (with corresponding carrying charges) covering the supply months of August 2006 to May 2007 incurred by the Parent Company during the suspension of AGRA and for the WESM bill in July 2008.

As discussed in Note 2(II)(a), the ERC allowed the Parent Company to collect the amount of ₱8,829 million and ₱1,149 million out of the ₱12,679 million which the Parent Company sought to recover through the ten separate applications for recovery of generation costs. For the remaining ₱2,701 million, the ERC ruled that the amount be disallowed for recovery from the customers. While the Parent Company is awaiting the ERC's decision, the Parent Company has made a provision for probable loss amounting to ₱2,519 million in 2008. As of December 31, 2009, the remaining balance of the approved generation cost for recovery amounted to ₱881 million.

(2) SC GRAM Case Refund Amount

As discussed in Note 2(II)(b), the Parent Company was directed to refund affected customers the GRAM refund amount of ₱0.1327 per kWh equivalent to a total amount of ₱780 million. As of December 31, 2009, the Parent Company has refunded ₱746 million to its customers. The Parent Company will be filing an application with the ERC for the recovery of the ₱746 million plus any additional amount that it will still refund to its customers pursuant to SC Resolution dated August 16, 2006, and the corresponding carrying charges.

(3) System Loss Under-recoveries

This largely represents system loss under-recoveries incurred by the Parent Company during the supply months of August 2006 to May 2007 when the AGRA was suspended.

As discussed in Note 2(II)(a), in the Decision dated June 4, 2008 on the Parent Company's ten consolidated applications for generation cost under-recoveries, the ERC directed the Parent Company to file a separate application for recovery of system loss adjustments amounting to ₱1,295 million after the ERC shall have confirmed the average transmission rate to be used in the calculation of the system loss rate in accordance with the AGRA Guidelines.

With the issuance on August 12, 2009 by the ERC of its Resolution No. 16, series of 2009, or the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities", Luzon DUs, such as the Parent Company, are to file their consolidated applications to resolve under/over-recoveries, including those for system loss charges, accumulated from the start of their rate unbundling until December 2008, not later than October 30, 2009. However, in a subsequent resolution dated October 12, 2009, the ERC deferred indefinitely the deadline for the filing of the consolidated applications. As of February 22, 2010, the ERC has not yet set a new deadline for the submission of the applications.

(4) Current Unbilled Revenues

The Parent Company changed its basis of estimating current unbilled revenues. Prior to 2009, the estimated current unbilled revenues were based on the conceptual view of one month lag in the recovery of purchased power costs. In 2009, the Parent Company's current unbilled revenues were estimated taking into consideration the various billing cycles of its customers.

d. *Functional Currency*

The functional currencies of the entities under the Company are the currency of the primary economic environment in which each entity operates. It is the currency that mainly influences the revenue and cost of rendering services. Based on the economic substance of the underlying circumstances relevant to the Company, the functional and presentation currency of the Company, except for LOIL, is the Philippine Peso.

The functional currency of LOIL is the United States (US) Dollar.

e. *Contingencies*

The Parent Company has contingent assets and liabilities amounting to ₱813 million and ₱94 million, respectively, consisting principally of accumulated advances in specific pass-through costs which do not have ERC-approved recovery mechanism at the reporting date (Note 6(I)(b)).

There are various claims and assessments against the Parent Company. The Parent Company's estimate of the probable costs of such claims and assessments is arrived at in consultation with its legal counsel handling defense in these matters and is based upon an analysis of potential results. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings or changes in government policies and decisions beyond the control of management (see Note 34).

Outstanding provisions to cover pending claims and assessments against the Parent Company which the Parent Company may be liable amounted to ₱4,978 million, ₱1,645 million and ₱1,396 million as of December 31, 2009, 2008 and 2007, respectively (see Note 22).

f. *Interest on Customers' Deposits*

As discussed in Note 21, the interest rates previously used by the Parent Company in accruing interest on customers' deposits are based on the Parent Company's interpretation of existing ERC rules. In view of the promulgation by the ERC on June 4, 2008 of Resolution No. 8, Series of 2008, entitled "A Resolution Adopting the Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers," the Parent Company has already applied the interest rates on meter deposits as embodied therein.

However, the Parent Company strongly believes that certain legal impediments and inconsistencies with previous pronouncements of the ERC on the issue of interest on bill deposit still exist. Hence, the Parent Company believes that rules similar to that applied to meter deposits as embodied in the aforesaid Resolution governing the refund of meter deposits must be put in place by the ERC to apply to bill deposits. In the meantime that there are no rules yet that specifically apply to bill deposits, the Parent Company will follow the same principles adopted by the ERC in the foregoing Rules governing the refund of meter deposits, insofar as the computation of interest for bill deposits is concerned.

For the years ended December 31, 2009, 2008 and 2007, total interest expense on bill deposits amounted to ₱1,120 million, ₱925 million and ₱864 million, respectively (see Note 28). Total interest expense on meter deposits for the years ended December 31, 2009, 2008 and 2007, amounted to ₱81 million, ₱89 million and ₱99 million, respectively (see Note 28).

Accrued interest on bill deposits as of December 31, 2009, 2008 and 2007 amounted to ₱8,685 million, ₱7,733 million and ₱6,981 million, respectively (see Note 21). Accrued interest on meter deposits as of December 31, 2009, 2008 and 2007 amounted to ₱1,272 million, ₱1,341 million and ₱1,296 million respectively (see Note 21).

*g.* *Operating Lease Commitments – The Company as a Lessor*

The Company has entered into commercial property leases on its investment property portfolio. The Company has determined, based on an evaluation of the terms and conditions of the arrangement, that it retains all the significant risks and rewards of ownership of these properties because the lease agreements do not transfer ownership of the assets to the lessee at the end of the lease term and do not give the lessee a bargain purchase option over the assets and so accounts for these agreements as operating leases.

*h.* *Operating Lease Commitments – The Company as a Lessee*

The Company has entered into commercial leases on certain payment offices, substation sites and tower and transmission lines. The Company has determined, based on an evaluation of the terms and conditions of the arrangement, that it has not acquired any significant risks and rewards of ownership of these properties because the lease agreements do not transfer to the Company the ownership over the assets at the end of the lease term and do not provide the Company with a bargain purchase option over the leased assets and so accounts for these arrangements as operating leases.

*i.* *Transfers of Investment Properties*

The Company has made transfers to investment property after determining that there is a change in use, evidenced by the ending of owner-occupation or commencement of an operating lease to another party. Transfers are also made from investment property when, and only when, there is a change in use, evidenced by the commencement of owner-occupation or commencement of development with a view to sale. These transfers are recorded using the carrying amount of the investment property at the date of change in use (see Note 12).

*j.* *Arrangements that Contain a Lease*

The Parent Company's PPAs and transmission line agreements (TLAs) with Independent Power Producers (IPPs) qualify as leases on the basis that the Parent Company and the IPPs have a take or pay arrangement where payments for purchased power are made on the basis of the availability of the Power Plant and not on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the IPPs' Power Plants are with the IPPs, thus the PPAs and TLAs are classified as operating leases. Accordingly, capacity fees, fixed operating fees and transmission line fees that form part of purchased power expense, are accounted for similar to a lease.

Components of purchased power expense which has been accounted for similar to a lease amounted to ₱20,900 million, ₱21,592 million and ₱17,107 million in 2009, 2008 and 2007, respectively (see Note 27).

**II. Estimates and Assumptions**

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

*a. Estimated Useful Lives*

The useful life of each item of the Company's utility plant and others is estimated based on the period over which the asset is expected to be available for use. Such estimation is based on a collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed at each reporting date and updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any utility plant and others and investment properties would increase the recorded operating expenses and decrease utility plant and others.

Utility plant and others, net of accumulated depreciation and amortization, amounted to ₱98,409 million, ₱95,704 million and ₱93,696 million as of December 31, 2009, 2008 and 2007, respectively (see Note 9).

*b. Fair Value of Investment Properties*

The Company adopted the fair value approach in determining the carrying value of investment properties. The Company opted to rely on independent appraisers in determining the fair values of investment properties, and such fair values were determined based on recent prices of similar properties, with adjustments to reflect any changes in economic conditions since the date of those transactions. The amounts and timing of recorded changes in fair value for any period would differ if different judgments and estimates are made or utilized a different basis for determining fair value.

The total fair value of investment properties as of December 31, 2009, 2008 and 2007 amounted to ₱10,893 million, ₱7,963 million and ₱7,807 million, respectively (see Note 12).

*c. Allowance for Doubtful Accounts*

For trade receivables, allowance for doubtful accounts is estimated based on specific identification method which includes different categories of customers, payment habits, historical loss experience and individual characteristics of customers. Specific accounts assessed as impaired and for probable write-off are provided with full allowance after offsetting corresponding customers' deposits.

In addition to specific allowance against individually significant receivables, the Company also makes a collective impairment allowance. Under collective assessment, the receivables are grouped according to the credit risk profile of customers and allowance provided is based on historical loss experience.

For other receivables, if there is an objective evidence that an impairment loss on receivables carried at amortized cost has been incurred, the amount of the potential loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate.

The total of the amounts calculated using these foregoing methods determines the total allowance to be maintained as of the reporting date.

The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made.

Provision for doubtful accounts, net of recoveries, amounted to ₱886 million in 2009, ₱1,566 million in 2008 and ₱576 million in 2007 (see Note 28). Trade and other receivables, net of allowance for doubtful accounts, amounted to ₱21,294 million, ₱37,506 million and ₱33,406 million as of December 31, 2009, 2008 and 2007, respectively (see Note 15).

*d.* *Impairment of AFS Investments*

The Company treats AFS investments as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgment. The Company treats "significant" generally as 20% or more and "prolonged" as greater than six months for quoted equity securities. In addition, the Company evaluates other factors, including normal volatility in share prices for quoted equities and the future cash flows and the discount factors for unquoted equities.

No impairment losses were recognized in 2009, 2008 and 2007. Unrealized fair value gain (loss) on AFS investments, net of tax effect, credited (charged) to other comprehensive income amounted to ₱24 million in 2009, (₱21 million) in 2008 and ₱25 million in 2007. AFS investments amounted to ₱356 million, ₱403 million and ₱404 million as of December 31, 2009, 2008 and 2007, respectively (see Note 13).

*e.* *Excess of cost over net realizable value*

The excess of cost over net realizable value relating to inventories consists of collective and specific provisions. A collective provision is established as a certain percentage based on the age and movement of stocks. Condominium units of Rockwell are written down to net realizable values when net realizable values of condominium units are less than their carrying values. The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made.

No provisions were made in 2009, 2008 and 2007. The carrying values of inventories amounted to ₱1,857 million, ₱1,648 million and ₱1,538 as of December 31, 2009, 2008 and 2007, respectively (see Note 16).

*f.* *Share-based Payments*

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payments requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model including the share price, expected life of the option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payments are disclosed in Note 19 to the financial information.

*g.* *Deferred Tax Assets*

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the deferred tax assets to be utilized. However, the amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

Deferred tax assets as of December 31, 2009, 2008 and 2007 amounted to ₱8,143 million, ₱8,032 million and ₱6,724 million, respectively (see Note 33).

h. *Goodwill*

The purchase accounting method requires the use of accounting estimates to allocate the purchase price to the fair values of the acquiree's identifiable assets and liabilities at the acquisition date. It also requires the acquirer to recognize goodwill.

The Company's business acquisition and acquisition of minority interests resulted in the recognition of goodwill which is subject to an annual impairment test or whenever there is an indication that such asset may be impaired.

The impairment on goodwill is determined by comparing the recoverable amount and the carrying amount of the cash-generating unit. The recoverable amount of the cash-generating unit is its value-in-use. Value-in-use is determined using cash flow projections.

The carrying amount of goodwill as of December 31, 2009, 2008 and 2007 amounted to ₱363 million.

No impairment losses were recognized in 2009, 2008 and 2007.

i. *Impairment of Non-financial Assets*

Determining the recoverable amounts of the non-financial assets listed below, which involves the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires the use of estimates and assumptions that can materially affect the financial information. Future events could indicate that these non-financial assets are impaired. Any resulting impairment loss could have a material adverse impact on the financial condition and results of operations of the Company.

The preparation of estimated future cash flows involves significant judgment and estimations. While the Company believes that its assumptions are appropriate and reasonable, significant changes in these assumptions may materially affect its assessment of recoverable values and may lead to future additional impairment charges under IFRS.

Non-current assets that are subjected to impairment testing when impairment indicators are present (such as obsolescence, physical damage, significant changes to the manner in which the asset is used, worse than expected economic performance, a drop in revenues or other external indicators) are as follows:

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Utility plant and others – net *(see Note 9)* | ₱98,409 | ₱95,704 | ₱93,696 |
| Construction in progress *(see Note 10)* | 3,703 | 5,149 | 2,811 |
| Investments in associates and a joint venture *(see Note 11)* | 1,182 | 2,036 | 1,608 |
| Deferred pass-through fuel costs *(see Note 13)* | 3,161 | 3,792 | 4,896 |

No impairment losses were recognized in 2009, 2008 and 2007.

j. *Financial Assets and Liabilities*

Where the fair value of financial assets and financial liabilities recorded in the consolidated and parent company statements of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Financial assets and liabilities carried at fair value as of December 31, 2009, 2008 and 2007 are as follows (see Note 31):

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| AFS investments *(see Note 13)* | ₱356 | ₱403 | ₱404 |
| Derivative assets – current and non-current *(see Notes 13 and 17)* | 183 | 121 | 300 |
| Derivative liabilities – current and non-current *(see Notes 25 and 31)* | 28 | 49 | – |

k. *Revenue Recognition*

The Company's revenue recognition policies require the use of estimates and assumptions that may affect the reported amounts of revenue and receivables.

Revenue of the Parent Company is billed under different cycles with different cycle cut-off dates, while take up in the accounts is based on calendar month. The recognition of unbilled revenues for billing cycles that have earlier than month-end cut-off dates requires the use of estimates.

As discussed above, the Parent Company likewise estimates its current unbilled revenues taking into consideration the various billing cycles of its customers.

The difference between the amount initially recognized and the actual settlement or actual billing is taken up in the accounts upon reconciliation normally in the following period. Management believes that such use of estimates will not result in material adjustments in future periods.

Revenue from construction contracts of MIESCOR is recognized based on the percentage of completion method. Percentage of completion is measured principally on the basis of the estimated completion of a physical proportion of the contract work – as determined from the reports of the contractors and project consultants. There is no assurance that such use of estimates may not result in material adjustments in future periods.

*l. Pension Cost and Benefits*

The determination of the obligation and cost for pension and other retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 29 and include among others, discount rate, expected rate of return on plan assets and future salary rate increases. In accordance with IFRS, actual results that differ from the Company's assumptions are recognized immediately in the consolidated statement of income as and when they occur. While it is believed that the Company's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Company's pension and other retirement obligations.

Consolidated net pension liability amounted to ₱8,873 million, ₱12,274 million and ₱12,953 million as of December 31, 2009, 2008 and 2007, respectively (see Note 29).

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the expected long-term rate of return on the relevant plan assets and the discount rate, among others. Any changes in these assumptions will affect the carrying amount of pension obligations.

**7. SEGMENT INFORMATION**

For management purposes, the Company's operating businesses are organized and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different products.

- The power distribution segment is involved in the distribution and supply of electricity covering franchise areas in the Luzon region.
- The real estate segment is involved in real estate development and leasing.
- The services segment is involved principally in the provisions of engineering, construction and consulting, e-transaction services and insurance.

Transfer prices between business segments are set on arm's-length basis in a manner similar to transactions with third parties. Segment revenues, segment expenses and segment results include transfers among business segments. Those transfers are eliminated in the consolidation.

The Company mainly operates and generates revenues only in the Philippines (i.e., one geographical location). Thus, geographical information is not presented.

| Years Ended December 31, | Power Distribution 2009 | Power Distribution 2008 | Power Distribution 2007 | Real Estate 2009 | Real Estate 2008 | Real Estate 2007 | Contracts and Services 2009 | Contracts and Services 2008 | Contracts and Services 2007 | Eliminations 2009 | Eliminations 2008 | Eliminations 2007 | Consolidated 2009 | Consolidated 2008 | Consolidated 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | *(Amounts in Millions)* | | | | | | | | |
| **Revenues** | | | | | | | | | | | | | | | |
| External sales | ₱178,686 | ₱186,999 | ₱196,171 | ₱182 | ₱6,132 | ₱60 | ₱3,273 | ₱2,563 | ₱2,400 | ₱– | ₱– | ₱– | ₱182,141 | ₱195,694 | ₱198,631 |
| Inter-segment sales | 200 | 65 | 217 | – | – | – | 716 | 492 | 524 | (916) | (557) | (741) | – | – | – |
| Total revenues | 178,886 | 187,064 | 196,388 | 182 | 6,132 | 60 | 3,989 | 3,055 | 2,924 | (916) | (557) | (741) | 182,141 | 195,694 | 198,631 |
| **Results** | | | | | | | | | | | | | | | |
| Segment results | 8,384 | 7,837 | 15,886 | 571 | 1,594 | (96) | 287 | 318 | 699 | – | – | – | 9,242 | 9,749 | 16,489 |
| Interest and other charges – net | 337 | (2,708) | (2,634) | (69) | 495 | 669 | 56 | 151 | 17 | – | – | – | 324 | (2,062) | (1,948) |
| Equity in net earnings of associates and a joint venture | 246 | 188 | 327 | – | – | – | – | – | – | – | – | – | 246 | 188 | 327 |
| Minority interests | – | – | – | – | – | – | – | – | – | (191) | (694) | (198) | (191) | (694) | (198) |
| Income tax expense | (2,815) | (2,217) | (4,800) | (118) | (748) | (209) | (112) | (116) | (99) | – | – | – | (3,045) | (3,081) | (5,108) |
| Net income attributable to equity holders of the Parent | 6,152 | 3,100 | 8,779 | 384 | 1,341 | 364 | 231 | 353 | 617 | (191) | (694) | (198) | 6,576 | 4,100 | 9,562 |
| **Other Information** | | | | | | | | | | | | | | | |
| Segment assets | 156,685 | 160,059 | 160,717 | 15,572 | 15,517 | 15,609 | 6,893 | 2,585 | 2,266 | (1,307) | (5,868) | (5,452) | 177,843 | 172,293 | 173,140 |
| Deferred tax assets | 7,404 | 7,599 | 5,814 | 716 | 418 | 902 | 23 | 15 | 8 | – | – | – | 8,143 | 8,032 | 6,724 |
| Investments in associates and a joint venture | 1,182 | 2,036 | 1,608 | – | – | – | – | – | – | – | – | – | 1,182 | 2,036 | 1,608 |
| Consolidated total assets | 165,271 | 169,694 | 168,139 | 16,288 | 15,935 | 16,511 | 6,916 | 2,600 | 2,274 | (1,307) | (5,868) | (5,452) | 187,168 | 182,361 | 181,472 |
| Segment liabilities | 45,387 | 40,482 | 38,080 | 6,432 | 4,856 | 9,038 | 2,613 | 1,491 | 1,767 | (1,157) | (487) | (1,061) | 53,275 | 46,342 | 47,824 |
| Interest-bearing liabilities | 55,890 | 60,916 | 63,906 | 2,909 | 2,476 | 1,749 | 3 | 9 | 371 | – | – | – | 58,802 | 63,401 | 66,026 |
| Deferred tax liabilities | 11,619 | 11,867 | 12,570 | 1,043 | 841 | 900 | 1 | 85 | 90 | – | – | – | 12,663 | 12,793 | 13,560 |
| Income tax payable | 2 | 2,199 | – | 57 | – | – | 74 | 86 | 51 | – | – | – | 133 | 2,285 | 51 |
| Consolidated total liabilities | 112,898 | 115,464 | 114,556 | 10,441 | 8,173 | 11,687 | 2,691 | 1,671 | 2,279 | (1,157) | (487) | (1,061) | 124,873 | 124,821 | 127,461 |
| Capital expenditures | 8,080 | 7,260 | 6,469 | 727 | 1,567 | 184 | 82 | 423 | 216 | – | – | – | 8,889 | 9,250 | 6,869 |
| Depreciation and amortization | 4,788 | 4,214 | 4,252 | 72 | 71 | 71 | 41 | 20 | 13 | – | – | – | 4,901 | 4,305 | 4,336 |
| Non-cash expenses other than depreciation and amortization | 6,916 | 12,366 | 4,582 | 262 | 123 | 585 | 13 | 6 | 17 | – | – | – | 7,191 | 12,495 | 5,184 |

The following table presents additional information on the power distribution business segment of the Company for 2009, 2008 and 2007:

| | Generation and Transmission | Distribution | Total |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Year Ended December 31, 2009: | | | |
| Revenue | ₱145,393 | ₱33,493 | ₱178,886 |
| Purchased power/cost and expenses | 149,965 | 20,537 | 170,502 |
| Segment results | (4,572) | 12,956 | 8,384 |
| Year Ended December 31, 2008: | | | |
| Revenue | ₱161,282 | ₱25,782 | ₱187,064 |
| Purchased power/cost and expenses | 163,489 | 15,738 | 179,227 |
| Segment results | (2,207) | 10,044 | 7,837 |
| Year Ended December 31, 2007: | | | |
| Revenue | ₱170,775 | ₱25,613 | ₱196,388 |
| Purchased power/cost and expenses | 172,577 | 7,925 | 180,502 |
| Segment results | (1,802) | 17,688 | 15,886 |

Revenues from generation and transmission do not include revenue accrual for pass-through charges during the periods that do not have the ERC-approved recovery mechanism. This portion of pass-through charges becomes part of contingent assets (see Note 34a(1)).

## 8. INFORMATION ON SUBSIDIARIES

### a. Rockwell

Rockwell is engaged in real estate development, sale or lease of residential and commercial lots and units and lease of mall facilities.

Land and development costs (before adjustment to reverse the effect of revaluation on land held for future development) consist of:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Land held for future development *(see Note 25)* | ₱– | ₱475 | ₱1,569 |
| Development costs – net of allowance for probable losses of ₱9 million in 2009 and 2008 and ₱170 million in 2007 | 5,558 | 3,382 | 5,698 |
| | ₱5,558 | ₱3,857 | ₱7,267 |

In 2008, land held for future development represents 9,026 square meters of land within the Rockwell Center. In 2009, this land, where the Edades Tower is being constructed, is classified under development costs.

Development costs include allocated cost of the land and construction costs incurred related to the following projects:

| | Balance | | | Estimated Cost to Complete | | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | **2007** | **2009** | **2008** | **2007** |
| | | | *(Amounts in Millions)* | | | |
| Project: | | | | | | |
| One Rockwell | ₱3,521 | ₱2,092 | ₱1,257 | ₱3,289 | ₱4,475 | ₱5,581 |
| The Grove | 1,445 | 1,183 | – | 10,184 | 10,251 | – |
| Edades | 578 | – | – | 4,350 | – | – |
| Joya | – | – | 4,112 | – | – | 394 |
| Meralco BPO | – | – | 256 | – | – | 2,257 |
| Others | 14 | 107 | 73 | – | – | – |
| | ₱5,558 | ₱3,382 | ₱5,698 | ₱17,823 | ₱14,726 | ₱8,232 |

The "Grove" by Rockwell, located in Pasig City, is a mid-rise residential condominium community project. "Edades" and "One Rockwell," are residential condominium projects within the Rockwell Center in Makati City.

Other development costs pertain to residential and commercial projects, which Rockwell plans to implement and complete in the following years.

Specific borrowing costs capitalized as part of development costs amounted to ₱40 million, ₱43 million and ₱24 million in 2009, 2008 and 2007, respectively.

In 2008, Rockwell entered into a Project Development Agreement with the Parent Company to construct a three-tower BPO complex at the Meralco Compound in Ortigas Center. The Parent Company, the landowner, agreed to contribute the use of the land and ₱3 million, which in aggregate shall be equivalent to 30% of the project contribution, while Rockwell agreed to shoulder the construction cost and contribute ₱7 million, which in aggregate shall be equivalent to 70% of the project contribution. Upon completion of the construction of two towers in 2009, the Parent Company and Rockwell divided and allocated the ownership of the BPO building in proportion to their respective contribution in accordance with the Project Development Agreement.

The Parent Company and Rockwell pooled together their interests in the Meralco BPO buildings under an unincorporated joint venture to operate and manage the same for a period of twenty five (25) years, for lease or similar arrangement to third parties under common property and administration. Rockwell acts as the Property Manager in accordance with the Joint Venture Agreement and the Property Management Plan.

Condensed financial information for Rockwell, before intercompany elimination and adjustment to reverse the effect of revaluation on land held for future development, is as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Current assets | ₱7,620 | ₱6,395 | ₱7,790 |
| Non-current assets | 10,634 | 9,483 | 8,495 |
| Current liabilities | (1,744) | (1,518) | (1,787) |
| Non-current liabilities | (8,639) | (6,597) | (7,859) |
| Net assets | ₱7,871 | ₱7,763 | ₱6,639 |
| Revenue | ₱999 | ₱7,051 | ₱831 |
| Costs and expenses | (689) | (5,711) | (520) |
| Net income | ₱310 | ₱1,340 | ₱311 |

Certain assets of Rockwell were used to secure loans from various local banks (see Note 20).

**b. RSIC and LOIL**

In March 2007, the Parent Company acquired 100% interest in RSIC as the vehicle to underwrite its risk exposures and address its insurance needs. The investment in RSIC, which was valued at ₱141 million, was accounted for using the purchase method of accounting. The cost of acquisition comprised cash payments and costs directly attributable to the acquisition. The purchase method of accounting involves allocating the cost of the business combination to the fair value of the assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. Accordingly, the consolidated financial statements include the results of RSIC from its acquisition in March 2007. The effect of inclusion of RSIC on the consolidated financial position and results of operations is not material.

The fair values of the assets and liabilities of RSIC as of the date of acquisition are as follows:

| | Recognized at Acquisition | Carrying Value |
|---|---|---|
| | *(Amounts in Thousands)* | |
| Assets: | | |
| Cash and cash equivalents | ₱65,455 | ₱65,455 |
| Other financial assets | 41,722 | 41,722 |
| Deferred tax asset | 126 | 126 |
| Other assets | 1,192 | 1,192 |
| | 108,495 | 108,495 |
| Liabilities: | | |
| Trade and other payables | 165 | 165 |
| Other financial liabilities | 2,819 | 2,819 |
| Deferred tax liability | 320 | 320 |
| | 3,304 | ₱3,304 |
| Fair value of net assets | 105,191 | |
| Goodwill arising on acquisition | 35,275 | |
| Total acquisition cost | ₱140,466 | |
| Net cash outflow from acquisition | ₱75,011 | |

The carrying value of the financial assets and liabilities and other assets approximate their fair values due to the short-term nature of the transactions and because other financial assets and liabilities are already stated at fair values.

On August 24, 2007, the Parent Company established LOIL, a wholly-owned subsidiary domiciled in the British overseas territory of Bermuda. LOIL obtained its license to operate in the territory in March 2008. With an initial capital of ₱12 million, this offshore company serves as the Parent Company's captive reinsurer, which is the vehicle to minimize the Parent Company's major catastrophic risk exposures.

RSIC acts as a domestic writing company and serves as the official resident agent of LOIL. RSIC, together with LOIL, completes the Parent Company's Business Risk Management Model following a standard model being used by many global companies.

**c. CEDC**

The Parent Company had a receivable from MIESCOR amounting to ₱136 million as of December 31, 2007. As settlement, on January 30, 2008, MIESCOR paid the receivable in exchange of 561,500 shares of stock equivalent to 65% ownership in CEDC. The equity interest in CEDC is based on the net book value of CEDC as of September 30, 2007.

Previously, CEDC was indirectly owned by the Parent Company and the accounts of the former are consolidated through MIESCOR but as a result of this transaction, the ownership interest of the Parent Company over CEDC is direct and its accounts are now directly consolidated.

**d. MIESCOR**

The financial statements of MIESCOR were prepared as of September 30. For consolidation purposes, no adjustments were made to the financial statements of MIESCOR as there were no significant transactions or events that occurred between that date and the date of the Parent Company's financial statements.

**9. UTILITY PLANT AND OTHERS**

The movements in utility plant and others as of December 31, 2009, 2008 and 2007 are as follows:

| | Consolidated 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
| | *(Amounts in Millions)* | | | | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱112,102 | ₱15,622 | ₱4,511 | ₱5,334 | ₱4,669 | ₱1,956 | ₱2,119 | ₱146,313 |
| Transfers from CIP *(see Note 10)* | 6,597 | – | 145 | 417 | 513 | 126 | 243 | 8,041 |
| Additions | 35 | – | 2 | 12 | 56 | 44 | 38 | 187 |
| Disposals/retirements | (1,766) | – | – | (132) | (53) | (199) | (24) | (2,174) |
| Transfer to investment properties | – | (621) | – | – | – | – | – | (621) |
| Reclassification and others | 784 | – | 69 | 16 | (14) | (5) | (40) | 810 |
| End of year | 117,752 | 15,001 | 4,727 | 5,647 | 5,171 | 1,922 | 2,336 | 152,556 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 40,044 | – | 1,695 | 3,280 | 3,498 | 1,087 | 1,005 | 50,609 |
| Charge for the year | 3,746 | – | 112 | 457 | 366 | 42 | 178 | 4,901 |
| Disposals/retirements | (1,466) | – | – | (132) | (52) | (99) | (23) | (1,772) |
| Reclassification and others | (80) | – | (5) | 277 | (35) | 75 | 177 | 409 |
| End of year | 42,244 | – | 1,802 | 3,882 | 3,777 | 1,105 | 1,337 | 54,147 |
| Net book value | ₱75,508 | ₱15,001 | ₱2,925 | ₱1,765 | ₱1,394 | ₱817 | ₱999 | ₱98,409 |

Consolidated
2008

| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | *(Amounts in Millions)* | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱107,716 | ₱15,621 | ₱4,309 | ₱5,661 | ₱4,062 | ₱1,810 | ₱1,857 | ₱141,036 |
| Transfers from CIP *(see Note 10)* | 4,888 | – | 204 | 145 | 589 | 190 | 144 | 6,160 |
| Additions | 122 | – | – | 102 | 52 | 43 | 310 | 629 |
| Disposals/retirements | (586) | – | (1) | (504) | (30) | (87) | (19) | (1,227) |
| Reclassification and others | (38) | 1 | (1) | (70) | (4) | – | (173) | (285) |
| End of year | 112,102 | 15,622 | 4,511 | 5,334 | 4,669 | 1,956 | 2,119 | 146,313 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 36,973 | – | 1,588 | 3,336 | 3,341 | 1,120 | 982 | 47,340 |
| Charge for the year | 3,503 | – | 107 | 448 | 172 | 39 | 36 | 4,305 |
| Disposals/retirements | (432) | – | – | (504) | (15) | (72) | (13) | (1,036) |
| End of year | 40,044 | – | 1,695 | 3,280 | 3,498 | 1,087 | 1,005 | 50,609 |
| Net book value | ₱72,058 | ₱15,622 | ₱2,816 | ₱2,054 | ₱1,171 | ₱869 | ₱1,114 | ₱95,704 |

Consolidated
2007

| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | *(Amounts in Millions)* | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱103,218 | ₱15,568 | ₱4,410 | ₱5,691 | ₱3,760 | ₱1,596 | ₱1,667 | ₱135,910 |
| Transfers from CIP *(see Note 10)* | 5,298 | – | 75 | 221 | 265 | 135 | 236 | 6,230 |
| Additions | 16 | – | 68 | 32 | 43 | 35 | 132 | 326 |
| Disposals/retirements | (944) | – | (28) | (193) | (4) | (16) | (5) | (1,190) |
| Reclassification and others | 128 | 53 | (216) | (90) | (2) | 60 | (173) | (240) |
| End of year | 107,716 | 15,621 | 4,309 | 5,661 | 4,062 | 1,810 | 1,857 | 141,036 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 34,412 | – | 1,500 | 3,143 | 3,088 | 1,103 | 948 | 44,194 |
| Charge for the year | 3,505 | – | 116 | 386 | 257 | 33 | 39 | 4,336 |
| Disposals/retirements | (944) | – | (28) | (193) | (4) | (16) | (5) | (1,190) |
| End of year | 36,973 | – | 1,588 | 3,336 | 3,341 | 1,120 | 982 | 47,340 |
| Net book value | ₱70,743 | ₱15,621 | ₱2,721 | ₱2,325 | ₱721 | ₱690 | ₱875 | ₱93,696 |

| | Parent Company 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
| | *(Amounts in Millions)* | | | | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱111,651 | ₱15,599 | ₱4,182 | ₱4,909 | ₱3,902 | ₱1,727 | ₱1,575 | ₱143,545 |
| Transfers from CIP *(see Note 10)* | 6,597 | – | 145 | 417 | 513 | 126 | 243 | 8,041 |
| Disposals/retirements | (1,398) | – | – | (129) | (52) | (191) | (10) | (1,780) |
| Transfer to investment properties | – | (621) | – | – | – | – | – | (621) |
| Reclassification and others | 379 | – | (20) | (5) | 12 | 5 | – | 371 |
| End of year | 117,229 | 14,978 | 4,307 | 5,192 | 4,375 | 1,667 | 1,808 | 149,556 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 39,877 | – | 1,494 | 3,387 | 3,001 | 1,022 | 794 | 49,575 |
| Charge for the year | 3,720 | – | 100 | 456 | 304 | 17 | 79 | 4,676 |
| Disposals/retirements | (1,330) | – | – | (129) | (52) | (177) | (10) | (1,698) |
| Reclassification and others | (135) | – | – | (2) | – | 81 | – | (56) |
| End of year | 42,132 | – | 1,594 | 3,712 | 3,253 | 943 | 863 | 52,497 |
| Net book value | ₱75,097 | ₱14,978 | ₱2,713 | ₱1,480 | ₱1,122 | ₱724 | ₱945 | ₱97,059 |

| | Parent Company 2008 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
| | *(Amounts in Millions)* | | | | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱107,395 | ₱15,598 | ₱3,979 | ₱5,266 | ₱3,332 | ₱1,614 | ₱1,449 | ₱138,633 |
| Transfers from CIP *(see Note 10)* | 4,888 | – | 204 | 145 | 589 | 190 | 144 | 6,160 |
| Disposals/retirements | (586) | – | – | (504) | (15) | (77) | (19) | (1,201) |
| Reclassification and others | (46) | 1 | (1) | 2 | (4) | – | 1 | (47) |
| End of year | 111,651 | 15,599 | 4,182 | 4,909 | 3,902 | 1,727 | 1,575 | 143,545 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 36,900 | – | 1,396 | 3,406 | 2,906 | 1,002 | 733 | 46,343 |
| Charge for the year | 3,409 | – | 98 | 485 | 110 | 92 | 74 | 4,268 |
| Disposals/retirements | (432) | – | – | (504) | (15) | (72) | (13) | (1,036) |
| End of year | 39,877 | – | 1,494 | 3,387 | 3,001 | 1,022 | 794 | 49,575 |
| Net book value | ₱71,774 | ₱15,599 | ₱2,688 | ₱1,522 | ₱901 | ₱705 | ₱781 | ₱93,970 |

| | Parent Company 2007 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Subtransmission and Distribution | Land | Buildings and Improvements | Communication Equipment | Office Furniture, Fixtures and Other Equipment | Transportation Equipment | Others | Total |
| | *(Amounts in Millions)* | | | | | | | |
| Cost: | | | | | | | | |
| Beginning of year | ₱102,869 | ₱15,565 | ₱4,164 | ₱5,491 | ₱3,072 | ₱1,313 | ₱1,171 | ₱133,645 |
| Transfers from CIP *(see Note 10)* | 5,298 | – | 75 | 221 | 265 | 135 | 236 | 6,230 |
| Disposals/retirements | (943) | – | (28) | (194) | (4) | (15) | – | (1,184) |
| Reclassification and others | 171 | 33 | (232) | (252) | (1) | 181 | 42 | (58) |
| End of year | 107,395 | 15,598 | 3,979 | 5,266 | 3,332 | 1,614 | 1,449 | 138,633 |
| Less accumulated depreciation: | | | | | | | | |
| Beginning of year | 34,356 | – | 1,326 | 3,059 | 2,717 | 1,002 | 668 | 43,128 |
| Charge for the year | 3,487 | – | 98 | 541 | 193 | 15 | 65 | 4,399 |
| Disposals/retirements | (943) | – | (28) | (194) | (4) | (15) | – | (1,184) |
| End of year | 36,900 | – | 1,396 | 3,406 | 2,906 | 1,002 | 733 | 46,343 |
| Net book value | ₱70,495 | ₱15,598 | ₱2,583 | ₱1,860 | ₱426 | ₱612 | ₱716 | ₱92,290 |

Utility plant and others are freehold and are held outside Hong Kong.

**10. CONSTRUCTION IN PROGRESS**

| | Consolidated | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱5,149 | ₱2,811 | ₱2,909 |
| Additions | 8,650 | 8,498 | 6,132 |
| Transfers to utility plant and others *(see Note 9)* | (8,041) | (6,160) | (6,230) |
| Transfer to investment property | (2,055) | – | – |
| Balance at end of year | ₱3,703 | ₱5,149 | ₱2,811 |

| | Parent Company | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱3,704 | ₱2,811 | ₱2,909 |
| Additions | 8,040 | 7,053 | 6,132 |
| Transfers to utility plant and others (see Note 9) | (8,041) | (6,160) | (6,230) |
| Balance at end of year | ₱3,703 | ₱3,704 | ₱2,811 |

**Parent Company**

Construction in progress of the Parent Company includes borrowing costs incurred in connection with the construction of subtransmission and distribution facilities. Borrowing costs capitalized amounted to ₱98 million, ₱53 million and ₱58 million in 2009, 2008 and 2007, respectively.

**Rockwell**

As discussed in Note 8(a), Rockwell entered into a Project Development Agreement with the Parent Company to construct the BPO buildings at the Meralco Compound in Ortigas Center. Construction in progress in 2008 represents the cost incurred related to the construction of the BPO buildings. The BPO building was completed in July 2009 and was reclassified to investment properties.

General borrowing costs capitalized as part of construction in progress amounted to ₱25 million, ₱75 million and ₱2 million in 2009, 2008 and 2007, respectively.

Consolidated capitalization rates in 2009, 2008 and 2007 ranged from 8.6% to 8.8%, 7.7% to 8.5% and 8.2% to 9.4%, respectively.

## 11. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND A JOINT VENTURE

In the consolidated financial statements, investments in the following associates and a joint venture are accounted for under the equity method:

| | Country of Incorporation | Principal Activities | Percentage of Ownership | | |
|---|---|---|---|---|---|
| | | | 2009 | 2008 | 2007 |
| **Associates** | | | | | |
| First Private Power Corporation and Subsidiary (FPPC) | Philippines | Power Generation | 40 | 40 | 40 |
| Batangas Cogeneration Corporation (Batangas Cogen)* | Philippines | Power Generation | – | 38 | 38 |
| General Electric Philippines Meter and Instrument Company, Inc. (GEPMICI) | Philippines | Sale of metering products and services | 35 | 35 | 35 |
| **Joint Venture** | | | | | |
| Indra Philippines, Inc. (Indra, formerly known as Soluziona Philippines, Inc.) | Philippines | Management and information technology consultancy | 50 | 50 | 50 |

* *Ceased operations in 2004.*

The details and movements in investments in associates and a joint venture are as follows:

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Acquisition costs: | | | |
| Balance at beginning of year | ₱465 | ₱465 | ₱655 |
| Return of capital | (6) | – | (190) |
| Balance at end of year | 459 | 465 | 465 |
| Accumulated equity in net earnings: | | | |
| Balance at beginning of year | 760 | 859 | 623 |
| Equity in net earnings for the year | 246 | 188 | 327 |
| Depreciation on share in revaluation increment | 129 | 169 | 169 |
| Dividends received | (1,100) | (456) | (260) |
| Return of capital | 6 | – | – |
| Balance at end of year | 41 | 760 | 859 |
| Share in revaluation increment of an associate: | | | |
| Balance at beginning of year | 129 | 298 | 467 |
| Depreciation on share in revaluation increment | (129) | (169) | (169) |
| Balance at end of year | – | 129 | 298 |
| Share in cumulative translation adjustment of an associate | 682 | 682 | (14) |
| | ₱1,182 | ₱2,036 | ₱1,608 |

The carrying values of investments in associates and a joint venture are as follows:

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Associates: | | | |
| FPPC | ₱965 | ₱1,835 | ₱1,420 |
| GEPMICI | 64 | 66 | 80 |
| Joint venture: | | | |
| Indra | 153 | 135 | 108 |
| | ₱1,182 | ₱2,036 | ₱1,608 |

In 2009, the Parent Company received from Batangas Cogen ₱6 million representing a return of capital.

In October 2007, the Company received from FPPC ₱190 million representing a return of capital.

Condensed financial information for FPPC and GEPMICI is as follows:

| | 2009 | | 2008 | | 2007 | |
|---|---|---|---|---|---|---|
| | FPPC | GEPMICI | FPPC | GEPMICI | FPPC | GEPMICI |
| | *(Amounts in Millions)* | | | | | |
| Current assets | ₱2,686 | ₱199 | ₱1,379 | ₱230 | ₱3,472 | ₱251 |
| Non-current assets | 2,268 | 13 | 4,644 | 15 | 1,807 | 15 |
| Current liabilities | (193) | (31) | (447) | (58) | (420) | (37) |
| Non-current liabilities | (2,351) | – | (2,619) | – | (2,219) | – |
| Net assets | ₱2,410 | ₱181 | ₱2,957 | ₱187 | ₱2,640 | ₱229 |
| Revenues | ₱973 | ₱377 | ₱1,210 | ₱396 | ₱2,458 | ₱518 |
| Costs and expenses | (437) | (335) | (758) | (359) | (1,358) | (489) |
| Net income | ₱536 | ₱42 | ₱452 | ₱37 | ₱1,100 | ₱29 |

The aggregate amounts of the Parent Company's interest in the assets, liabilities, income and expenses related to its 50% interest in Indra are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Current assets | ₱472 | ₱549 | ₱204 |
| Non-current assets | 146 | 85 | 51 |
| Current liabilities | (278) | (322) | (112) |
| Non-current liabilities | (22) | (44) | (33) |
| Net assets | ₱318 | ₱268 | ₱110 |
| Revenue | ₱921 | ₱832 | ₱325 |
| Costs and expenses | (834) | (777) | (312) |
| Net income | ₱87 | ₱55 | ₱13 |

In the parent company financial statements, investments in subsidiaries, associates and a joint venture are accounted for at cost.

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | | *(Amounts in Millions)* | |
| Shares at cost: | | | |
| Subsidiaries | ₱1,777 | ₱1,773 | ₱1,311 |
| Associates | 452 | 458 | 458 |
| Joint Venture | 891 | 7 | 7 |
| | ₱3,120 | ₱2,238 | ₱1,776 |

The Parent Company's subsidiaries, associates and joint venture are non-listed entities.

## 12. INVESTMENT PROPERTIES

| | Consolidated 2009 | | |
|---|---|---|---|
| | Land | Buildings and Improvements | Total |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱3,628 | ₱4,335 | ₱7,963 |
| Additions | – | 52 | 52 |
| Transfer from utility plant and others | 676 | – | 676 |
| Net gains from fair value changes | 79 | 117 | 196 |
| Transfer to utility plant and others | (17) | (27) | (44) |
| Transfer from construction in progress | – | 2,055 | 2,055 |
| Transfer to land and development cost | – | (5) | (5) |
| Balance at end of year | ₱4,366 | ₱6,527 | ₱10,893 |

| | Consolidated 2008 | | |
|---|---|---|---|
| | Land | Buildings and Improvements | Total |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱3,564 | ₱4,243 | ₱7,807 |
| Additions | – | 48 | 48 |
| Net gains from fair value changes | 64 | 44 | 108 |
| Balance at end of year | ₱3,628 | ₱4,335 | ₱7,963 |

| | Consolidated 2007 | | |
|---|---|---|---|
| | Land | Buildings and Improvements | Total |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱1,745 | ₱3,937 | ₱5,682 |
| Additions | – | 74 | 74 |
| Transfer from land and development costs | 1,522 | – | 1,522 |
| Net gains from fair value changes | 297 | 274 | 571 |
| Transfer to land and development costs | – | (34) | (34) |
| Transfer to utility plant and others | – | (8) | (8) |
| Balance at end of year | ₱3,564 | ₱4,243 | ₱7,807 |

| | Parent Company 2009 | | |
|---|---|---|---|
| | Land | Buildings and Improvements | Total |
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱849 | ₱225 | ₱1,074 |
| Net gain (loss) from fair value changes | 20 | (62) | (42) |
| Transfer from utility plant and others | 676 | – | 676 |
| Transfer to utility plant and others | (17) | – | (17) |
| Balance at end of year | ₱1,528 | ₱163 | ₱1,691 |

The Parent Company's land as of December 31, 2008 and 2007 amounted to ₱849 million. Buildings and improvements amounted to ₱225 million as of December 31, 2008 and 2007.

Investment properties consist of real properties held for capital appreciation and real properties which are being leased to related and third parties. Lease income earned from investment properties amounted to ₱566 million, ₱542 million and ₱516 million in 2009, 2008 and 2007, respectively. Direct operating expenses incurred amounted to ₱141 million, ₱123 million and ₱129 million in 2009, 2008 and 2007, respectively.

Investment properties were valued by Asian Appraisal Company, Inc. for the Parent Company and Vitale Valuation Services, Inc. for Rockwell, independent professionally qualified appraisers at December 31, 2009, 2008 and 2007. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction at the date of valuation.

The value of the property was arrived at through the use of the "Income Approach." The Income Approach considers the resulting net income of the lease business operations of the mall including the parking fees that is then capitalized in accordance with commensurate return on investment plus due allowance rate for depreciation to indicate the value of which the property can be duly offered under open market conditions. The value of other investment property held for lease within the Rockwell Center and land held for appreciation was arrived at through the use of the "Market Data Approach." The market data approach is based on the assumption that no prudent purchaser will buy more than what it will cost to acquire an equally desirable substitute parcel or site. This approach is primarily based on sales and listings, which are adjusted for the time of sale, location, and general characteristics of comparable lots in the neighborhood where the subject lot is situated.

## 13. DEFERRED PASS-THROUGH FUEL COSTS AND OTHER NON-CURRENT ASSETS

### Deferred Pass-Through Fuel Costs

Deferred pass-through fuel costs represent the billed amounts for the quantity and cost of natural gas that was contracted for but not consumed by the Parent Company's major IPPs, FGPC and FGP Corp., collectively referred to as "First Gas" (see Notes 25, 26 and 35(c)), due to the lower dispatch requirements of the Parent Company from the First Gas' plants than the stipulated capacity levels under the covering power purchase agreements (see Note 35) for the period from 2002 to 2004 and 2006. There were no additional billings for unconsumed gas for 2005 and the period from 2007 to 2009.

In 2005, First Gas billed the Parent Company for a total of US$231 million (equivalent to 44 million Giga Joules in Gross Calorific Value (GJGCV), representing unconsumed gas for the years 2002-2004.

The Parent Company's obligations to pay for unconsumed gas were deferred until the resolution of the dispute between First Gas and the Gas Sellers (Shell Philippines Exploration B.V., Shell Philippines LLC, Texaco Philippines, Inc., and PNOC Exploration Corporation) under the Gas Sale and Purchase Agreements (GSPA) between First Gas and the Gas Sellers. On March 22, 2006, First Gas and the Gas Sellers signed settlement agreements that became effective on May 31, 2006. Payment obligations of First Gas under the settlement agreements were passed on to the Parent Company in accordance with its power purchase agreements with First Gas.

Under the terms of the settlement agreements, the total claim of US$231 million was reduced to US$148 million effective October 1, 2005, less a recognized credit on January 31, 2006 of US$13 million corresponding to gas consumption in excess of the take-or-pay quantities for 2005.

In 2006, the Parent Company received from First Gas provisional invoices representing the Gas Sellers' bill for the take-or-pay quantity which gas plants failed to consume in 2006 amounting to US$9.38 million. First Gas informed the Parent Company that it is formally disputing the aforementioned amount and that payment of such provisional invoices is not due until the dispute has been resolved. The dispute is currently in arbitration under the International Chamber of Commerce (ICC) Rules of Arbitration pursuant to the terms of the GSPA. First Gas' position is that First Gas plants actually consumed more than their respective take-or-pay quantities in 2006 as the Gas Sellers' calculation did not account for force majeure events. The Parent Company recognized the billing from First Gas for 2006 amounting to US$9.38 million (equivalent to ₱433 million in 2009, ₱446 million in 2008 and ₱387 million in 2007, shown as part of "Current portion of liability arising from deferred pass-through fuel costs" included under the "Trade and other payables" account in the consolidated and parent company statements of financial position). There was no additional billing for unconsumed gas in 2009, 2008 and 2007.

Based on the Payment Deferral Agreement between First Gas and the Gas Sellers, First Gas is allowed to consume the banked gas until 2014. Consumption of the banked gas requires that the First Gas plants exceed the required take-or-pay fuel volume for the current year and any gas consumption above the required volume is credited against the banked gas. Based on the latest operating data of the plants, the Parent Company believes that the banked gas will be consumed within the prescriptive period up to December 2014, allowed by the settlement agreements.

Deferred pass-through fuel costs, representing the remaining unconsumed gas, amounted to ₱3,161 million, ₱3,792 million and ₱4,896 million as of December 31, 2009, 2008 and 2007, respectively.

The non-current portion of the liability for unconsumed gas, amounting to ₱692 million as of December 31, 2007 is shown as "Liability arising from deferred pass-through fuel costs" account. There was no non-current portion of the liability as of December 31, 2009 and 2008. The current portions amounting to ₱433 million, ₱1,242 million and ₱2,043 million as of December 31, 2009, 2008 and 2007, respectively, are shown as part of "Trade and other payables" account in the consolidated and parent company statements of financial position (see Note 25).

**Other Non-current Assets**

| | | Consolidated | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | | *(Amounts in Millions)* | |
| Deferred input VAT *(see Notes 2 and 25)* | ₱4,467 | ₱4,789 | ₱3,801 |
| Unbilled receivables – net of current portion *(see Notes 2(II)(a) and 2(II) (d))* | 5,406 | 2,250 | 9,683 |
| SC GRAM case refund amount *(see Note 2(II)(b))* | 780 | 780 | 780 |
| Receivable from Bureau of Internal Revenue (BIR) – net of current portion *(see Note 34(a)(2))* | 577 | 577 | 577 |
| Goodwill | 363 | 363 | 363 |
| AFS investments *(see Note 31)* | 356 | 403 | 404 |
| Derivative assets – net of current portion of ₱11 million in 2009, ₱19 million in 2008 and ₱117 million in 2007 *(see Notes 17, 20, 30 and 31)* | 172 | 102 | 183 |
| Non-current trade receivables of a subsidiary *(see Note 15)* | 54 | 115 | 49 |
| Others | 1,187 | 614 | 373 |
| | ₱13,362 | ₱9,993 | ₱16,213 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| Deferred input VAT *(see Notes 2 and 25)* | ₱4,466 | ₱4,789 | ₱3,801 |
| Unbilled receivables – net of current portion *(see Note 2II(a))* | 5,406 | 2,250 | 9,683 |
| SC GRAM case refund amount *(see Note 2II(b))* | 780 | 780 | 780 |
| Receivable from BIR – net of current portion *(see Note 34(a)(2))* | 577 | 577 | 577 |
| AFS investments *(see Note 31)* | 98 | 146 | 146 |
| Derivative assets – net of current portion of ₱11 million in 2009, ₱19 million in 2008 and ₱83 million in 2007 *(see Notes 17, 30 and 31)* | 172 | 102 | 173 |
| Others | 701 | 453 | 289 |
| | ₱12,200 | ₱9,097 | ₱15,449 |

**a. Unbilled Receivables**

Unbilled receivables represents purchased power costs incurred by the Parent Company which will be billed over collection periods approved by the ERC. Based on these collection periods, the current and non-current portions of the unbilled generation cost are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Amounts in Millions) | | |
| Current ((shown as part of "Trade and other receivables – Unbilled" account *(see Note 15))* | ₱5,537 | ₱20,078 | ₱17,189 |
| Non-current | 6,186 | 3,030 | 10,463 |
| | ₱11,723 | ₱23,108 | ₱27,652 |

* *Includes the GRAM case refund amount of ₱780 million in 2009, 2008 and 2007.*

On June 7, 2007, the Joint Congressional Power Commission approved an amendment by the Department of Energy (DOE) of Section 3, Rule 4(e) of the IRR of EPIRA. The amendment exempted the adjustment of pass-through electric bill components from the jurisdictional and hearing requirements of the IRR. Soon after, the ERC lifted its September 1, 2006 Order and again allowed the Parent Company to automatically update the Generation and System Loss Charges beginning with the July 2007 bills to customers. This prevented a further accumulation of unbilled generation cost by the Parent Company.

**b. AFS Investments**

AFS investments in the consolidated statements of financial position mainly consist of investment in Rockwell Leisure Club, Inc. amounting to ₱242 million as of December 31, 2009 and ₱241 million as of December 31, 2008 and 2007. Other AFS investments are investments in other club shares which are at fair value and investments in common shares which are carried at cost less allowance for impairment. Unrealized fair value gains on AFS investments, net of tax effect, amounted to ₱71 million, ₱47 million and ₱68 million as of December 31, 2009, 2008 and 2007, respectively.

| | Consolidated | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| Quoted | ₱334 | ₱329 | ₱330 |
| Unquoted | 22 | 74 | 74 |
| | ₱356 | ₱403 | ₱404 |

| | Parent Company | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| Quoted | ₱79 | ₱75 | ₱75 |
| Unquoted | 19 | 71 | 71 |
| | ₱98 | ₱146 | ₱146 |

The quoted AFS investments represent club shares and are carried at fair value using published quoted prices by market makers. Fair value changes on the quoted AFS investments, net of tax effect, amounted to ₱24 million gain, ₱21 million loss and ₱25 million gain in 2009, 2008 and 2007, respectively, are shown in the consolidated statements of comprehensive income.

The unquoted AFS investments represent investments in common shares of unlisted companies. The fair values of the unquoted AFS investments are not determinable and accordingly, are carried at cost less allowance for impairment.

The Company recognized dividend income from investments in unquoted common shares amounting to ₱1 million, nil and ₱2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The Company has no listed AFS investments.

**14. CASH AND CASH EQUIVALENTS**

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Cash on hand and in banks | ₱6,399 | ₱3,601 | ₱2,641 |
| Cash equivalents | 10,669 | 1,801 | 2,235 |
| | ₱17,068 | ₱5,402 | ₱4,876 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Cash on hand and in banks | ₱5,244 | ₱2,861 | ₱2,067 |
| Cash equivalents | 10,186 | 1,162 | 1,995 |
| | ₱15,430 | ₱4,023 | ₱4,062 |

Cash in banks earn interest at prevailing bank deposit rates. Cash equivalents are short-term investments which are made for varying periods of between one and thirty days depending on the immediate cash requirements of the Company, and earn interest at the respective short-term investment rates.

**15. TRADE AND OTHER RECEIVABLES**

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Trade Receivables: | | | |
| Billed | | | |
| Residential | ₱5,337 | ₱5,779 | ₱7,588 |
| Commercial | 6,988 | 7,179 | 5,200 |
| Industrial | 2,469 | 3,491 | 2,930 |
| Flat streetlights | 452 | 421 | 60 |
| Unbilled *(see Notes 2II and 13)* | 5,537 | 20,078 | 17,189 |
| Trade receivables of subsidiaries – net of non-current portion of ₱54 million, ₱115 million and ₱49 million as of December 31, 2009, 2008 and 2007, respectively | 1,759 | 1,373 | 752 |
| Others *(see Note 26)* | 1,074 | 1,204 | 1,063 |
| | 23,616 | 39,525 | 34,782 |
| Less allowance for doubtful accounts | 2,322 | 2,019 | 1,376 |
| | ₱21,294 | ₱37,506 | ₱33,406 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| Trade Receivables: | | | |
| Billed | | | |
| Residential | ₱5,337 | ₱5,779 | ₱7,588 |
| Commercial | 6,988 | 7,179 | 5,200 |
| Industrial | 2,469 | 3,491 | 2,930 |
| Flat streetlights | 452 | 421 | 60 |
| Unbilled *(see Notes 2II(a) and 13)* | 5,537 | 20,078 | 17,189 |
| Others *(see Note 26)* | 1,293 | 1,699 | 1,429 |
| | 22,076 | 38,647 | 34,396 |
| Less allowance for doubtful accounts | 2,144 | 1,994 | 1,185 |
| | ₱19,932 | ₱36,653 | ₱33,211 |

Trade receivables of the Parent Company include charges for pass-through costs and distribution charges. Billed receivables are generally due ten days after bill date. Unbilled receivables represent pass-through costs incurred by the Parent Company that will be billed to customers in the succeeding months. The Parent Company's trade receivables are non-interest-bearing and are secured by bill deposits.

For terms and conditions relating to related party receivables, refer to Note 26.

Movements in allowance for doubtful accounts are as follows:

| | Consolidated 2009 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions *(see Note 28)* | Recoveries *(see Note 28)* | Write-Off | Ending |
| | (Amounts In Millions) | | | | |
| Billed trade receivables of Parent: | | | | | |
| Residential | ₱774 | ₱319 | (₱84) | (₱480) | ₱529 |
| Commercial | 608 | 478 | (8) | (71) | 1,007 |
| Industrial | 267 | 22 | (8) | (22) | 259 |
| Flat streetlights | 278 | 26 | (1) | (10) | 293 |
| | 1,927 | 845 | (101) | (583) | 2,088 |
| Other receivables | 92 | 148 | (6) | – | 234 |
| | ₱2,019 | ₱993 | (₱107) | (₱583) | ₱2,322 |

| | Consolidated 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Others | Total |
| | *(Amounts In Millions)* | | | | | |
| Individually impaired | ₱452 | ₱303 | ₱187 | ₱87 | ₱185 | ₱1,214 |
| Collectively impaired | 77 | 704 | 72 | 206 | 49 | 1,108 |
| Total | ₱529 | ₱1,007 | ₱259 | ₱293 | ₱234 | ₱2,322 |

| | Consolidated 2008 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions *(see Note 28)* | Recoveries *(see Note 28)* | Write-Off | Ending |
| | *(Amounts In Millions)* | | | | |
| Billed trade receivables of Parent: | | | | | |
| Residential | ₱317 | ₱1,061 | (₱75) | (₱529) | ₱774 |
| Commercial | 635 | 110 | (13) | (124) | 608 |
| Industrial | 161 | 197 | (4) | (87) | 267 |
| Flat streetlights | 9 | 277 | (1) | (7) | 278 |
| | 1,122 | 1,645 | (93) | (747) | 1,927 |
| Other receivables | 254 | 14 | – | (176) | 92 |
| | ₱1,376 | ₱1,659 | (₱93) | (₱923) | ₱2,019 |

| | Consolidated 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Others | Total |
| | *(Amounts In Millions)* | | | | | |
| Individually impaired | ₱661 | ₱183 | ₱193 | ₱83 | ₱– | ₱1,120 |
| Collectively impaired | 113 | 425 | 74 | 195 | 92 | 899 |
| Total | ₱774 | ₱608 | ₱267 | ₱278 | ₱92 | ₱2,019 |

| | Consolidated 2007 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions *(see Note 28)* | Recoveries *(see Note 28)* | Write-Off | Ending |
| | *(Amounts In Millions)* | | | | |
| Billed trade receivables of Parent: | | | | | |
| Residential | ₱272 | ₱339 | (₱94) | (₱200) | ₱317 |
| Commercial | 503 | 173 | (5) | (36) | 635 |
| Industrial | 167 | 99 | (4) | (101) | 161 |
| Flat streetlights | 12 | 3 | (1) | (5) | 9 |
| | 954 | 614 | (104) | (342) | 1,122 |
| Other receivables | 241 | 132 | (66) | (53) | 254 |
| | ₱1,195 | ₱746 | (₱170) | (₱395) | ₱1,376 |

| | Consolidated 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Others | Total |
| | *(Amounts In Millions)* | | | | | |
| Individually impaired | ₱271 | ₱191 | ₱116 | ₱3 | ₱– | ₱581 |
| Collectively impaired | 46 | 444 | 45 | 6 | 254 | 795 |
| Total | ₱317 | ₱635 | ₱161 | ₱9 | ₱254 | ₱1,376 |

| | Parent Company 2009 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions | Recoveries | Write-Off | Ending |
| | *(Amounts In Millions)* | | | | |
| Billed trade receivables of Parent | ₱1,927 | ₱743 | ₱101 | (₱683) | ₱2,088 |
| Related parties | 18 | 4 | – | (16) | 6 |
| Other receivables | 49 | 1 | – | – | 50 |
| | ₱1,994 | ₱748 | ₱101 | (₱699) | ₱2,144 |

| | Parent Company 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Related Parties | Others | Total |
| | *(Amounts In Millions)* | | | | | | |
| Individually impaired | ₱452 | ₱303 | ₱187 | ₱87 | ₱6 | ₱– | ₱1,035 |
| Collectively impaired | 77 | 704 | 72 | 206 | – | 50 | 1,109 |
| Total | ₱529 | ₱1,007 | ₱259 | ₱293 | ₱6 | ₱50 | ₱2,144 |

| | Parent Company 2008 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions | Recoveries | Write-Off | Ending |
| | *(Amounts In Millions)* | | | | |
| Billed trade receivables of Parent | ₱1,122 | ₱1,645 | (₱93) | (₱747) | ₱1,927 |
| Related parties | 14 | 5 | – | (1) | 18 |
| Other receivables | 49 | – | – | – | 49 |
| | ₱1,185 | ₱1,650 | (₱93) | (₱748) | ₱1,994 |

| | Parent Company 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Related Parties | Others | Total |
| | *(Amounts In Millions)* | | | | | | |
| Individually impaired | ₱661 | ₱183 | ₱193 | ₱83 | ₱18 | ₱– | ₱1,138 |
| Collectively impaired | 113 | 425 | 74 | 195 | – | 49 | 856 |
| Total | ₱774 | ₱608 | ₱267 | ₱278 | ₱18 | ₱49 | ₱1,994 |

| | Parent Company 2007 | | | | |
|---|---|---|---|---|---|
| | Beginning | Provisions | Recoveries | Write-Off | Ending |
| | *(Amounts In Millions)* | | | | |
| Billed trade receivables of Parent | ₱954 | ₱614 | (₱104) | (₱342) | ₱1,122 |
| Related parties | 168 | 5 | – | (159) | 14 |
| Other receivables | – | 49 | – | – | 49 |
| | ₱1,122 | ₱668 | (₱104) | (₱501) | ₱1,185 |

| | Parent Company 2007 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Residential | Commercial | Industrial | Flat Streetlights | Related Parties | Others | Total |
| | *(Amounts In Millions)* | | | | | | |
| Individually impaired | ₱271 | ₱191 | ₱116 | ₱3 | ₱14 | ₱– | ₱595 |
| Collectively impaired | 46 | 444 | 45 | 6 | – | 49 | 590 |
| Total | ₱317 | ₱635 | ₱161 | ₱9 | ₱14 | ₱49 | ₱1,185 |

## 16. INVENTORIES

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Materials and supplies – at net realizable value | ₱1,801 | ₱1,563 | ₱1,525 |
| Condominium units for sale – at cost | 56 | 85 | 13 |
| | ₱1,857 | ₱1,648 | ₱1,538 |

The cost of materials and supplies of the Company amounted to ₱1,862 million, ₱1,638 million and ₱1,680 million as of December 31, 2009, 2008 and 2007, respectively.

Materials and supplies of the Parent Company are carried at their net realizable values amounting to ₱1,751 million, ₱1,525 million and ₱1,491 million as of December 31, 2009, 2008 and 2007, respectively. The cost of materials and supplies amounted to ₱1,812 million, ₱1,600 million and ₱1,645 million as of December 31, 2009, 2008, and 2007, respectively.

## 17. OTHER CURRENT ASSETS

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Advance payments to suppliers | ₱1,197 | ₱957 | ₱37 |
| Creditable withholding tax | 515 | 652 | 360 |
| Prepaid income tax | 305 | – | – |
| Input VAT | 177 | 75 | – |
| Prepaid cost | 83 | 38 | – |
| Derivative assets *(see Notes 13, 20, 30 and 31)* | 11 | 19 | 117 |
| Prepaid creditable withholding taxes *(see Note 23)* | – | 431 | 1,037 |
| Tax credit certificates | – | 90 | 140 |
| Others | 182 | 3 | 279 |
| | ₱2,470 | ₱2,265 | ₱1,970 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| Creditable withholding taxes | ₱396 | ₱511 | ₱197 |
| Prepaid income tax | 305 | – | – |
| Derivative assets *(see Notes 13, 20, 30 and 31)* | 11 | 19 | 83 |
| Advance payments to suppliers | 13 | 26 | 37 |
| Prepaid creditable withholding taxes *(see Note 23)* | – | 431 | 1,037 |
| Others | 8 | 9 | 7 |
| | ₱733 | ₱996 | ₱1,361 |

Prepaid creditable withholding taxes represent remittances to the BIR in advance relative to the refund of Phase IV (see Note 23). These will be applied against the withholding tax due to the BIR upon actual refund of Phase IV. As of December 31, 2009, ₱431 million and ₱71 million have been remitted and applied, respectively.

## 18. EQUITY

### a. Common Stock

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Amounts in Millions) | | |
| Common stock – ₱10 par value | | | |
| Authorized – 1,250,000,000 shares | ₱12,500 | ₱12,500 | ₱12,500 |
| Issued – 1,127,270,820 shares in 2009, 1,103,768,012 shares in 2008 and 1,103,342,882 shares in 2007 | ₱11,273 | ₱11,038 | ₱11,033 |

Movement in common stock follows:

| | Number of Shares | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| Issued: | | | |
| Balance at beginning of year | 1,103,768,012 | 1,103,342,882 | 998,812,167 |
| Issuance of shares *(see Note 19)* | 23,502,808 | 425,130 | 104,530,715 |
| Balance at end of year | 1,127,270,820 | 1,103,768,012 | 1,103,342,882 |

On February 26, 2007, the BOD approved a resolution increasing the Parent Company's authorized capital stock from ₱13,800 million, consisting of 1,080 million common shares and 300 million preferred shares, both with par value of ₱10, to ₱15,500 million, consisting of 1,250 million common shares and 300 million preferred shares, both with par value of ₱10.

Also on February 26, 2007, the BOD approved a resolution removing the classification of the capital stock into Class "A" and Class "B" shares. The declassification of shares will effectively remove the restriction on the ownership of Class "A" shares by Filipino citizens, corporations or associations only and will make the shares available for subscription by foreigners.

On August 22, 2007, the SEC approved the Parent Company's application for an increase in authorized capital stock and the declassification of Class "A" and Class "B" shares effective September 3, 2007.

**b. Revaluation Increment in Utility Plant and Others and Share in Revaluation Increment of an Associate**

At the date of transition to PFRS on January 1, 2004, the Parent Company availed of one of the voluntary exemptions allowed under PFRS 1 and elected to measure items of "Utility plant and others" account at the deemed cost determined on January 1, 2004 which is broadly comparable to the fair value at the date of the revaluation. At the date of transition to IFRS on January 1, 2007, the Parent Company elected to use the deemed cost that was established under PFRS.

**c. Retained Earnings**

On December 18, 2006, the BOD resolved to present to the stockholders for approval in the forthcoming 2007 Stockholders' Meeting, a stock dividend equivalent to 10% of the outstanding capital stock of the Parent Company. For this purpose, the BOD likewise approved a resolution to transfer ₱1,000 million of the unappropriated retained earnings to appropriated retained earnings.

On May 21, 2007, the BOD declared a stock dividend equivalent to 10% of the Parent Company's outstanding common stock. For this purpose, the SEC approved on August 22, 2007 the issuance of 100,256,130 shares at the par value of ₱10 per share, amounting to ₱1,006 million, to common shareholders as of record date on September 10, 2007.

On March 17, 2008, the BOD approved the dividend policy that, "As a public utility, it is the Parent Company's policy to annually declare dividends out of its unrestricted retained earnings taking into account operating results, cash flows, debt covenants, capital expenditure levels, and liquidity. The BOD shall determine, by resolution, the exact amount, date and shareholders entitled to such dividend."

On the same date, the BOD likewise approved the declaration of cash dividends to common shareholders of record as of April 16, 2008 at the rate of ₱0.50 per share payable on May 13, 2008. Another tranche of cash dividends was approved to common shareholders of record as of September 25, 2008 at the rate of ₱0.5025 per common share. The cash dividends were paid on October 21, 2008. Total cash dividends declared and paid in 2008 amounted to ₱1,103 million.

On December 15, 2008, the BOD approved the appropriation of unrestricted retained earnings amounting to ₱4,198 million for contingencies.

On May 26, 2009, the BOD approved the declaration of a cash dividends of ₱1.00 per share to all common shareholders of record as of June 9, 2009. On October 29, 2009, the BOD declared cash dividends of ₱1.50 per share to all common shareholders of record as of November 13, 2009. The total cash dividends declared and paid in 2009 amounted to ₱2,695 million.

On February 22, 2010, the BOD approved the reversal of appropriated retained earnings of ₱4,198 million as of December 31, 2008 previously appropriated for contingencies related to under-recoveries, which have been subsequently approved by the ERC. At the same time, the BOD approved the appropriation of ₱6,000 million out of the balance of the Parent Company's unrestricted retained earnings as of December 31, 2009 for planned business expansion.

Further, the BOD approved the revised dividend policy of declaring regular dividends equivalent to 50% of core earnings which may be supplemented by special dividends on a "look-back" basis.

**d. Parent Company statement of changes in equity**

The movements in the statements of changes in equity of the Parent Company for the years ended December 31, 2009, 2008 and 2007 follow:

| | Common Stock *(Note 18)* | Subscription Receivable *(Note 19)* | Additional Paid-in Capital | Employee Share-Based Payment Plan *(Note 19)* | Available-for-Sale Reserves *(Note 13)* | Revaluation Increment in Utility Plant and Others *(Note 18)* | Unappropriated Retained Earnings (Deficit) *(Note 18)* | Appropriated Retained Earnings *(Note 18)* | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | *(Amounts in Millions)* | | | | |
| At January 1, 2009, PFRS | ₱11,038 | ₱– | ₱2,932 | ₱268 | ₱57 | ₱19,765 | ₱11,636 | ₱4,198 | ₱49,894 |
| Adoption of IFRS | – | – | – | – | – | (332) | (39) | – | (371) |
| At January 1, 2009, as remeasured | 11,038 | – | 2,932 | 268 | 57 | 19,433 | 11,597 | 4,198 | 49,523 |
| Net income | – | – | – | – | – | – | 6,290 | – | 6,290 |
| Other comprehensive income | – | – | – | – | 5 | 38 | – | – | 43 |
| Total comprehensive income | – | – | – | – | 5 | 38 | 6,290 | – | 6,333 |
| Depreciation on appraisal increase transferred to unappropriated retained earnings | – | – | – | – | – | (532) | 532 | – | – |
| Share-based payments | – | – | – | (153) | – | – | – | – | (153) |
| Issuance of shares | 235 | (960) | 1,634 | – | – | – | – | – | 909 |
| Dividends and others | – | – | – | – | – | – | (2,705) | – | (2,705) |
| | 235 | (960) | 1,634 | (153) | 5 | (494) | 4,117 | – | 4,384 |
| At December 31, 2009 | ₱11,273 | (₱960) | ₱4,566 | ₱115 | ₱62 | ₱18,939 | ₱15,714 | ₱4,198 | ₱53,907 |
| At January 1, 2008, PFRS | ₱11,033 | ₱– | ₱2,931 | ₱152 | ₱57 | ₱20,131 | ₱14,299 | ₱200 | ₱48,803 |
| Adoption of IFRS | – | – | – | – | – | (310) | (990) | – | (1,300) |
| At January 1, 2008, as remeasured | 11,033 | – | 2,931 | 152 | 57 | 19,821 | 13,309 | 200 | 47,503 |
| Net income | – | – | – | – | – | – | 3,015 | – | 3,015 |
| Other comprehensive income | – | – | – | – | – | – | – | – | – |
| Total comprehensive income | – | – | – | – | – | – | 3,015 | – | 3,015 |
| Depreciation on appraisal increase transferred to unappropriated retained earnings | – | – | – | – | – | (388) | 388 | – | – |
| Share-based payments | – | – | – | 116 | – | – | – | – | 116 |
| Issuance of shares | 5 | – | 1 | – | – | – | – | – | 6 |
| Dividends and others | – | – | – | – | – | – | (1,117) | – | (1,117) |
| Appropriation for generation cost under recoveries | – | – | – | – | – | – | (4,198) | 4,198 | – |
| Reversal of appropriation | – | – | – | – | – | – | 200 | (200) | – |
| | 5 | – | 1 | 116 | – | (388) | (1,712) | 3,998 | 2,020 |
| At December 31, 2008 | ₱11,038 | ₱– | ₱2,932 | ₱268 | ₱57 | ₱19,433 | ₱11,597 | ₱4,198 | ₱49,523 |

| | Common Stock *(Note 18)* | Subscription Receivable *(Note 19)* | Additional Paid-in Capital | Employee Share-Based Payment Plan *(Note 19)* | Available-for-Sale Reserves *(Note 13)* | Revaluation Increment in Utility Plant and Others *(Note 18)* | Unappropriated Retained Earnings (Deficit) *(Note 18)* | Appropriated Retained Earnings *(Note 18)* | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | *(Amounts in Millions)* | | | | |
| At January 1, 2007, PFRS | ₱9,988 | ₱– | ₱2,918 | ₱79 | ₱39 | ₱20,545 | ₱10,285 | ₱1,200 | ₱45,054 |
| Adoption of IFRS | – | – | – | – | – | (311) | (6,869) | – | (7,180) |
| At January 1, 2007, as remeasured | 9,988 | – | 2,918 | 79 | 39 | 20,234 | 3,416 | 1,200 | 37,874 |
| Net income | – | – | – | – | – | – | 9,486 | – | 9,486 |
| Other comprehensive income | – | – | – | – | 18 | – | – | – | 18 |
| Total comprehensive income | – | – | – | – | 18 | – | 9,486 | – | 9,504 |
| Depreciation on appraisal increase transferred to unappropriated retained earnings | – | – | – | – | – | (413) | 413 | – | – |
| Share-based payments | – | – | – | 73 | – | – | – | – | 73 |
| Issuance of shares | 1,045 | – | 13 | – | – | – | – | – | 1,058 |
| Dividends and others | – | – | – | – | – | – | (6) | (1,000) | (1,006) |
| | 1,045 | – | 13 | 73 | 18 | (413) | 9,893 | (1,000) | 9,629 |
| At December 31, 2007 | ₱11,033 | ₱– | ₱2,931 | ₱152 | ₱57 | ₱19,821 | ₱13,309 | ₱200 | ₱47,503 |

## 19. SHARE-BASED PAYMENT PLAN

The Parent Company's Share-Based Payment Plan (Plan) entitles regular employees of the Parent Company and its subsidiaries and retirees of the Parent Company to purchase shares of common stock of the Parent Company during the offering period at a stated purchase price, with payment and other terms to be defined at the time of offering in accordance with the Plan. The purchase price per share shall not be less than 80% of the weighted average daily closing market price at the PSE during a 30day calendar period that ends two weeks before the start of the offering period. The terms of the Plan include, among others, a two to three-year holding period of the purchased shares and an option to cancel the purchase prior to full payment of the purchase price. It has been the policy of the Parent Company to re-offer cancelled shares to qualified participants in subsequent offerings.

The outstanding share-based payment plans in 2009 consist of the 13th Employee Stock Purchase Plan (ESPP), the 13th-A ESPP and the 14th ESPP.

The primary terms of the grants are as follows:

| | **12th** | **13th** | **13th-A** | **14th** |
|---|---|---|---|---|
| Participants | All regular employees and retirees of the Company | Regular employees of the Company, including probationary employees qualified for regular employment as of April 1, 2007 | All newly-hired employees starting May 1, 2007 until December 2008 who remain active as of January 2009 | Regular and probationary employees of the Company, including retirees |
| Grant date | December 31, 2003 | April 30, 2007 | January 07, 2009 | April 28, 2009 |
| Offer price per share | ₱13.00 | ₱62.00 | ₱51.00 | ₱74.00 |
| Offering period | December 16 to 31, 2007 | May 16 to 31, 2007 | January 16 to 30, 2009 | May 16 to 31, 2009 |
| Payment period | 5 years starting in March 2004 | 5 years starting in August 2007 | 5 years starting in April 2009 | 5 years starting in October 2009 |
| Vesting date | February 28, 2007 | July 31, 2010 (accelerated to July 31, 2009) | March 30, 2012 | September 30, 2012 |
| Number of shares subscribed | 8.5 million | 7.3 million | 0.4 million | 12.5 million |
| Option value per share | ₱10.71 | ₱51.06 | ₱26.26 | ₱46.99 |

The fair value of the equity-settled share options granted are estimated as at the dates of the grant using the Black-Scholes Option Model, taking into account the terms and conditions upon which the options were granted. Below are the inputs to the models used for each of the grants:

| | 12th | 13th | 13th-A | 14th |
|---|---|---|---|---|
| Historical volatility (%) | 50.00 | 52.62 | 46.77 | 50.99 |
| Weighted average share price on grant date | 18.70 | 62.00 | 51.00 | 74.00 |
| Risk-free interest rate (%) | 10.28 | 4.67 | 5.60 | 5.77 |
| Expected life of option (years) | 3.17 | 3.17 | 3.22 | 3.43 |
| Dividend yield (%) | – | – | – | – |

The expected life of the awards is based on the vesting period. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome. No other features of options grant were incorporated into the measurement of fair value.

Movements in shares subscribed under each of the grants are as follows:

| | | | 2009 | | |
|---|---|---|---|---|---|
| | 12th | 13th | 13th-A | 14th | Total |
| Outstanding at beginning of year | 2,789,031 | 6,978,620 | – | – | 9,767,651 |
| Subscribed | – | – | 419,453 | 12,448,838 | 12,868,291 |
| Cancelled | – | (58,399) | (12,316) | (31,844) | (102,559) |
| Redeemed | (2,789,031) | (5,008,902) | – | – | (7,797,933) |
| Outstanding at end of year | – | 1,911,319 | 407,137 | 12,416,994 | 14,735,450 |

| | | | 2008 | | |
|---|---|---|---|---|---|
| | 12th | 13th | 13th-A | 14th | Total |
| Outstanding at beginning of year | 3,170,060 | 7,212,477 | – | – | 10,382,537 |
| Subscribed | – | – | – | – | – |
| Cancelled | – | (232,263) | – | – | (232,263) |
| Redeemed | (381,029) | (1,594) | – | – | (382,623) |
| Outstanding at end of year | 2,789,031 | 6,978,620 | – | – | 9,767,651 |

| | | | 2007 | | |
|---|---|---|---|---|---|
| | 12th | 13th | 13th-A | 14th | Total |
| Outstanding at beginning of year | 7,439,008 | 7,265,048 | – | – | 14,704,056 |
| Redeemed | (4,256,411) | (52,571) | – | – | (4,308,982) |
| Cancelled | (12,537) | – | – | – | (12,537) |
| Outstanding at end of year | 3,170,060 | 7,212,477 | – | – | 10,382,537 |

In July 2009, the BOD ratified the resolution of the Board of Administrators of the ESPP to shorten the vesting period of the 13th grant to two years. This resulted in the acceleration of the recognition of the cost of the grant. The total expense arising from the share-based payment plan amounted to ₱301 million in 2009, ₱116 million in 2008 and ₱73 million in 2007 (see Note 28).

## 20. INTEREST-BEARING LOANS AND OTHER BORROWINGS

The details, terms and maturities of the Company's interest-bearing loans and other borrowings including the value of the embedded call option are as follows:

| | | Consolidated | | | |
|---|---|---|---|---|---|
| | Interest Rate (%) | Maturity | 2009 | 2008 | 2007 |
| | | | *(Amounts In Millions)* | | |
| **Parent Company** | | | | | |
| Philippine Peso loan payable in quarterly installments evidenced by fixed rate corporate notes* | 9% | 2013 | ₱5,127 | ₱5,633 | ₱6,140 |
| Philippine Peso loan payable in annual installments evidenced by floating rate corporate notes | 3-month PDST-F plus 1.1% | 2015 | 3,900 | – | – |
| Philippine Peso loan payable in semi-annual installments evidenced by floating rate corporate notes | 6-month PDST-F plus 1.5% | 2014 | 3,000 | – | – |
| Philippine Peso loan payable in annual installments evidenced by fixed rate corporate notes | 8.7865% | 2014 | 2,715 | – | – |
| Philippine Peso loan evidenced by fixed rate corporate notes | 7.4683% | 2014 | 1,600 | – | – |
| Philippine Peso loans payable to government entities payable in quarterly installments | 3.5% | 2011 | 1 | 2 | 3 |
| Philippine Peso loan payable in quarterly installments evidenced by floating rate corporate notes | 3-month PDST-F plus 2% | 2013 | – | 5,520 | 6,000 |
| Euro availment under the Master Credit Agreement payable in equal semi-annual installments | 5.56% | 2010 | 35 | 71 | 98 |
| CHF availment under the Master Credit Agreement payable in equal semi-annual installments | 6 month LIBOR plus 0.7% | 2010 | 19 | 38 | 48 |
| US dollar availment under the Master Credit Agreement payable in semi-annual installments | 6 month LIBOR plus 0.65% | 2009 | – | 22 | 58 |
| | | | 16,397 | 11,286 | 12,347 |

| | Interest Rate (%) | Maturity | Consolidated 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| | | | *(Amounts In Millions)* | | |
| **Rockwell – Secured by Rockwell Assets** (see *Note 8*) | | | | | |
| Corporate notes | 8.8% fixed in 2009, 8.5% fixed in 2008 and 8.2% fixed in 2007 | 2009-2014 | 1,860 | 2,000 | 1,000 |
| Loans from various local banks: | | | | | |
| Peso Denominated | 3-month PDST-F plus 2%; 1-yr PDST-F plus 2.25% | 2011-2014 | 1,060 | 398 | 521 |
| US Dollar-Denominated | 3-month LIBOR plus 2% | 2009 | – | 91 | 236 |
| | | | 2,920 | 2,489 | 1,757 |
| Total long-term debt (a) | | | 19,317 | 13,775 | 14,104 |
| Less unamortized debt issuance costs (b) | | | 123 | 80 | 91 |
| | | | 19,194 | 13,695 | 14,013 |
| Preferred stock (c) | | | 960 | 1,798 | 2,278 |
| | | | 20,154 | 15,493 | 16,291 |
| Less current portion | | | 2,920 | 2,265 | 2,122 |
| | | | ₱17,234 | ₱13,228 | ₱14,169 |

* *Includes the value of embedded call option*

| | Parent Company 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Interest-bearing loans and other borrowings (a) | ₱16,397 | ₱11,286 | ₱12,347 |
| Less unamortized debt issuance costs | 113 | 67 | 83 |
| | 16,284 | 11,219 | 12,264 |
| Preferred stock (c) | 960 | 1,798 | 2,278 |
| | 17,244 | 13,017 | 14,542 |
| Less current portion | 2,159 | 1,636 | 1,514 |
| | ₱15,085 | ₱11,381 | ₱13,028 |

**a. Long-term Debt**

• *Parent Company*

In January 2009, the Parent Company entered into a Note Facility Agreement for the issuance of 2,715 million fixed rate notes with final maturity in January 2014 The fixed rate notes carry an interest rate of 8.7865%.

On October 2, 2009, the Parent Company signed a ₱3,000 million, 5-year bilateral term agreement with a local bank. The loan was fully drawn on October 5, 2009 and will mature in October 2014. The loan is repriced on a semi-annual basis at a rate of 6-month PDST-F plus 1.5%.

On December 9, 2009, the Parent Company signed a ₱5,500 million Note Facility Agreement for the issuance of fixed and floating rate notes. The ₱1,600 million in fixed rate notes carry an interest rate of 7.4683% and will mature in 2014 while the ₱3,900 million floating rate notes are repriced quarterly based on 3-month PDST-F plus 1.1% and will mature in 2015.

The Parent Company's current loan agreements contain restrictions with respect to, among others, payments of dividends subject to certain conditions; disposition of a significant portion of the Parent Company's assets; incurrence of additional borrowings; and maintenance of certain financial ratios. As of December 31, 2009, 2008 and 2007, the Parent Company has met these loan covenants.

The Parent Company has an embedded call option (prepayment option) in its ₱6,000 million 9% Tranche A fixed rate corporate notes which gives the Parent Company the right to redeem all or a part of any of the outstanding notes at an amount equivalent to 105% of the outstanding principal amount on any interest payment starting at the end of the second year from the issue date.

The estimated schedule of repayments of long-term debt of the Parent Company, excluding the value of the embedded call option, is as follows:

| | Amount in Original Currency | | | Total |
|---|---|---|---|---|
| | | Swiss | Philippine | Peso |
| Year | Euro | Franc | Pesos | Equivalent |
| | *(Amounts in Millions)* | | | |
| 2010 | €0.54 | CHF 0.44 | ₱1,469 | ₱1,524 |
| 2011 | – | – | 1,469 | 1,469 |
| 2012 | – | – | 1,469 | 1,469 |
| 2013 | – | – | 4,587 | 4,587 |
| 2014 | – | – | 3,946 | 3,946 |
| 2015 | – | – | 3,315 | 3,315 |
| | €0.54 | CHF 0.44 | ₱16,255 | ₱16,310 |
| In peso equivalent | ₱36 | ₱19 | ₱16,255 | ₱16,310 |

- *Rockwell*

On July 19, 2007, Rockwell entered into a Fixed Rate Corporate Notes Facility Agreement ("the Agreement") with First Metro Investment and Philippine Commercial Capital, Inc. (Joint Issue Managers and Lead Underwriters), Metropolitan Bank and Trust Company – Trust Banking Group (Facility Agent and Collateral Trustee), and Philippine Commercial Capital, Inc. – Trust and Investment Group (Paying Agent) for ₱2,000 million fixed rate corporate notes ("the Notes") for the purpose of financing the development of the BPO Building to be located in the Meralco compound (see Note 10). The Notes comprised of Tranche 1 and Tranche 2, each amounting to ₱1,000 million. Tranche 1 was availed of in August 2007. Tranche 2 was availed of on February 28, 2008 and July 30, 2008, each amounting to ₱500 million. The corporate note amounting to ₱1,400 million of the Notes is payable in twenty quarterly payments starting August 2009 and the ₱600 million balance is payable lumpsum at maturity in August 2014.

Interest is fixed up to maturity at 75 bps over the seven-year PDST-F, grossed-up for Gross Receipts Tax.

The Agreement contains provisions regarding the maintenance of certain financial ratios such as the debt service coverage ratio and debt-to-equity ratio. As of December 31, 2009, 2008 and 2007, Rockwell has complied with these ratios.

**Loans from Various Local Banks and Financial Institutions**

*Peso-denominated*. As of December 31, 2009, Peso denominated loans from various local banks and financial institutions consisted of bridge facilities mostly payable by the end of 2011 and a term loan payable by December 2014. This consisted of bridge facilities fully paid in June 2009 and a term loan that was fully settled in August 2009.

*US Dollar-denominated*. As of December 31, 2008, outstanding US dollar-denominated loans amounting to US$1.9 million are payable in two quarterly payments and was fully paid in April 2009.

All interest-bearing loans and borrowings outstanding as of December 31, 2009, 2008 and 2007 are secured by the assignment of One Rockwell and Joya receivables recognized under PFRS with gross undiscounted amounts of ₱912 million, ₱364 million and ₱342 million, respectively and Mortgage Participation Certificates amounting to ₱2,000 million, ₱2,500 million and ₱1,500 million, respectively, on a Mortgage Trust Indenture and its amendments and supplements over the Power Plant Mall.

The repayments of the loans based on existing terms are scheduled as follows:

| | **Amounts in Millions** |
|---|---|
| 2010 | ₱761 |
| 2011 | 764 |
| 2012 | 310 |
| 2013 and after | 1,085 |
| | ₱2,920 |

The total interest payable for all bank loans and other loans repayable within five years amounted to ₱170 million, ₱201 million and ₱80 million as of December 31, 2009, 2008 and 2007, respectively.

b. As of December 31, 2009, 2008 and 2007, the balance of unamortized debt issuance costs, relating to the long-term debt, amounted to ₱123 million, 80 million and ₱91 million, respectively, and has been deferred and reflected as a reduction in the amount of debt.

Movements in unamortized debt issuance costs related to the long-term debt are as follow:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Balance at beginning of year | ₱80 | ₱91 | ₱104 |
| Additions during the year | 97 | 7 | 8 |
| | 177 | 98 | 112 |
| Less amortization during the year (see Note 28) | 54 | 18 | 21 |
| Balance at end of year | ₱123 | ₱80 | ₱91 |

c. Redeemable, Non-convertible Preferred Shares

Preferred stock, with a par value of ₱10, is non-participating, non-convertible and, like common stock, has no pre-emptive right to subscribe to any or all issues or other disposition of preferred stock. Preferred stock is also non-voting, except in those cases expressly provided by law. Preferred stockholders are entitled to cumulative preferential dividends not exceeding 20% a year, payable at such interval as may be determined by the BOD. As provided for in the Articles of Incorporation of the Parent Company, redeemed shares are not considered retired and may be reissued.

Preferred stock should be issued serially in blocks of not less than 100,000 shares. Shares of preferred stock comprising one series shall have the same rights and restrictions.

Series B preferred stock is redeemable five years from the date of issue at the option of the Parent Company or holder upon 90 days' notice. In cases where a service application would require extension or new distribution facilities, the "Terms and Conditions of Service" of the Parent Company, which was approved by the then Energy Regulatory Board (ERB), requires applicants for electric service to subscribe preferred stock with 10% dividend a year to cover the costs. The Parent Company ceased requiring the customers to subscribe to preferred shares effective April 8, 2005. This has since been amended by the Magna Carta for Residential Electricity Consumers (Magna Carta) and the Distribution Services Open Access Rules (DSOAR), which allows the customers to purchase preferred shares of the utility only when the same is available.

As of December 31, 2009, 2008 and 2007, dividend cheques of certain preferred stockholders remained outstanding with cumulative amount approximates ₱288 million, ₱307 million and ₱411 million, respectively. These are shown as part of "Trade and other payables" account in the consolidated and parent company statements of financial position (see Note 25).

Movement of preferred stock follows:

| | Number of Shares | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| Balance at beginning of year | 266,364,384 | 243,415,560 | 251,911,810 |
| Redemption of shares | (55,435,729) | (19,447,517) | (8,496,250) |
| Reclassification | – | 42,396,341 | – |
| Balance at end of year | 210,928,655 | 266,364,384 | 243,415,560 |

Interest expense on interest-bearing loans and borrowings in 2009, 2008 and 2007 amounted to ₱1,365 million, ₱1,237 million and ₱1,183 million, respectively (see Note 28).

## 21. CUSTOMERS' DEPOSITS

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Meter deposits | ₱1,389 | ₱1,538 | ₱1,578 |
| Accrued interest on meter deposits | 1,272 | 1,341 | 1,296 |
| | 2,661 | 2,879 | 2,874 |
| Less current portion *(see Note 25)* | 1,372 | 457 | 237 |
| | 1,289 | 2,422 | 2,637 |
| Bill deposits | 15,774 | 14,448 | 13,060 |
| Accrued interest on bill deposits | 8,685 | 7,733 | 6,981 |
| | 24,459 | 22,181 | 20,041 |
| Less current portion *(see Note 25)* | 685 | 1,160 | 1,255 |
| | 23,774 | 21,021 | 18,786 |
| | ₱25,063 | ₱23,443 | ₱21,423 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Meter deposits | ₱1,389 | ₱1,538 | ₱1,578 |
| Accrued interest on meter deposits | 1,272 | 1,341 | 1,296 |
| | 2,661 | 2,879 | 2,874 |
| Less current portion *(see Note 25)* | 1,372 | 457 | 237 |
| | 1,289 | 2,422 | 2,637 |
| Bill deposits | 15,662 | 14,344 | 12,958 |
| Accrued interest on bill deposits | 8,660 | 7,713 | 6,960 |
| | 24,322 | 22,057 | 19,918 |
| Less current portion *(see Note 25)* | 684 | 1,158 | 1,255 |
| | 23,638 | 20,899 | 18,663 |
| | ₱24,927 | ₱23,321 | ₱21,300 |

**Meter Deposits**

Meter deposits are intended to guarantee the provision of metering equipment.

On June 17, 2004, the ERC issued the Magna Carta for Residential Customers. The Guidelines to implement Articles 7, 8, 14 and 28 of the Magna Carta were issued on October 27, 2004. Under the Magna Carta, residential customers are now exempt from the payment of meter deposits. Prior to the effectivity of Magna Carta, meter deposits covered 50% of the cost of the metering equipment.

On January 18, 2006, the DSOAR was issued by the ERC. Under the DSOAR, non-residential customers are now also exempt from the payment of meter deposits.

On June 4, 2008, the ERC released its Resolution No. 8, Series of 2008, approving the "Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers." These were finalized after the ERC's deliberation of the draft rules and the completion of a public consultation on March 26, 2008. The rules aim to provide the DUs with parameters for the refund of meter deposits and interests. The related accrued interest on meter deposits was updated based on this ruling.

Among the salient features of the rules are:

a. Start of Refund – The refund will commence not later than six (6) months upon effectivity of the rules.

b. Duration of Refund Period – The refund should be completed not longer than sixty-six (66) months from the effectivity of the rules.

c. Mode of Refund – The customer has the option of to receive the his refund through cash, credit to his future monthly billings, or to receive it as an offset to other due and demandable claims that the private utilities may have against him.

d. Amount of Interest

*Residential Customers*

- For those paying meter deposits before effectivity of Resolution No. 95-21 or September 22, 1995:
  - From date of payment to date prior to September 22, 1995 — 6%
  - From September 22, 1995 to date prior to the effectivity of the Guidelines to Implement Articles 7, 8, 14 and 28 of the Magna Carta — 10%
  - From effectivity of the Magna Carta Guidelines to the start of refund — 6%

- For those paying meter deposits on or after September 22, 1995 — 10%

*Non-residential Customers*

- For those paying meter deposits before September 22, 1995:
  - From date of payment to date prior to September 22, 1995 — 6%
  - From September 22, 1995 to date prior to the effectivity of DSOAR — 10%
  - From effectivity of DSOAR until date prior to the start of refund — 6%

- For those paying meter deposit on or after September 22, 1995 — 10%

The rules were published on June 20, 2008 in a newspaper of general circulation and took effect fifteen (15) days after or on July 5, 2008.

On August 8, 2008, in compliance with ERC Resolution No. 8, the Parent Company submitted to the ERC an accounting of the total meter deposit principal amount for refund which as of June 30, 2008 was at ₱1,507 million. The actual refund of meter deposits commenced on November 3, 2008.

For the year ended December 31, 2009 and 2008, the Parent Company refunded ₱387 million and ₱309 million in principal and interests, respectively.

**Bill Deposits**

Bill deposits serve to guarantee payment of bills by a customer which is estimated to equal one month's consumption or bill of the customer.

Both the Magna Carta and DSOAR also provide that residential and non-residential customers, respectively, must pay a bill deposit to guarantee payment of bills equivalent to their estimated monthly billing. The amount of deposit shall be adjusted after one year to approximate the actual average monthly bills. A customer who has paid his electric bills on or before due date for three consecutive years, may now apply for the full refund of the bill deposit, together with the accrued interest, prior to the termination of electric supply; otherwise, bill deposits and accrued interest shall be refunded within one month from termination of electric supply, provided all bills have been paid.

With regard to the interest rate on customer deposits, while the Implementing Guidelines of the Magna Carta provided that the interest rate on meter deposits shall be at 6% for contracts of service entered into prior to the effectivity of the ERB Resolution No. 95-21, it was silent on the corresponding interest rate for bill deposits of residential customers for the same period. ERB Resolution No. 95-21 was issued by the then ERB on August 3, 1995 allowing a 10% interest on customers' deposits. The Parent Company's legal counsel opined that the same interest rate of 6% should apply to bill deposits as such rate was agreed upon in the service contract. Pursuant to the Magna Carta, the rate of interest on bill deposits shall be equivalent to the interest incorporated in the WACC, otherwise, the rate shall be based on the prevailing interest rate on savings deposit as approved by the Bangko Sentral ng Pilipinas (BSP). In the case of non-residential customers, the DSOAR likewise provides that the Parent Company shall pay interest on bill deposits at the rate equivalent to the prevailing interest rate for savings deposits as approved by the BSP.

The DSOAR superseded ERB Resolution No. 95 21, as amended, in its entirety. In the letter of the ERC to the Parent Company dated November 3, 2006, it was clarified that the "currently prevailing interest rate for savings deposits is one percent (1%) since this is the interest rate used by two of the largest commercial banks and Land Bank of the Philippines, as government bank." The Parent Company wrote a letter to ERC on January 24, 2007 clarifying the Parent Company's interpretation of the rules and regulations issued by the ERC, to mean that customers, whether residential or non-residential, with contracts of service executed prior to the effectivity of the DSOAR, can earn interest for both meter and bill deposits, at the rate of 6% or 10% depending on contract effectivity. Further, in the case of bill deposits, the rate of interest becomes 10% as incorporated in the Parent Company's WACC, starting from June 2003 effectivity of the Parent Company's unbundling decision as approved by the ERC.

With respect to contracts of service executed by non-residential customers on or after the effectivity of DSOAR, the 1% interest rate for bill deposits applies, while in the case of residential customers, the residential customers shall continue to be entitled to 10% interest rate, as incorporated in the Parent Company's WACC, in accordance with the provisions of the Magna Carta, until such time that a new WACC is put in place where bill deposits are no longer incorporated.

The Parent Company believes that the foregoing interpretation is consistent with law and in harmony with the ERC's own interpretation as embodied in the Implementing Guidelines of the Magna Carta, considering that the same principle of law applies to meter and bill deposits.

In response to the Parent Company's letter dated January 24, 2007, the ERC, in its letter in April 2007, said that the interest rate on bill and meter deposits of residential customers shall be governed by the Magna Carta for Residential Electricity Consumers and its Implementing Guidelines while the interest rate for the bill deposits of non-residential customers shall be either 10% or 1% depending on the date of contract effectivity.

With respect to the interest rate on bill deposits of non-residential customers, the ERC has maintained that the interest rate of 6% should be raised to 10%, regardless of contract date, upon effectivity of ERB Resolution No. 95-21 in September 1995. The Parent Company, without necessarily conceding its position, argued that the same principle should be applied upon the effectivity of DSOAR, in as much as the ERC has retained the 10% interest rate, for the contract date before the Parent Company's unbundling decision, even after the DSOAR effectivity. Further, the Parent Company emphasized that the DSOAR has already reduced the interest rate from 10% to 1%, which is the prevailing interest rate of savings deposit. Conformably therewith, the Parent Company posits that the interest rate on bill deposits should be reduced from 10% to 1% upon the effectivity of DSOAR, for contracts dates prior to the Parent Company's unbundling decision.

The Parent Company strongly believes that certain legal impediments and inconsistencies with previous pronouncements of the ERC on the issue of interest on bill deposits still exist. Hence, the Parent Company believes that rules similar to those applied to meter deposits must be put in place by the ERC to apply to bill deposits. In the meantime, the Parent Company will follow the same principles adopted by the ERC in the Rules to Govern the Refund of Meter Deposits, insofar as the computation of interest for bill deposits is concerned. Accordingly, the Parent Company has computed the interest on bill deposits using the rates of interest as follows:

*Residential Customers*

- For those paying bill deposits before effectivity of Res. 95-21 or September 22, 1995:
  - From date of payment to date prior to September 22, 1995 — 6%
  - From September 22, 1995 to date prior to the refund — 10%

- For those paying bill deposits on or after September 22, 1995 — 10%

*Non-residential Customers*

- For those paying bill deposit before effectivity of Res. 95-21 or September 22, 1995:
  - From date of payment to date prior to September 22, 1995 — 6%
  - From September 22, 1995 to date prior to the effectivity of DSOAR — 10%
  - From effectivity of DSOAR until the date prior to the refund — 1%

- For those paying bill deposits on or after September 22, 1995:
  - From September 22, 1995 to date prior to the effectivity of the DSOAR — 10%
  - From effectivity of DSOAR until the day prior to the refund — 1%

- For those paying Bill Deposit on or after effectivity of DSOAR — 1%

The above interest rates shall be subject to change to conform to the final interest rates that may be determined by the ERC upon its promulgation of separate rules or guidelines to govern the refund of bill deposits.

Interests on meter and bill deposits are determined using the simple interest computation method. There is no expressed stipulation in its "Terms and Conditions of Service" that the interest due and unpaid shall be added to the principal and shall earn new interest; consequently, the interest on meter and bill deposits of the customers cannot be compounded, consistent with the law and jurisprudence on the matter. This is supported by the opinion of the Parent Company's external legal counsel.

Meter and bill deposits and related accrued interest which are currently being refunded, based on historical experience and the relevant ERC guidelines, are shown separately as part of "Trade and other payables" account in the consolidated and parent company statements of financial position (see Note 25).

## 22. PROVISIONS

Movements during the year are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Provisions for various claims against the Parent Company *(see Note 34)*: | | | |
| Balance at beginning of year | ₱1,645 | ₱1,396 | ₱1,724 |
| Provisions during the year | 3,351 | 318 | 400 |
| Settlement during the year | (18) | (69) | – |
| Reversals during the year | – | – | (728) |
| Balance at end of year | 4,978 | 1,645 | 1,396 |
| Provisions for probable losses and refund *(see Note 34)* | | | |
| Balance at beginning of year | 4,098 | – | – |
| Provisions during the year | 3,333 | 4,098 | – |
| Settlement during the year | (4,917) | – | – |
| Balance at end of year | 2,514 | 4,098 | – |
| | ₱7,492 | ₱5,743 | ₱1,396 |

## 23. CUSTOMERS' REFUND

This account refers to the refund discussed in Note 2(III)(b) and consists of:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Gross refund amount | ₱9,372 | ₱11,385 | ₱14,396 |
| Less present value effect | 225 | 780 | 1,626 |
| | 9,147 | 10,605 | 12,770 |
| Less current portion | 9,147 | 7,925 | 4,904 |
| | ₱– | ₱2,680 | ₱7,866 |

Movements in the unamortized discount related to the present value effect on the refund liability are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱780 | ₱1,626 | ₱2,722 |
| Less interest accretion during the year | 555 | 846 | 1,096 |
| Balance at end of year | ₱225 | ₱780 | ₱1,626 |

The Parent Company implemented the refund in four phases:

- Phase I, which involves refunds to residential and general service customers who consumed 100 kWh or less of electricity in April 2003 (or in their last complete month's bill for services whose contracts with the Parent Company have been terminated).

- Phase II, which involves refunds to residential and general service customers who consumed 101 to 300 kWh in April 2003 (or in their last complete month's bill for services whose contracts with the Parent Company have been terminated), from September 2003 to February 2004.

- Phase III, which involves refunds to residential and general service customers who consumed more than 300 kWh of electricity in April 2003, was implemented by the Parent Company over a period of twelve months starting January 2004.

- For Phase IV, involving refunds to commercial and industrial customers and all other customers not covered by Phases I – III, the refund covers two sub-phases.

In February 2005, the BIR issued Revenue Regulation 8 2005 which stated that the refunds to Phase IV customers are income payments subject to creditable withholding tax. The creditable withholding tax is withheld on the gross amount of the refund at the following rates: 25% for customers with active contracts and 32% for customers with terminated contracts.

The BIR implementing guidelines on the imposition of creditable withholding tax on the Phase IV refund were released in August 2005. To comply with the guidelines, customers are required to submit complete documents to the Parent Company prior to the latter's release of their refund either through checks or monthly credit to bill. Once the customer is able to comply with the requirements, he will receive the refunds due to him from the original start dates as approved by the ERC.

The Parent Company has remitted in advance a portion of the creditable withholding tax for Phase IV refund, amounting to ₱431 million, ₱71 million and ₱1,037 million as of December 31, 2009, 2008 and 2007, respectively.

The Parent Company is currently implementing the refund in accordance with the ERC-approved scheme.

As of December 31, 2009, the balance of the refund (inclusive of the present value effect) for each of the four phases is as follows:

| Phase | Beginning Balance | Refund | Ending Balance |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| I | ₱338 | (₱3) | ₱335 |
| II | 295 | – | 295 |
| III | 334 | (153) | 181 |
| IV | 10,418 | (1,857) | 8,561 |
| | ₱11,385 | (₱2,013) | ₱9,372 |

**24. NOTES PAYABLE**

Notes payable represents unsecured peso-denominated interest-bearing short-term loans obtained from various local financial institutions to meet the Parent Company's monthly payment obligations to power suppliers and other working capital requirements. Annual interest rates ranged from 4.0% to 9.50% in 2009, 6.50% to 10.50% in 2008 and 4.75% to 13.5% in 2007. Interest expense on notes payable amounted to ₱170 million, ₱595 million and ₱260 million in 2009, 2008 and 2007, respectively (see Note 28).

## 25. TRADE AND OTHER PAYABLES

| | Consolidated | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Trade accounts payable *(see Note 26)* | ₱16,943 | ₱9,836 | ₱14,615 |
| Output VAT – net | 2,238 | 2,890 | 2,430 |
| Preferred stock redemption payable | 1,147 | 866 | 156 |
| Accrued expenses | 1,639 | 588 | 457 |
| Current portion of meter deposits, including interest *(see Note 21)* | 1,372 | 457 | 237 |
| Current portion of CERA I and II over recoveries, including carrying charges | 983 | 917 | 3,092 |
| Accrued taxes | 770 | 956 | 992 |
| Current portion of bill deposits, including interest *(see Note 21)* | 685 | 1,160 | 1,255 |
| Current portion of liability arising from deferred pass-through fuel costs *(see Notes 13 and 26)* | 433 | 1,242 | 2,043 |
| Universal charges | 425 | 178 | 177 |
| Accrued dividends on preferred stock *(see Note 20)* | 288 | 307 | 411 |
| Current portion of security deposits | 191 | 87 | 111 |
| Advances for construction | 163 | 2,325 | 1,432 |
| Payable to customers | 132 | 134 | 237 |
| GSL liability | 124 | – | – |
| Current portion of retention payable | 96 | 94 | 1 |
| Current portion of deferred lease income | 62 | 32 | 37 |
| SC GRAM refund liability | 34 | 34 | 82 |
| Current portion of derivative liability *(see Note 31)* | 28 | 35 | – |
| Dividends payable | 26 | 14 | – |
| Accrued development costs | – | 149 | 340 |
| Other current liabilities | 2,260 | 1,875 | 2,180 |
| | ₱30,039 | ₱24,176 | ₱30,285 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | *(Amounts in Millions)* | | |
| Trade accounts payable *(see Note 26)* | ₱16,200 | ₱9,359 | ₱14,462 |
| Output VAT – net | 2,153 | 2,808 | 2,368 |
| Current portion of meter deposits, including interest *(see Note 21)* | 1,372 | 457 | 237 |
| Preferred stock redemption payable | 1,147 | 866 | 156 |
| Current portion of CERA I and II over recoveries, including carrying charges | 983 | 917 | 3,092 |
| Accrued taxes | 741 | 946 | 992 |
| Current portion of bill deposits, including interest *(see Note 21)* | 684 | 1,158 | 1,255 |
| Current portion of liability arising from deferred pass-through fuel costs *(see Notes 13 and 26)* | 433 | 1,242 | 2,043 |
| Universal charges | 425 | 178 | 177 |
| Accrued dividends on preferred stock *(see Note 20)* | 288 | 307 | 411 |
| Accrued employee benefits | 178 | 178 | 178 |
| Advances for construction | 163 | 2,325 | 1,432 |
| Accrued expenses | 266 | 228 | 78 |
| Payable to customers | 132 | 134 | 237 |
| GSL liability | 124 | – | – |
| SC GRAM refund liability | 34 | 34 | 82 |
| Derivative liability | 24 | 28 | – |
| Dividends payable | 15 | 14 | 63 |
| Other current liabilities | 1,629 | 1,046 | 1,489 |
| | ₱26,991 | ₱22,225 | ₱28,752 |

Trade payables are non-interest-bearing and are normally settled on 60-day terms. Other payables are non-interest-bearing and have an average term of six months.

**Trade Accounts Payable**

Trade accounts payable includes obligations to power suppliers such as NPC, TransCo, PEMC, First Gas (a related party), Quezon Power Philippines Limited Company (QPPL) and Philippine Power Development Corporation for cost of power purchased. This also includes other payables to local and foreign suppliers for goods and services needed to ensure normal operations.

Trade accounts payable also includes transmission line fee charges in connection with the Parent Company's TLA with QPPL. In an order dated September 20, 2004, the ERC disallowed the recovery of a portion of the transmission line fee, the bulk of which was for "scheduled extension costs," which the ERC believed "were caused by management inefficiency on the part of NPC."

On February 21, 2008, the Parent Company and QPPL amended their TLA to conform its terms to those already approved by the ERC. Based on the amendment, the Parent Company and QPPL acknowledge and confirm that all claims that each may have against the other are resolved as of the date of the amendment. Accordingly, the Parent Company derecognized its liability to QPPL pertaining to the disallowed transmission line fee amounting to ₱839 million and is shown as part of "Recovery of probable losses on disallowed receivables" account in the 2007 consolidated statement of income.

**CERA I and II**

After the Parent Company substantially settled all of its foreign currency-denominated debt in 2006, the Parent Company made a final accounting of the amounts of CERA I and II that have been billed to the customers. Based on the Parent Company's final accounting of the CERA I and II billings, the Parent Company has an over-recovery of ₱3,092 million from June 2003 to December 2006.

On October 22, 2008, the ERC directed the Parent Company to refund the CERA over-recoveries, along with carrying charges estimated at ₱833 million, over a period of twelve months, equivalent to ₱0.1461 per kWh. On December 4, 2008, the Parent Company filed a Motion asking the ERC to defer the CERA refund. In asking for a deferment, the Parent Company cited financial constraints due to, among others, the accumulation of substantial generation cost under-recoveries and the servicing of the ERC-mandated meter deposit refund.

In its order dated February 16, 2009, the ERC granted (with modification) the Parent Company's Motion to defer the CERA refund. In granting this Motion, the ERC said that "…the Commission is cognizant of the fact that requiring MERALCO to refund the amount of ₱3,925 million would result in substantial and tremendous impact on its financial resources. Thus, the Commission deems it reasonable to recalculate the amount and the period of CERA refund in order to cushion its impact on Meralco's financial viability." Accordingly, the ERC directed the Parent Company to refund the total refund amount of ₱3,925 million, equivalent to ₱0.0400 per kWh starting the March 2009 billing cycle until such time that the full amount shall have been refunded. Subsequently, on April 25, 2009, the ERC released an Order reinstating its directive for the Parent Company to refund the CERA over-recovery at a rate of ₱0.1461 per kWh.

The total outstanding balance of ₱983 million, inclusive of ₱209 million carrying charges, is estimated to be refunded in the first four months of 2010.

**Payable to Customers**

On October 1, 2004, the ERC released an Order on the Parent Company's Motion for Clarification/Reconsideration on ERC Case Nos. 2001-646 and 2001-900 dated July 1, 2003, resulting in the revision of the minimum charge provision in the Parent Company's rate schedules. This revision, which involves a change in the basis of the computation of the Transmission Charge component of the minimum charge, resulted in a potential liability to customers estimated at ₱1,085 million. In 2006, the Parent Company commenced the refund of this minimum charge. As of December 31, 2009, 2008 and 2007, the outstanding liability amounted to ₱132 million, ₱134 million and ₱237 million, respectively. The estimated amount of the refund has been incorporated in the application for collection of Transmission Charge under-recoveries (see Note 34(a)(1)).

**Advances for Construction**

In June 2005, the Parent Company offered a cash advance scheme to residential customers in accordance with Article 14 "Right to Extension of Lines and Facilities" of the Magna Carta for Residential Customers. Under this scheme, customers requesting for an extension of lines and facilities located beyond thirty (30) meters serving distance from the nearest voltage facilities of the utility shall advance the cost of the project. The customer advance scheme is non-interest- bearing.

To recover their aforementioned expenditures, the customers are entitled to an annual refund at the rate of twenty five percent (25%) of the gross distribution revenue derived from all customers connected to the line extension. The period covered by each refund payment pertains to the 12 months from the date of energization of the service and the succeeding year thereafter until such amounts are fully refunded or for five years, whichever period is shorter (based on Article 2.6.2 of the DSOAR which also applies to residential developers).

Discussion with the ERC regarding the treatment of the unpaid advances is still ongoing.

As of December 31, 2009, the non-current portion of advances for construction amounted to ₱3,022 million included under "Other non-current liabilities" account in the 2009 consolidated and parent company statement of financial position.

**GSL Liability**

For the regulatory years 2008, 2009 and the first half of regulatory year 2010, GSL obligations amounted to ₱100 million, ₱66 million and ₱50 million, respectively. The payouts were implemented beginning the September 2009 billing cycle. As of December 31, 2009, ₱92 million out of the ₱100 million for RY 2008 was refunded. The balance of ₱124 million representing the remaining amount for RY 2008, RY 2009 and RY 2010 is expected to be paid in the succeeding years and is shown as part of "Trade and other payables" account.

## 26. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. This includes: (a) individuals owning, directly or indirectly through one or more intermediaries; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Company that give them significant influence over the Company and close members of the family of any such individual and; (d) affiliate, which is a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the Company.

The following table provides the total amount of transactions, which have been entered into by the Company with related parties for the relevant financial years. Outstanding balances at the year-end are unsecured, interest-free except those relating to deferred pass-through fuel costs (see Note 13) and settled in cash. There have been no guarantees provided for or received from any related party receivables or payables.

| Related Party | Relationship with Company | Year | Purchases from Related Parties | Amounts Owed by Related Parties *(see Note 15)* | Amounts Owed to Related Parties *(see Notes 13 and 25)* |
|---|---|---|---|---|---|
| | | | *(Amounts in Millions)* | | |
| San Miguel Corporation (SMC) and Subsidiaries | Major Shareholder | 2009 | ₱54 | ₱– | ₱– |
| | | 2008 | – | – | – |
| Philippine Long Distance Telephone Company (PLDT) and Subsidiaries | Major Shareholder | 2009 | 31 | – | – |
| | | 2008 | – | – | – |
| First Philippine Holdings Corporation (FPHC) and Subsidiaries | Major Shareholder | 2009 | 1,019 | – | – |
| | | 2008 | – | – | – |
| Metro Pacific Investments Corporation (MPIC) and Subsidiaries | Major Shareholder | 2009 | 6 | – | – |
| | | 2008 | – | – | – |
| FGPC**(see Notes 13 and 35)* | Affiliate | 2009 | 32,356 | – | – |
| | | 2008 | 36,849 | – | 2,033 |
| | | 2007 | 30,110 | – | 1,779 |
| FGP Corp.**(see Notes 13 and 35)* | Affiliate | 2009 | 16,163 | – | – |
| | | 2008 | 18,434 | – | 924 |
| | | 2007 | 14,866 | – | 4,605 |
| Indra | Joint Venture | 2009 | 571 | – | 15 |
| | | 2008 | 493 | 6 | 5 |
| | | 2007 | 403 | 6 | 17 |
| GEPMICI | Associate | 2009 | 194 | – | – |
| | | 2008 | 129 | – | – |
| | | 2007 | 356 | 4 | 2 |
| Philippine Electric Corp. (PHILEC) | Affiliate | 2009 | 957 | – | 24 |
| | | 2008 | 876 | – | 34 |
| | | 2007 | 786 | – | 26 |
| Others** | Affiliates | 2009 | 250 | 555 | 11 |
| | | 2008 | 193 | – | 1 |
| | | 2007 | 208 | – | 3 |
| | | 2009 | ₱51,601 | ₱555 | ₱50 |
| | | 2008 | 56,974 | 6 | 2,997 |
| | | 2007 | 46,729 | 10 | 6,432 |

* *Purchases include utilization of unconsumed gas classified under "Deferred Pass-Through Fuel Cost" account (see Note 13).*

** *Consist of transactions with MMLDC (a foundation of Meralco), FEDCOR and others.*

**Revenues**

In the ordinary course of business, the Parent Company sells electricity to related parties within its franchise area. The rates charged to related parties are the same ERC-mandated rates charged to all customers within the franchise area. As of December 31, 2009, revenues billed to major shareholders, PLDT, SMC and FPHC and their respective subsidiaries are ₱1,548 million, ₱1,006 million and ₱166 million, respectively.

The assessment to determine the provision for doubtful accounts is undertaken at each reporting date through the examination of the financial position of the related party and the market in which the related party operates.

**Purchases**

Purchases from related parties consist of purchases of power and deferred pass-through fuel costs (FGPC and FGP Corp.), information systems technology services (Indra), transformers (PHILEC) and meters (GEPMICI). Purchases from related parties amounted to ₱51,601 million, ₱56,974 million and ₱46,729 million in 2009, 2008 and 2007, respectively.

**Compensation of Key Management Personnel of the Company**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Short-term employee benefits | ₱220 | ₱275 | ₱288 |
| Long-term and retirement benefits | 62 | 71 | 84 |
| Share-based payments | 11 | 25 | 9 |
| Total compensation paid to key management personnel | ₱293 | ₱371 | ₱381 |

**27. REVENUES AND PURCHASED POWER**

Revenues of the Parent Company consist principally of the sale of electricity. Below is the breakdown of revenues from the sale of electricity for the years ended December 31, 2009, 2008 and 2007:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Generation charge | ₱106,695 | ₱120,445 | ₱126,816 |
| Transmission charge | 23,250 | 25,512 | 27,227 |
| Distribution charge | 21,276 | 17,594 | 17,435 |
| System loss charge | 16,108 | 16,139 | 17,316 |
| Supply charge | 6,560 | 5,753 | 5,707 |
| Metering charge | 3,923 | 2,923 | 2,894 |
| Power act reduction | (660) | (814) | (584) |
| Inter-class, lifeline subsidy and others | 1,734 | (488) | (423) |
| | 178,886 | 187,064 | 196,388 |
| Less intersegment sales *(see Note 7)* | 200 | 65 | 217 |
| | ₱178,686 | ₱186,999 | ₱196,171 |

Actual purchased power costs, which are pass-through costs and are revenue-neutral to the Parent Company, for the years ended December 31, 2009, 2008 and 2007 are as follows (see Note 35):

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Generation charge | ₱127,116 | ₱131,863 | ₱144,388 |
| Transmission charge | 23,812 | 25,009 | 28,449 |
| | ₱150,928 | ₱156,872 | ₱172,837 |

Purchased power includes capacity fees, fixed operating fees and transmission line fees that are accounted for similar to a lease under IFRIC 4, "Determining whether an Arrangement contains a Lease". These amounted to ₱20,900 million, ₱21,592 million and ₱17,107 million in 2009, 2008 and 2007, respectively, and are presented as part of purchased power account in the consolidated statements of income. These also include unrecoverable system loss charges representing system loss charges over the 9.5% cap amounting to ₱260 million in 2007. In 2009 and 2008, however, the Parent Company's system loss rate was below the 9.5% cap.

Thus, net revenue (expense) from pass-through costs for the years ended December 31, 2009, 2008 and 2007 are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Generation charge | ₱106,695 | ₱120,445 | ₱126,816 |
| Transmission charge | 23,250 | 25,512 | 27,227 |
| System loss charge | 16,108 | 16,139 | 17,316 |
| Power act reduction | (660) | (814) | (584) |
| Recoverable purchased power | (150,928) | (156,872) | (172,837) |
| Net over-recoveries (under-recoveries) for the year | (₱5,535) | ₱4,410 | (₱2,062) |

The status of the accumulated over and under-recoveries in pass-through costs is discussed in Notes 6I(b) and 34(a)(1).

## 28. EXPENSES AND INCOME

**Operations and Maintenance**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Salaries, wages and employee benefits *(see Notes 19, 26 and 29)* | ₱6,793 | ₱5,744 | (₱1,073) |
| Contractors' services | 3,626 | 3,283 | 2,954 |
| Provision for doubtful accounts, net of recoveries *(see Note 15)* | 886 | 1,566 | 576 |
| Materials and supplies | 326 | 338 | 360 |
| Supervision and regulation fees | 269 | 328 | 198 |
| Corporate expenses | 302 | 306 | 300 |
| Transportation and travel | 398 | 272 | 379 |
| Property insurance | 199 | 92 | 70 |
| Others | 4 | 104 | 648 |
| | ₱12,803 | ₱12,033 | ₱4,412 |

**Salaries, Wages and Employee Benefits**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Wages, salaries and benefits | ₱5,466 | ₱4,986 | ₱4,882 |
| Pension cost (income) *(see Note 29)* | 98 | 675 | (6,201) |
| Post-employment benefits cost (income) other than pensions *(see Note 29)* | 822 | (139) | 78 |
| Expense of share-based payments *(see Note 19)* | 301 | 116 | 73 |
| Social security costs | 106 | 106 | 95 |
| | ₱6,793 | ₱5,744 | (₱1,073) |

**Cost of Contracts and Services**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Salaries, wages and employee benefits | ₱708 | ₱584 | ₱563 |
| Contractors' services | 661 | 517 | 437 |
| Materials and supplies | 171 | 163 | 294 |
| Others | 263 | 192 | 121 |
| | ₱1,803 | ₱1,456 | ₱1,415 |

**Interest and Financial Expenses**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Interest expense on interest-bearing loans and other borrowings *(see Note 20)* | ₱1,365 | ₱1,237 | ₱1,183 |
| Interest expense on bill deposits *(see Note 21)* | 1,120 | 925 | 864 |
| Carrying charge expense *(see Note 2)* | 543 | 934 | 124 |
| Interest expense on notes payable *(see Note 24)* | 170 | 595 | 260 |
| Interest expense on meter deposits *(see Note 21)* | 81 | 89 | 99 |
| Amortization of debt issuance costs *(see Note 20)* | 54 | 18 | 21 |
| Amortization of loans premium *(see Note 20)* | (27) | (27) | (25) |
| Interest expense on deferred pass-through fuel costs *(see Notes 13 and 26)* | 15 | 141 | 320 |
| Others | 7 | 223 | 153 |
| | ₱3,328 | ₱4,135 | ₱2,999 |

**Interest and Financial Income**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Carrying cost for recovery *(see Note 2)* | ₱2,782 | ₱813 | ₱19 |
| Interest income on cash and cash equivalents | 418 | 321 | 369 |
| Mark-to-market gains (losses) from derivative instruments *(see Note 31)* | 82 | (167) | 187 |
| Amortization of unearned interest on trade receivables of subsidiaries *(see Note 15)* | – | 68 | – |
| Others | 557 | 1,502 | 998 |
| | ₱3,839 | ₱2,537 | ₱1,573 |

**Auditors' Remuneration**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Audit services | ₱13 | ₱17 | ₱15 |
| Other services | 5 | 15 | 5 |
| | ₱18 | ₱32 | ₱20 |

**29. RETIREMENT PLAN**

The Company has noncontributory defined benefit retirement plans covering substantially all of the permanent employees of the Parent Company and most of its subsidiaries.

The retirement plan of the Parent Company is a funded, non-contributory defined benefit plan. The retirement fund (Meralco Pension Fund) is held in trust by the Board of Trustees and is overseen by the Compensation and Retirement Fund Committee of the BOD.

The Parent Company also provides certain additional post-employment benefits upon retirement.

On January 22, 2007, the BOD approved the Retirement Benefits Conversion Plan (RBCP) which would buyout at present value the monthly pension and retirement benefits of qualified retirees as of January 2, 2007. This was offered on a voluntary basis and, initially, 1,022 retirees availed of the RBCP. On November 26, 2007, the BOD approved the extension offer of the RBCP until December 31, 2007 and 205 retirees availed of the offer.

The following tables summarize the components of net pension and other post-employment benefit expense of the Company recognized in the consolidated statements of income and the funded status and amounts recognized in the consolidated and parent company statements of financial position for the respective plans.

**Net Pension Cost (included as part of "Operations and maintenance expenses – Salaries, wages and employee benefits" account)**

| | 2009 | | |
|---|---|---|---|
| | Parent | Subsidiaries | Consolidated |
| | *(Amounts in Millions)* | | |
| Interest cost on benefit obligation | ₱2,033 | ₱10 | ₱2,043 |
| Current service cost | 793 | 6 | 799 |
| Expected return on plan assets | (722) | (5) | (727) |
| Past service cost | 1 | 17 | 18 |
| Settlement gain | (252) | – | (252) |
| Actuarial loss (gain) | (1,801) | 18 | (1,783) |
| Net pension cost | ₱52 | ₱46 | ₱98 |
| Actual return on plan assets | ₱4,128 | ₱22 | ₱4,150 |

| | 2008 | | |
|---|---|---|---|
| | Parent | Subsidiaries | Consolidated |
| | *(Amounts in Millions)* | | |
| Interest cost on benefit obligation | ₱1,730 | ₱10 | ₱1,740 |
| Current service cost | 964 | 12 | 976 |
| Expected return on plan assets | (826) | (4) | (830) |
| Past service cost | 1 | 2 | 3 |
| Actuarial gain | (1,197) | (17) | (1,214) |
| Net pension cost | ₱672 | ₱3 | ₱675 |
| Actual loss on plan assets | (₱1,695) | (₱6) | (₱1,701) |

| | 2007 | | |
|---|---|---|---|
| | Parent | Subsidiaries | Consolidated |
| | *(Amounts in Millions)* | | |
| Interest cost on benefit obligation | ₱1,915 | ₱10 | ₱1,925 |
| Current service cost | 1,104 | 12 | 1,116 |
| Expected return on plan assets | (373) | (3) | (376) |
| Past service cost | 1 | – | 1 |
| Actuarial gain | (8,427) | (24) | (8,451) |
| Settlement gain | (416) | – | (416) |
| Net pension cost | (₱6,196) | (₱5) | (₱6,201) |
| Actual return on plan assets | ₱5,889 | ₱5 | ₱5,894 |

**Pension Liability (Asset)**

| | 2009 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Defined benefit obligation | ₱25,068 | ₱187 | ₱25,255 |
| Fair value of plan assets | (16,167) | (181) | (16,348) |
| Unrecognized past service cost | (4) | (30) | (34) |
| Pension liability (asset) | ₱8,897 | (₱24) | ₱8,873 |

**Presentation in the consolidated and parent company statements of financial position:**

| | 2009 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Pension asset | ₱– | (₱68) | (₱68) |
| Pension liability | 8,897 | 44 | 8,941 |
| | ₱8,897 | (₱24) | ₱8,873 |

| | 2008 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Defined benefit obligation | ₱22,594 | ₱100 | ₱22,694 |
| Fair value of plan assets | (10,309) | (99) | (10,408) |
| Unrecognized past service cost | (5) | (7) | (12) |
| Pension liability (asset) | ₱12,280 | (₱6) | ₱12,274 |

**Presentation in the consolidated and parent company statements of financial position:**

| | 2008 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Pension asset | ₱– | (₱39) | (₱39) |
| Pension liability | 12,280 | 33 | 12,313 |
| | ₱12,280 | (₱6) | ₱12,274 |

| | 2007 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Defined benefit obligation | ₱24,714 | ₱111 | ₱24,825 |
| Fair value of plan assets | (11,800) | (57) | (11,857) |
| Unrecognized past service cost | (6) | (9) | (15) |
| Pension liability | ₱12,908 | ₱45 | ₱12,953 |

**Changes in the present value of the defined benefit obligation are as follows:**

| | 2009 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening defined benefit obligation | ₱22,594 | ₱100 | ₱22,694 |
| Interest cost | 2,033 | 10 | 2,043 |
| Current service cost | 793 | 6 | 799 |
| Benefits paid | (1,282) | (4) | (1,286) |
| Actuarial losses (gains) due to: | | | |
| Changes in assumptions | 2,052 | 20 | 2,072 |
| Experience adjustments | (482) | 15 | (467) |
| Past service cost | – | 40 | 40 |
| Effect of settlement | (640) | – | (640) |
| Closing defined benefit obligation | ₱25,068 | ₱187 | ₱25,255 |

| | 2008 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening defined benefit obligation | ₱24,714 | ₱111 | ₱24,825 |
| Interest cost | 1,730 | 10 | 1,740 |
| Current service cost | 964 | 12 | 976 |
| Benefits paid | (1,096) | (6) | (1,102) |
| Actuarial losses (gains) due to: | | | |
| Changes in assumptions | (3,886) | (24) | (3,910) |
| Experience adjustments | 168 | (3) | 165 |
| Closing defined benefit obligation | ₱22,594 | ₱100 | ₱22,694 |

| | 2007 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening defined benefit obligation | ₱27,360 | ₱113 | ₱27,473 |
| Interest cost | 1,915 | 10 | 1,925 |
| Current service cost | 1,104 | 12 | 1,116 |
| Benefits paid | (1,024) | (2) | (1,026) |
| Actuarial losses (gains) due to: | | | |
| Changes in assumptions | (2,038) | (23) | (2,061) |
| Experience adjustments | (749) | 1 | (748) |
| Effect of settlement | (1,854) | – | (1,854) |
| Closing defined benefit obligation | ₱24,714 | ₱111 | ₱24,825 |

**Changes in the fair value of the plan assets are as follows:**

| | 2009 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening fair value of plan assets | ₱10,309 | ₱99 | ₱10,408 |
| Expected return on plan assets | 722 | 5 | 727 |
| Actuarial gains | 3,406 | 17 | 3,423 |
| Benefits paid | (1,705) | (4) | (1,709) |
| Contributions by employer | 3,435 | 64 | 3,499 |
| Closing fair value of plan assets | ₱16,167 | ₱181 | ₱16,348 |

| | 2008 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening fair value of plan assets | ₱11,800 | ₱57 | ₱11,857 |
| Expected return on plan assets | 826 | 4 | 830 |
| Actuarial losses | (2,521) | (10) | (2,531) |
| Benefits paid | (1,096) | (6) | (1,102) |
| Contributions by employer | 1,300 | 54 | 1,354 |
| Closing fair value of plan assets | ₱10,309 | ₱99 | ₱10,408 |

| | 2007 | | |
|---|---|---|---|
| | **Parent** | **Subsidiaries** | **Consolidated** |
| | *(Amounts in Millions)* | | |
| Opening fair value of plan assets | ₱5,925 | ₱39 | ₱5,964 |
| Expected return on plan assets | 373 | 3 | 376 |
| Actuarial gains | 5,516 | 2 | 5,518 |
| Benefits paid | (2,338) | (2) | (2,340) |
| Contributions by employer | 2,324 | 15 | 2,339 |
| Closing fair value of plan assets | ₱11,800 | ₱57 | ₱11,857 |

The Parent Company expects to contribute ₱3,435 million to its defined benefit pension plan in 2010.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| | *(In Percentage)* | | |
| Marketable equity securities | 94 | 49 | 18 |
| Bonds and commercial notes | 1 | 25 | 5 |
| Government securities | – | 18 | 70 |
| Real properties | 5 | 7 | 6 |
| Receivables | – | 1 | 1 |
| | 100 | 100 | 100 |

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

**Other Post-employment Benefits Expense (included as part of "Operations and maintenance expenses – Salaries, wages and employee benefits" account)**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Interest cost | ₱100 | ₱92 | ₱92 |
| Current service cost | 21 | 33 | 29 |
| Actuarial loss (gain) | 749 | (264) | 40 |
| Settlement gain | (48) | – | (83) |
| Net other post-employment benefit expense | ₱822 | (₱139) | ₱78 |

Pension amounts for 2009 and the previous four years are as follows:

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| | *(Amounts in Millions)* | | | | |
| Present value of defined benefit obligation | ₱25,255 | ₱22,694 | ₱24,825 | ₱27,473 | ₱12,905 |
| Fair value of plan assets | 16,348 | 10,408 | 11,857 | 5,964 | 3,076 |
| Excess of present value of defined benefit obligation over fair value of plan assets | 8,907 | 12,286 | 12,968 | 21,509 | 9,829 |
| Experience adjustments on plan liabilities | (467) | 165 | (748) | 233 | (3) |
| Actuarial gain (loss) on plan assets | 3,423 | (2,531) | 5,518 | 3,176 | 79 |

**Other Post-employment Benefits Liability (recorded as part of "Other non-current liabilities" account)**

Changes in the present value of the other post-employment benefit liability are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts in Millions)* | | |
| Balance at beginning of year | ₱1,115 | ₱1,321 | ₱1,305 |
| Interest cost | 100 | 92 | 92 |
| Current service cost | 21 | 33 | 29 |
| Benefits paid | (51) | (67) | (63) |
| Actuarial losses (gains) | 835 | (264) | 162 |
| Effect of settlement | (133) | – | (204) |
| Balance at end of year | ₱1,887 | ₱1,115 | ₱1,321 |

The principal assumptions used as of January 1, 2009, 2008 and 2007 in determining pension and other post-employment benefits obligations are shown below:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Percentage)* | | |
| Discount rate | 8.0-11.63 | 7.0–10.15 | 7.0–8.29 |
| Expected rate of return on assets | 7.0-10.0 | 7.0 | 7.0 |
| Future range of salary increases | 4.0-10.0 | 5.0-10.0 | 5.0–10.0 |

In addition to its defined benefit retirement plan, MIESCOR also has a defined contribution retirement plan on which it contributes to a Provident Fund annually an amount equal to 6% of the current monthly basic salaries of the covered employees. The Provident Fund is maintained primarily for the purpose of establishing periodically the amounts of the benefits pertaining to the covered employees. The employees' shares are represented by the units of the Provident Fund. Each unit is determined by dividing the net asset value of the Provident Fund by the aggregate number of units earned by the employee. Pension expense under this plan amounted to ₱1 million in 2009, 2008 and 2007.

## 30. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company's principal financial instruments, other than derivatives, are composed of bank loans and cash and cash equivalents. The main purpose of these financial instruments is to finance the Company's operations. The Company has various other financial assets and liabilities such as trade receivables, trade payables and other liabilities, which arise directly from its operations.

The main risks arising from the Company's financial instruments are cash flow interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The BOD reviews and approves policies for managing each of these risks which are summarized below:

**Cash Flow Interest Rate Risk**

The Company's exposure to the changes in market interest rates relates primarily to the Company's debt obligations with floating interest rates since the Company's interest-bearing short-term investments mature within 45 days or less.

The Company's policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts, depending on what strategy will yield a reasonably lower effective cost based on market conditions. Refinancing of fixed rate loans may also be undertaken to manage interest cost. As of December 31, 2009, 2008 and 2007, approximately 61%, 73% and 50% of the Company's borrowings are at a fixed rate of interest, respectively.

Rockwell's policy is to source loans with fixed interest rates whenever available.

The following table sets out the maturity profile of the Parent Company, Rockwell and MIESCOR's bank loans and the amounts that are exposed to interest rate risk (exclusive of debt issuance costs):

| | Within 1 Year | 1–2 Years | 2–3 Years | 3–4 Years | 4–5 Years | More than 5 Years | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(Amounts in Millions)* | | | |
| **2009 Fixed Rate** | | | | | | | |
| Parent Company | | | | | | | |
| Interest-bearing loans and borrowings | ₱788 | ₱752 | ₱752 | ₱3,958 | ₱3,227 | ₱– | ₱9,477 |
| Notes payable | 500 | – | – | – | – | – | 500 |
| Short-term investments | 10,669 | – | – | – | – | – | 10,669 |
| Rockwell | | | | | | | |
| Interest-bearing loans and borrowings | 454 | 308 | 310 | 1,085 | – | – | 2,157 |
| Short-term investments | 215 | – | – | – | – | – | 215 |
| **2009 Floating Rate** | | | | | | | |
| Parent Company | | | | | | | |
| Interest-bearing loans and borrowings | 737 | 717 | 717 | 717 | 717 | 3,315 | 6,920 |
| Rockwell | | | | | | | |
| Interest-bearing loans and borrowings | 307 | 456 | – | – | – | – | 763 |

| | Within 1 Year | 1–2 Years | 2–3 Years | 3–4 Years | 4–5 Years | More than 5 Years | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(Amounts in Millions)* | | | |
| **2008 Fixed Rate** | | | | | | | |
| Parent Company | | | | | | | |
| Interest-bearing loans and borrowings | 516 | 516 | 480 | 480 | 3,714 | – | 5,706 |
| Notes payable | 9,770 | – | – | – | – | – | 9,770 |
| Short-term investments | 1,801 | – | – | – | – | – | 1,801 |
| Rockwell | | | | | | | |
| Interest-bearing loans and borrowings | 140 | 280 | 280 | 1,300 | – | – | 2,000 |
| Short-term investments | 384 | – | – | – | – | – | 384 |
| **2008 Floating Rate** | | | | | | | |
| Parent Company | | | | | | | |
| Interest-bearing loans and borrowings | 521 | 499 | 480 | 480 | 3,600 | – | 5,580 |
| Rockwell | 489 | – | – | – | – | – | 489 |
| Interest-bearing loans and borrowings | 489 | – | – | – | – | – | 489 |
| **2007 Fixed Rate** | | | | | | | |
| Parent Company | 11,014 | 513 | 513 | 480 | 480 | 3,741 | 16,741 |
| Rockwell | – | 70 | 140 | 790 | – | – | 1,000 |
| MIESCOR | 248 | – | – | – | – | – | 248 |
| **2007 Floating Rate** | | | | | | | |
| Parent Company | 535 | 515 | 496 | 480 | 480 | 3,600 | 6,106 |
| Rockwell | 608 | 149 | – | – | – | – | 757 |

| | Bank loans | | | Other Loans | | | Consolidated | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2009 | 2008 | 2007 | 2009 | 2008 | 2007 |
| | | | | | *(Amounts in Millions)* | | | | |
| Representing amount repayable | | | | | | | | | |
| – wholly within five years | ₱15,830 | ₱22,690 | ₱11,949 | ₱1 | ₱2 | ₱3 | ₱15,831 | ₱22,692 | ₱11,952 |
| – not wholly within five years | 3,900 | 740 | 12,510 | – | – | – | 3,900 | 740 | 12,510 |
| | ₱19,730 | ₱23,430 | ₱24,459 | ₱1 | ₱2 | ₱3 | ₱19,731 | ₱23,432 | ₱24,462 |

Interest on bank loans classified as floating rate is repriced at intervals of less than one year. Interest on bank loans classified as fixed rate is fixed until the maturity of the instrument. The other financial liabilities of the Company that are not included in the above table are non-interest-bearing or have no fixed or determinable maturity and are, therefore, not subject to interest rate risk. As previously mentioned, the Company's short-term investments are not exposed to significant changes in market rates because they mature within 30 days or less to coincide with the Company's monthly payment obligations.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Parent Company and Rockwell's profit before tax as of December 31, 2009, 2008 and 2007 (through the impact on floating rate borrowings). There is no other impact on the Parent Company and Rockwell's equity other than those already affecting the profit and loss.

| | 2009 | | 2008 | | 2007 | |
|---|---|---|---|---|---|---|
| | Increase (Decrease) in Basis Points | Effect on Profit before Tax | Increase (Decrease) in Basis Points | Effect on Profit before Tax | Increase (Decrease) in Basis Points | Effect on Profit before Tax |
| **Parent Company** | | | | | | |
| Floating rate loans from various banks | +100 | (₱69 million) | +100 | (₱56 million) | +100 | (₱61 million) |
| | (100) | 69 million | (100) | 56 million | (100) | 61 million |
| **Rockwell** | | | | | | |
| Floating rate loans from various banks | +100 | (₱3 million) | +100 | (₱2 million) | +100 | (₱4 million) |
| | (100) | 3 million | (100) | 2 million | (100) | 4 million |

Interest expense on floating rate borrowings is computed for the year, taking into account actual principal movements during the year, based on management's best estimate of a +/-100 basis points change in interest rates. There has been no change in the methods and assumptions used by the management in the above analysis.

**Foreign Currency Risk**

*a.* *Parent Company*

The Parent Company is allowed to recover foreign exchange losses on foreign currency-denominated loans through adjustments of customers' bills in accordance with CERA II.

Presented below are the Parent Company's foreign currency-denominated financial assets and liabilities as of December 31, 2009, 2008 and 2007, translated to Philippine Peso at the following exchange rates:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| US Dollar ($) | ₱46.20 | ₱47.52 | ₱41.28 |
| Japanese Yen (¥) | 0.5059 | 0.5221 | 0.3642 |
| Euro (€) | 66.6646 | 66.2463 | 60.5572 |
| Swiss Francs (CHF) | 44.8101 | 43.6644 | 36.3326 |

| | December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Foreign Currency | | | | |
| | US Dollar | Japanese Yen | Euro | Swiss Franc | Peso Equivalent |
| | (Amounts in Millions) | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | $83 | ¥– | €– | CHF– | ₱3,842 |
| Trade receivables | 1 | – | – | – | 25 |
| Advance payments to suppliers | 3 | – | – | – | 138 |
| | 87 | – | – | – | 4,005 |
| Financial liabilities: | | | | | |
| Trade and other payables | (141) | – | (2) | – | (6,655) |
| Liability arising from deferred pass-through fuel cost | (9) | – | – | – | (433) |
| Interest-bearing loans and other borrowings | – | – | (1) | – | (55) |
| | (150) | – | (3) | – | (7,143) |
| | ($63) | ¥– | (€3) | (CHF–) | (₱3,138) |

| | December 31, 2008 | | | | |
|---|---|---|---|---|---|
| | Foreign Currency | | | | |
| | US Dollar | Japanese Yen | Euro | Swiss Franc | Peso Equivalent |
| | (Amounts in Millions) | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | $6 | ¥– | €– | CHF– | ₱285 |
| Trade receivables | 1 | – | – | – | 24 |
| Advance payments to suppliers | – | 15 | – | – | 20 |
| | 7 | 15 | – | – | 329 |
| Financial liabilities: | | | | | |
| Trade and other payables | (66) | (15) | (1) | – | (3,207) |
| Liability arising from deferred pass-through fuel cost | (26) | – | – | – | (1,242) |
| Interest-bearing loans and other borrowings | – | – | (1) | (1) | (131) |
| | (92) | (15) | (2) | (1) | (4,580) |
| | ($85) | ¥– | (€2) | (CHF1) | (₱4,251) |

| | December 31, 2007 | | | | |
|---|---|---|---|---|---|
| | Foreign Currency | | | | |
| | US Dollar | Japanese Yen | Euro | Swiss Franc | Peso Equivalent |
| | (Amounts in Millions) | | | | |
| Financial assets: | | | | | |
| Cash and cash equivalents | $53 | ¥– | €– | CHF– | ₱2,183 |
| Trade receivables | 1 | – | – | – | 25 |
| Advance payments to suppliers | – | 6 | – | – | 31 |
| | 54 | 6 | – | – | 2,239 |
| Financial liabilities: | | | | | |
| Trade and other payables | 111 | 7 | 1 | – | 4,648 |
| Liability arising from deferred pass-through fuel cost | 66 | – | – | – | 2,735 |
| Interest-bearing loans and other borrowings | 2 | – | 1 | 1 | 203 |
| | 179 | 7 | 2 | 1 | 7,586 |
| | ($125) | (¥1) | (€2) | (CHF1) | (₱5,347) |

The Parent Company's exposure to foreign currency risk on long-term debt principal payments is minimal because almost 100% of the Company's debt is denominated in Philippine Peso. Thus, the impact of a one peso movement of the US$/PHP exchange rate will not have a significant impact on the Parent Company's principal and interest payments. Further, PBR assumes a forecast level of foreign currency movements in its calculation of the forecasted regulatory asset base and expenditures. PBR also allows for adjustment of the rates the Parent Company charges under PBR should there be significant deviations in the foreign exchange forecast from what is actually realized.

**b. Rockwell**

As a result of Rockwell's marketing operations in the United States, its statement of financial position can be affected significantly by movements in the US$ exchange rates. Rockwell's foreign-currency denominated assets and liabilities are as follows:

| | 2009 | | 2008 | | 2007 | |
|---|---|---|---|---|---|---|
| | US$ | Peso Equivalent | US$ | Peso Equivalent | US$ | Peso Equivalent |
| | (Amounts in Millions) | | | | | |
| Assets: | | | | | | |
| Cash and cash equivalents | $2 | ₱94 | $3 | ₱132 | $2 | ₱73 |
| Trade and other receivables | 3 | 125 | 1 | 70 | 10 | 417 |
| Liabilities: | | | | | | |
| Trade and other payables | – | – | 4 | 178 | – | 1 |
| Interest-bearing loans and borrowings | – | – | 2 | 91 | 6 | 236 |
| Net foreign currency-denominated assets (liabilities) | $5 | ₱219 | ($2) | (₱67) | $6 | ₱253 |

It is Rockwell's policy to limit its US$-denominated receivables just to match the estimated US$-denominated component of its development costs as well as its US$-denominated borrowings. Also, Rockwell enters into deliverable currency forward contracts to hedge its foreign currency exposure should there be an excess in US$-denominated assets over the US$-denominated liabilities.

The following table demonstrates the sensitivity to a reasonably possible change in the US$ exchange rate with respect to Peso, with all other variables held constant, of Rockwell's profit before tax as of December 31, 2009, 2008 and 2007 (due to changes in the fair value of financial assets and liabilities). There is no other impact on Rockwell's equity other than those already affecting the profit and loss.

| | 2009 | | 2008 | | 2007 | |
|---|---|---|---|---|---|---|
| | Increase (Decrease) in US Rate (in %) | Effect on Profit before Tax | Increase (Decrease) in US Rate (in %) | Effect on Profit before Tax | Increase (Decrease) in US Rate (in %) | Effect on Profit before Tax |
| Foreign currency-denominated financial assets and liabilities | +5% | ₱7 million | +5% | (₱14 million) | +5% | (₱8 million) |
| | –5% | (₱7 million) | (5%) | 14 million | (5%) | 8 million |

Foreign exchange gain (loss) is computed for the year based on management's best estimate of a +/-5 percent change in the closing Peso-US$ conversion rate using the year end balances of US dollar-denominated cash and cash equivalents, accounts receivable, loans, and forward contracts. There has been no change in the methods and assumptions used by management in the above analysis.

**Commodity Price Risk**

The Company's exposure to price risk is minimal. The cost of fuel is part of the Parent Company's generation cost that is recoverable from the customers through the Parent Company's generation charge.

**Credit Risk**

The Company trades only with recognized, creditworthy third parties. The Company only places its excess cash in financial institutions that meet the Company's accreditation standards based on liquidity and solvency ratios and the bank's credit rating. The Company will only transact derivatives with similarly accredited financial institutions. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis.

Trade receivables from sale of condominium units are secured with condominium units the legal title and ownership of which are transferred to the customers upon full payment of the contract price. Receivables from leases are assured by security deposits, while receivables from sale of club shares are guaranteed by the shares held by the Company. For other receivables, since the Company trades only with recognized third parties, there is no requirement for collateral.

There are no significant concentrations of credit risk within the Company.

With respect to credit risk arising from the other financial assets of the Company, which comprise cash and cash equivalents, trade and other receivables, available-for-sale financial assets and certain derivative instruments, the Company's exposure arises from default of the counterparty.

The table below shows the maximum exposure to credit risk for the components of the consolidated statements of financial position, including derivatives. The maximum exposure is shown gross, without taking account of collateral and other credit enhancement such as bill deposits and accrued interest.

| | Gross Maximum Exposure | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| Cash and cash equivalents | ₱17,068 | ₱5,402 | ₱4,876 |
| Trade and other receivables – current and non-current: | | | |
| Billed: | | | |
| Residential | 4,808 | 5,005 | 7,271 |
| Commercial | 5,981 | 6,571 | 4,565 |
| Industrial | 2,210 | 3,224 | 2,769 |
| Flat streetlights | 159 | 143 | 51 |
| Unbilled receivables | 5,537 | 20,078 | 17,189 |
| Trade receivables of subsidiaries | 1,813 | 1,488 | 801 |
| Other receivables | 840 | 1,112 | 809 |
| AFS investments | 356 | 403 | 404 |
| Derivative assets | 183 | 121 | 300 |
| Refundable deposits (included under "Other current assets" account) | 13 | 13 | 11 |
| | ₱38,968 | ₱43,560 | ₱39,046 |

The credit quality of financial assets is managed by the Parent Company using "High Grade," "Standard Grade" and "Sub-standard Grade" as internal credit ratings. The table below shows the credit quality by class of asset:

| | December 31, 2009 | | | | | |
|---|---|---|---|---|---|---|
| | Neither Past Due nor Impaired | | | | | |
| | High Grade | Standard Grade | Sub-standard Grade | Past Due but not Impaired | Impaired Financial Assets | Total |
| | (Amounts in Millions) | | | | | |
| Cash and cash equivalents | ₱15,430 | ₱– | ₱– | ₱– | ₱– | ₱15,430 |
| Trade receivables | | | | | | |
| Billed: | | | | | | |
| Residential | 1,433 | 1,142 | 1,831 | 402 | 529 | 5,337 |
| Commercial | 1,521 | 1,211 | 1,943 | 1,306 | 1,007 | 6,988 |
| Industrial | 718 | 478 | 767 | 247 | 259 | 2,469 |
| Flat streetlights | 3 | 4 | 6 | 146 | 293 | 452 |
| Unbilled receivables | 5,537 | – | – | – | – | 5,537 |
| | 9,212 | 2,835 | 4,547 | 2,101 | 2,088 | 20,783 |
| Other receivables | 707 | – | 236 | 240 | 56 | 1,239 |
| Derivative assets | 183 | – | – | – | – | 183 |
| AFS investments | 98 | – | – | – | – | 98 |
| Refundable deposits | 13 | – | – | – | – | 13 |
| | ₱25,643 | ₱2,835 | ₱4,783 | ₱2,341 | ₱2,144 | ₱37,746 |

| | December 31, 2008 | | | | | |
|---|---|---|---|---|---|---|
| | Neither Past Due nor Impaired | | | | | |
| | High Grade | Standard Grade | Sub-standard Grade | Past Due but not Impaired | Impaired Financial Assets | Total |
| | *(Amounts in Millions)* | | | | | |
| Cash and cash equivalents | ₱4,023 | ₱– | ₱– | ₱– | ₱– | ₱4,023 |
| Trade receivables – | | | | | | |
| Billed: | | | | | | |
| Residential | 1,290 | 1,294 | 1,908 | 513 | 774 | 5,779 |
| Commercial | 1,265 | 1,436 | 2,118 | 1,752 | 608 | 7,179 |
| Industrial | 1,483 | 597 | 882 | 262 | 267 | 3,491 |
| Flat streetlights | 2 | 3 | 4 | 134 | 278 | 421 |
| Unbilled receivables | 20,078 | – | – | – | – | 20,078 |
| | 24,118 | 3,330 | 4,912 | 2,661 | 1,927 | 36,948 |
| Other receivables | 829 | – | 495 | 283 | 92 | 1,699 |
| Derivative assets | 121 | – | – | – | – | 121 |
| AFS investments | 28 | 118 | – | – | – | 146 |
| | ₱29,119 | ₱3,448 | ₱5,407 | ₱2,944 | ₱2,019 | ₱42,937 |

| | December 31, 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Neither Past Due nor Impaired | | | | | |
| | High Grade | Standard Grade | Sub-standard Grade | Past Due but not Impaired | Impaired Financial Assets | Total |
| | *(Amounts in Millions)* | | | | | |
| Cash and cash equivalents | ₱4,062 | ₱– | ₱– | ₱– | ₱– | ₱4,062 |
| Trade receivables: | | | | | | |
| Billed: | | | | | | |
| Residential | 2,730 | 2,258 | 369 | 1,914 | 317 | 7,588 |
| Commercial | 1,246 | 987 | 962 | 1,370 | 635 | 5,200 |
| Industrial | 1,231 | 762 | 306 | 470 | 161 | 2,930 |
| Flat streetlights | 1 | 6 | 4 | 40 | 9 | 60 |
| Unbilled receivables | 17,189 | – | – | – | – | 17,189 |
| | 22,397 | 4,013 | 1,641 | 3,794 | 1,122 | 32,967 |
| Other receivables | 209 | 1 | 602 | 363 | 254 | 1,429 |
| Derivative assets | 256 | – | – | – | – | 256 |
| AFS investments | 28 | 118 | – | – | – | 146 |
| | ₱26,952 | ₱4,132 | ₱2,243 | ₱4,157 | ₱1,376 | ₱38,860 |

Credit ratings are determined as follows:

- "High Grade"

  This includes cash and cash equivalents, derivative assets and AFS investments to counterparties with good credit rating or bank standing, thus credit risk is minimal. This normally includes large prime financial institutions, companies and government agencies. For trade receivables, this consists of current month's billings (less than 30 days) that are expected to be collected before due date (1 to 9 days after billed date).

- "Standard Grade"

  This includes AFS investments that are not classified as "High Grade." For trade receivables, this consists of current month's billings (less than 30 days) that are expected to be collected before expiry date (10 to 14 days after billed date).

- "Sub-standard Grade"

  This includes trade receivables that consist of current month's billings which are not foreseen to be collected within 60 days.

The credit quality of financial assets is managed by Rockwell using internal credit ratings. The table below shows the credit quality by class of asset:

| | 2009 | | |
|---|---|---|---|
| | **A Rating** | **B Rating** | **Total** |
| | *(Amounts in Millions)* | | |
| Cash and cash equivalents | ₱393 | ₱– | ₱393 |
| Trade receivables from: | | | |
| Sale of condominium units | – | 69 | 69 |
| Leases | 61 | 7 | 68 |
| Advances to officers and employees | 9 | – | 9 |
| AFS investments: | | | |
| Quoted | 242 | – | 242 |
| Unquoted | 3 | – | 3 |
| | 708 | 76 | 784 |
| Less unrecognized portion of trade receivable from sale of condominium units due IAS 39 | – | 59 | 59 |
| | ₱708 | ₱17 | ₱725 |

| | 2008 | | |
|---|---|---|---|
| | **A Rating** | **B Rating** | **Total** |
| | *(Amounts in Millions)* | | |
| Cash and cash equivalents | ₱456 | ₱– | ₱456 |
| Trade receivables from: | | | |
| Sale of condominium units | 249 | 283 | 532 |
| Leases | 42 | 29 | 71 |
| Advances to officers and employees | 7 | – | 7 |
| AFS investments: | | | |
| Quoted | 240 | – | 240 |
| Unquoted | 3 | – | 3 |
| | 997 | 312 | 1,309 |
| Less unrecognized portion of trade receivable from sale of condominium units due to IAS 39 | 9 | 10 | 19 |
| | ₱988 | ₱302 | ₱1,290 |

| | 2007 | | |
|---|---|---|---|
| | A Rating | B Rating | Total |
| | *(Amounts in Millions)* | | |
| Cash and cash equivalents | ₱112 | ₱– | ₱112 |
| Trade receivables from: | | | |
| Sale of condominium units | 295 | 346 | 641 |
| Leases | 24 | 29 | 53 |
| Advances to officers and employees | 8 | – | 8 |
| Other receivables | 3 | – | 3 |
| AFS investments: | | | |
| Quoted | 241 | – | 241 |
| Unquoted | 3 | – | 3 |
| Derivative assets | 44 | – | 44 |
| Refundable deposits | 2 | – | 2 |
| | 732 | 375 | 1,107 |
| Less unrecognized portion of trade receivable from sale of condominium units due to IAS 39 | 295 | 346 | 641 |
| | ₱437 | ₱29 | ₱466 |

For trade receivables from sale of condominium units, customers who have no history of delayed payment are classified as having a credit rating of "A" while customers who have history of delayed payment but is currently updated are given a credit rating of "B."

Trade receivables from leases are classified as having a credit rating of "A" when tenants pay within the discount period and "B" when tenants pay on or before due date.

The following table shows the aging analysis of financial assets of the Company:

| | 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Past Due But Not Impaired | | | | | |
| | Neither Past Due nor Impaired | Less than 30 days | 31 to 60 Days | 61 to 90 Days | More than 90 Days | Impaired Financial Assets | Total |
| | *(Amounts in Millions)* | | | | | | |
| Cash and cash equivalents | ₱17,068 | ₱– | ₱– | ₱– | ₱– | ₱– | ₱17,068 |
| Trade receivables – | | | | | | | |
| Billed: | | | | | | | |
| Residential | 4,406 | – | 310 | 84 | 8 | 529 | 5,337 |
| Commercial | 4,675 | – | 602 | 206 | 498 | 1,007 | 6,988 |
| Industrial | 1,963 | – | 86 | 43 | 118 | 259 | 2,469 |
| Flat streetlights | 13 | – | 59 | 39 | 48 | 293 | 452 |
| Unbilled receivables | 5,537 | – | – | – | – | – | 5,537 |
| Trade receivables of subsidiaries | 1,398 | 211 | 50 | 37 | 63 | – | 1,759 |
| Other receivables | 598 | 2 | 4 | 3 | 233 | 234 | 1,074 |
| AFS investments: | | | | | | | |
| Quoted | 334 | – | – | – | – | – | 334 |
| Unquoted | 22 | – | – | – | – | – | 22 |
| Derivative assets | 183 | – | – | – | – | – | 183 |
| Refundable deposits | – | – | – | – | 13 | – | 13 |
| | 36,197 | 213 | 1,111 | 412 | 981 | 2,322 | 41,236 |
| Less unrecognized portion due to effect of discounting | 59 | 71 | 17 | 13 | 21 | – | 181 |
| | ₱36,138 | ₱142 | ₱1,094 | ₱399 | ₱960 | ₱2,322 | ₱41,055 |

| | 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Past Due But Not Impaired | | | | | |
| | Neither Past Due nor Impaired | Less than 30 days | 31 to 60 Days | 61 to 90 Days | More than 90 Days | Impaired Financial Assets | Total |
| | | | | (Amounts in Millions) | | | |
| Cash and cash equivalents | ₱5,402 | ₱– | ₱– | ₱– | ₱– | ₱– | ₱5,402 |
| Trade receivables: | | | | | | | |
| Billed | | | | | | | |
| Residential | 4,492 | – | 344 | 84 | 85 | 774 | 5,779 |
| Commercial | 4,819 | – | 638 | 268 | 846 | 608 | 7,179 |
| Industrial | 2,962 | – | 123 | 35 | 104 | 267 | 3,491 |
| Flat streetlights | 9 | – | 78 | 44 | 12 | 278 | 421 |
| Unbilled receivables | 20,078 | – | – | – | – | – | 20,078 |
| Trade receivables of subsidiaries | 1,106 | 191 | 4 | 11 | 61 | – | 1,373 |
| Other receivables | 805 | 22 | 7 | 3 | 275 | 92 | 1,204 |
| AFS investments: | | | | | | | |
| Quoted | 329 | – | – | – | – | – | 329 |
| Unquoted | 74 | – | – | – | – | – | 74 |
| Derivative assets | 121 | – | – | – | – | – | 121 |
| Refundable deposits | – | 1 | – | – | 12 | – | 13 |
| | 40,197 | 214 | 1,194 | 445 | 1,395 | 2,019 | 45,464 |
| Less: Unrecognized portion due to effect of discounting | 19 | 6 | – | – | 2 | – | 27 |
| | ₱40,178 | ₱ 208 | ₱1,194 | ₱445 | ₱1,393 | ₱2,019 | ₱45,437 |

| | 2007 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | Past Due But Not Impaired | | | | | |
| | Neither Past Due nor Impaired | Less than 30 days | 31 to 60 Days | 61 to 90 Days | More than 90 Days | Impaired Financial Assets | Total |
| | | | | (Amounts in Millions) | | | |
| Cash and cash equivalents | ₱4,876 | ₱– | ₱– | ₱– | ₱– | ₱– | ₱4,876 |
| Trade receivables: | | | | | | | |
| Billed: | | | | | | | |
| Residential | 5,357 | – | 357 | 129 | 1,428 | 317 | 7,588 |
| Commercial | 3,195 | – | 470 | 231 | 669 | 635 | 5,200 |
| Industrial | 2,299 | – | 154 | 49 | 267 | 161 | 2,930 |
| Flat streetlights | 11 | – | 4 | 3 | 33 | 9 | 60 |
| Unbilled receivables | 17,189 | – | – | – | – | – | 17,189 |
| Trade receivables of subsidiaries | 642 | 32 | 15 | 12 | 51 | – | 752 |
| Other receivables | 440 | – | 1 | 17 | 351 | 254 | 1,063 |
| AFS investments: | | | | | | | |
| Quoted | 330 | – | – | – | – | – | 330 |
| Unquoted | 74 | – | – | – | – | – | 74 |
| Derivative assets | 300 | – | – | – | – | – | 300 |
| Refundable deposits | 2 | – | – | – | 9 | – | 11 |
| | 34,715 | 32 | 1,001 | 441 | 2,808 | 1,376 | 40,373 |
| Less: Unrecognized portion due to effect of discounting | 641 | 13 | 2 | 2 | 8 | – | 666 |
| | ₱34,074 | ₱19 | ₱999 | ₱439 | ₱2,800 | ₱1,376 | ₱39,707 |

**Liquidity Risk**

Liquidity risk is the risk that the Company will be unable to meet its payment obligations when they fall due. The Company manages this risk through daily monitoring of cash flows in consideration of future payment due dates and daily collection amounts. The Company also ensures that there are sufficient, available and approved working capital lines that it can draw from at any time.

The Company maintains an adequate amount of cash and cash placements in the event of unforeseen interruption of its cash collections. The Company also maintains accounts with several relationship banks to avoid significant concentration of cash with one institution.

The following table sets out the maturity profile of the Company's financial liabilities based on the contractual undiscounted payments:

| | 2009 | | | | |
|---|---|---|---|---|---|
| | **Less than 3 Months** | **3–12 Months** | **1–5 Years** | **More than 5 Years** | **Total** |
| | *(Amounts in Millions)* | | | | |
| Notes payable* | ₱513 | ₱– | ₱– | ₱– | ₱513 |
| Trade accounts payables | 16,943 | – | – | – | 16,943 |
| Other payables | 6,473 | 25 | – | – | 6,498 |
| CERA I and II over-recoveries, including carrying charges | 946 | 37 | – | – | 983 |
| Derivative financial instruments: | | | | | |
| Parent Company | 24 | – | – | – | 24 |
| Rockwell | | | | | |
| Derivative payments | – | 111 | – | – | 111 |
| Derivative receipts | – | (111) | – | – | (111) |
| Interest-bearing loans and borrowings*: | | | | | |
| Floating rate borrowings: | | | | | |
| Parent Company | 53 | 1,065 | 4,486 | 3,668 | 9,272 |
| Rockwell | 51 | 301 | 482 | – | 834 |
| Fixed rate borrowings: | | | | | |
| Parent Company | 598 | 980 | 10,626 | – | 12,204 |
| Rockwell | 260 | 717 | 2,567 | – | 3,544 |
| Preferred stock | – | 923 | 325 | – | 1,248 |
| Liability arising from deferred pass-through fuel costs – current and non-current* | – | 433 | – | – | 433 |
| Meter deposits* | – | 1,372 | 1,289 | – | 2,661 |
| Customers' refund | 365 | 1,096 | 7,508 | – | 8,969 |
| Security deposits | 8 | 158 | 30 | – | 196 |
| Retention payable | 4 | 92 | 111 | – | 207 |
| Total undiscounted financial liabilities | ₱26,238 | ₱7,199 | ₱27,424 | ₱3,668 | ₱64,529 |

* *Principal plus interest payments*

| | 2008 | | | | |
|---|---|---|---|---|---|
| | **Less than 3 Months** | **3–12 Months** | **1–5 Years** | **More than 5 Years** | **Total** |
| | *(Amounts in Millions)* | | | | |
| Notes payable* | ₱– | ₱9,976 | ₱– | ₱– | ₱9,976 |
| Trade accounts payables | 9,293 | 543 | – | – | 9,836 |
| Other payables | 2,331 | 160 | 2,350 | – | 4,841 |
| CERA I and II over-recoveries, including carrying charges | 87 | 830 | 3,008 | – | 3,925 |
| Derivative financial instruments: | | | | | |
| Parent Company | 28 | – | – | – | 28 |
| Rockwell | | | | | |
| Derivative payments | 59 | 24 | 114 | – | 197 |
| Derivative receipts | (54) | (23) | (111) | – | (188) |
| Interest-bearing loans and borrowings*: | | | | | |
| Floating rate borrowings: | | | | | |
| Parent Company | – | 958 | 6,315 | – | 7,273 |
| Rockwell | 403 | 93 | – | – | 496 |
| Fixed rate borrowings: | | | | | |
| Parent Company | – | 996 | 6,448 | – | 7,444 |
| Rockwell | 43 | 267 | 2,359 | – | 2,669 |
| Preferred stock | – | 906 | 1,199 | – | 2,105 |
| Liability arising from deferred pass-through fuel costs – current and non-current* | 933 | 325 | – | – | 1,258 |
| Meter deposits* | 114 | 343 | 2,422 | – | 2,879 |
| Customers' refund | 726 | 7,754 | 2,905 | – | 11,385 |
| Security deposits | 197 | – | – | – | 197 |
| Retention payable | 12 | 76 | 31 | – | 119 |
| Total undiscounted financial liabilities | ₱14,172 | ₱23,228 | ₱27,040 | ₱– | ₱64,440 |

* *Principal plus interest payments*

| | 2007 | | | | |
|---|---|---|---|---|---|
| | **Less than 3 Months** | **3–12 Months** | **1–5 Years** | **More than 5 Years** | **Total** |
| | *(Amounts in Millions)* | | | | |
| Notes payable* | ₱5,034 | ₱5,834 | ₱– | ₱– | ₱10,868 |
| Trade accounts payables | 14,615 | – | – | – | 14,615 |
| Other payables | 2,896 | 33 | 1,461 | – | 4,390 |
| CERA I and II over-recoveries, including carrying charges | – | 3,092 | – | – | 3,092 |
| Derivative assets: | | | | | |
| Rockwell | | | | | |
| Derivative payments | 45 | 126 | 142 | – | 313 |
| Derivative receipts | (56) | (149) | (159) | – | (364) |
| Interest-bearing loans and borrowings*: | | | | | |
| Floating rate borrowings: | | | | | |
| Parent Company | – | 959 | 3,394 | 3,784 | 8,137 |
| Rockwell | – | 608 | 149 | – | 757 |
| Fixed rate borrowings: | | | | | |
| Parent Company | – | 1,015 | 3,610 | 3,805 | 8,430 |
| Rockwell | – | – | 1,000 | – | 1,000 |
| Preferred stock | – | 876 | 1,813 | – | 2,689 |
| Liability arising from deferred pass-through fuel costs – current and non-current* | 486 | 1,395 | 1,315 | – | 3,196 |
| Customers' refund | 726 | 5,054 | 8,646 | – | 14,426 |
| Security deposits | 82 | 29 | 53 | – | 164 |
| Retention payable | – | 1 | 161 | – | 162 |
| Total undiscounted financial liabilities | ₱23,828 | ₱18,873 | ₱21,585 | ₱7,589 | ₱71,875 |

* *Principal plus interest payments*

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service which is not reasonably predictable. However, the Company estimates that a portion of bill deposits (including related interest), amounting to ₱687 million, will be refunded in 2010. This is shown as part of "Trade and other payables" account in the 2009 consolidated and parent company statement of financial position.

**Capital Management**

The primary objective of the Parent Company's capital management is to enhance shareholder value. It reviews its capital structure with the end view of achieving a competitive cost of capital and at the same time ensures that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

The capital structure optimization plan is complemented by efforts to improve capital efficiency to increase yields on invested capital. This entails efforts to improve the efficiency of capital assets, working capital and non-core assets.

To do this, the Parent Company manages its level of long-term debt versus equity ratio, as well as its gearing, based on levels with comparable electric utilities.

The Parent Company monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Parent Company includes within net debt the interest-bearing loans and borrowings, preferred shares less cash and cash equivalents.

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts In Millions, except Gearing Ratio)* | | |
| Interest-bearing loans and borrowings | ₱16,284 | ₱11,219 | ₱10,500 |
| Notes payable | 500 | 9,770 | 12,264 |
| Preferred shares | 960 | 1,798 | 2,278 |
| Cash and cash equivalents | (15,430) | (4,023) | (4,062) |
| Net debt (a) | 2,314 | 18,764 | 20,980 |
| Capital | 53,907 | 49,523 | 47,503 |
| Capital and net debt (b) | ₱56,221 | ₱68,287 | ₱68,483 |
| Gearing ratio (a/b) | 4% | 27% | 31% |

Rockwell monitors its capital adequacy using the debt-to-equity ratio, which is interest-bearing loans and borrowings divided by equity. Rockwell's policy is to limit the debt-to-equity ratio to 0.40x.

As of December 31, 2009, 2008 and 2007, Rockwell is required to maintain certain financial ratios as set forth in the Fixed Rate Corporate Notes Facility Agreement, including debt-to-equity ratio (see Note 20). The Agreement provides for a higher ratio than the internal limit set by Rockwell's management.

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | *(Amounts In Millions, except Debt-to-equity Ratio)* | | |
| Interest-bearing loans and borrowings | ₱2,909 | ₱2,476 | ₱1,749 |
| Equity | 7,416 | 6,984 | 6,630 |
| Debt-to-equity ratio | 39% | 35% | 26% |

### 31. FINANCIAL INSTRUMENTS

**Fair Values**

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the consolidated statements of financial position:

| | Carrying Amount | | | Fair Value | | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2009 | 2008 | 2007 |
| | | | *(Amounts in Millions)* | | | |
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | ₱17,068 | ₱5,402 | ₱4,876 | ₱17,068 | ₱5,402 | ₱4,876 |
| Trade and other receivables – current and non-current: | | | | | | |
| Billed: | | | | | | |
| Residential | 4,808 | 5,005 | 7,271 | 4,808 | 5,005 | 7,271 |
| Commercial | 5,981 | 6,571 | 4,565 | 5,981 | 6,571 | 4,565 |
| Industrial | 2,210 | 3,224 | 2,769 | 2,211 | 3,224 | 2,769 |
| Flat streetlights | 159 | 143 | 51 | 158 | 143 | 51 |
| Unbilled | 5,537 | 20,078 | 17,189 | 5,537 | 20,078 | 17,189 |
| Trade receivables of subsidiaries | 1,813 | 1,488 | 801 | 1,813 | 1,488 | 801 |
| Other receivables | 840 | 1,112 | 809 | 840 | 1,112 | 809 |
| AFS investments | 356 | 403 | 404 | 356 | 403 | 404 |
| Derivative assets – current and non-current | 183 | 121 | 300 | 183 | 121 | 300 |
| Refundable deposits (included under "Other current assets" account) | 13 | 13 | 11 | 13 | 13 | 11 |
| | ₱38,968 | ₱43,560 | ₱39,046 | ₱38,968 | ₱43,560 | ₱39,046 |
| **Financial Liabilities** | | | | | | |
| Notes payable | ₱513 | ₱9,828 | ₱10,748 | ₱513 | ₱9,828 | ₱10,748 |
| Trade and other payables | 24,085 | 14,645 | 18,960 | 24,085 | 14,645 | 18,960 |
| CERA I and II over-recoveries, including carrying charges – current and non-current | 983 | 3,925 | 3,092 | 983 | 3,925 | 3,092 |
| Derivative liabilities – current and non-current | 28 | 49 | – | 28 | 49 | – |
| Interest-bearing loans and other borrowings*: | | | | | | |
| Floating rate borrowings | 7,636 | 6,054 | 6,821 | 8,054 | 6,349 | 7,351 |
| Fixed rate borrowings | 11,558 | 7,641 | 7,192 | 12,440 | 7,835 | 7,217 |
| Preferred stock | 960 | 1,798 | 2,278 | 960 | 1,798 | 2,278 |
| Liability arising from deferred pass-through fuel costs – current and non-current | 433 | 1,242 | 2,735 | 433 | 1,242 | 2,735 |
| Bill deposits – current and non-current | 24,459 | 22,181 | 20,041 | 24,459 | 22,181 | 20,041 |
| Meter deposits – current and non-current | 2,661 | 2,879 | 2,874 | 2,661 | 2,406 | 2,874 |
| Customers' refund – current and non-current | 9,147 | 10,605 | 12,770 | 9,147 | 10,464 | 8,716 |
| Deferred lease income – current and non-current | 72 | 68 | 62 | 72 | 68 | 62 |
| Security deposits – current and non-current | 196 | 197 | 164 | 196 | 197 | 151 |
| Retention payable – current and non-current | 208 | 119 | 162 | 186 | 98 | 150 |
| | ₱82,939 | ₱81,231 | ₱87,899 | ₱84,217 | ₱81,085 | ₱84,375 |

* *Carrying amounts are net of debt issuance costs.*

The fair value of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

*Cash and Cash Equivalents, Trade and Other Receivables – Billed and Others, Refundable Deposits, Trade and Other Payables, Notes Payable and Liability Arising from Deferred Pass-Through Fuel Costs*. Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as of reporting date. The value of "Trade and other payables" includes the value of bifurcated embedded currency forwards.

*Trade Receivables of Subsidiaries.* The fair values of trade and other receivables were calculated by discounting the expected future cash flows at prevailing credit adjusted PDEx interest rates ranging from 6.5% to 8.3% in 2009, 7.1% to 8.7% in 2008 and 6.4% to 8.2% in 2007.

*Bifurcated Foreign Currency Forward and Foreign Currency Forward (Rockwell).* The fair values of embedded currency forwards and freestanding currency forwards were calculated by reference to forward exchange market rates.

*Bifurcated Call Option*. The fair values of the embedded prepayment option were estimated based on prices derived using the binomial pricing methodology. The following inputs were used to determine the fair value of the bifurcated call option; contractual future cash flows, exercise price of ₱105, interest rate volatility of 26.29%, interest rate spot curves ranging from 6.28% to 8.12% in 2009 and 7.72% to 8.82% in 2008.

*AFS Investments*. The fair values were determined by reference to market bid quotes as of the reporting date. The unquoted equity securities were valued at cost.

*Interest-bearing Loans and Other Borrowings*. The fair values were computed by discounting the expected future cash flows using the prevailing credit adjusted LIBOR, PDST-F, CHF LIBOR and EURIBOR rates ranging from 4.68% to 7.30% in 2009, 1.75% to 8.135% in 2008 and 2.80% to 6.28% in 2007 and PDEx interest rate ranging from 6.5% to 8.4% in 2009, 6.5% to 7.7% in 2008 and 4.9% to 8.05% in 2007.

*Bill Deposits*. The fair values of bill deposits are not determinable since the timing of each refund is linked to the cessation of service which is not reasonably predictable. Bill deposits are presented at cost.

*Meter Deposits*. The fair values of meter deposits were computed by discounting the expected future cash flows using the prevailing credit adjusted PDST-F rates ranging from 4.81% to 5.12% in 2009 and 6.22% to 6.83% in 2008.

*Customers' Refund*. The fair values were computed by discounting the expected future cash flows using the prevailing credit adjusted PDST-F rates ranging from 6.28% to 8.13%in 2009, 7.75% to 8.44% in 2008 and 6.19% to 7.86% in 2007.

*Preferred Stock*. The fair values of preferred stock are not determinable since the timing of each redemption is not reasonably predictable. Preferred stock are presented at cost.

*Retention Payable and Security Deposits*. The fair values were calculated by discounting the expected future cash flows at prevailing credit adjusted PDEx interest rates ranging from 6.3% to7.4% in 2009, 6.4% to 7.5% in 2008 and 6.4% to 8.2% in 2007.

**Fair Value Hierarchy**

As at December 31, 2009, the Parent Company held the following financial instruments measured at fair value. The Parent Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

| | | 2009 | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| | | *(Amounts in Millions)* | |
| **Assets measured at fair value** | | | |
| AFS investments (included in "Other non-current assets" account) | ₱– | ₱356 | ₱– |
| Derivative assets – current and non-current | – | 183 | – |
| **Liabilities measured at fair value** | | | |
| Derivative liability | – | (28) | – |

For the year ended December 31, 2009, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

**Derivative Financial Instruments**

*Embedded Currency Forward*. The Parent Company has bifurcated embedded currency forwards noted in various purchases and service agreements denominated in US$, Euro and various other currencies. As of December 31, 2009, 2008 and 2007, these agreements represent only around 6%, 56% and 40% of the Parent Company's trade payables, respectively. As of December 31, 2009, 2008 and 2007, the US$-denominated agreements amounted to US$12 million (equivalent to ₱572 million), US$27 million (equivalent to ₱1,274 million) and US$37 million (equivalent to ₱1,534 million), respectively. As of December 31, 2009, 2008 and 2007, the Euro-denominated agreements amounted to EUR 4 million (equivalent to ₱259 million), EUR 8 million (equivalent to ₱519 million) and EUR 5 million (equivalent to ₱305 million), respectively. These are part of "Trade and other payables" account in the consolidated and parent company statements of financial position. Net fair value gain (loss) of these derivatives are (₱13 million), (₱9 million) and ₱83 million as of December 31, 2009, 2008 and 2007, respectively.

*Embedded Call Option*. As discussed in Note 20, the Parent Company has an embedded call option (prepayment option) in its ₱6,000 million 9% Tranche A Fixed rate corporate notes issued in December 2006. The Parent Company recognized separately at transaction date the fair value of the embedded call option on Tranche A Note amounting to ₱167 million. As of December 31, 2009, 2008 and 2007, the net fair value gain of this derivative amounted to ₱172 million, ₱102 million and ₱173 million, respectively.

The net movements in fair value changes of the Parent Company's derivative instruments as of December 31, 2009, 2008 and 2007 are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Balance at beginning of year | ₱93 | ₱256 | ₱190 |
| Net changes in fair value of derivatives not designated as accounting hedges | 72 | (123) | 143 |
| Fair value of settled instruments | (6) | (40) | (77) |
| Balance at end of year | ₱159 | ₱93 | ₱256 |

*Currency Forward (Rockwell)*. Rockwell entered into deliverable currency forward contracts to hedge its foreign currency exposure arising from its US$-denominated receivables. As of December 31, 2009, 2008 and 2007, Rockwell has outstanding currency forward contracts to sell US$ with an aggregate notional amount of US$2.4 million, US$4.2 million and US$7.6 million, respectively, and weighted average contracted forward rate of ₱46.21 to US$1.00, ₱45.30 to US$1.00 and ₱47.96 to US$1.00, respectively. Outstanding derivatives will mature in 2009 until 2010. The net fair value gain (loss) on the outstanding currency forward contracts amounted to ₱10 million, (₱44 million) and ₱44 million as of December 31, 2009, 2008 and 2007, respectively. As of December 31, 2009, 2008 and 2007, Rockwell's outstanding currency forward contracts had a fair value loss of ₱4 million, ₱21 million and ₱44 million, respectively.

The net movements in fair value changes of Rockwell's derivative instruments as of December 31, 2009, 2008 and 2007 are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Balance at beginning of year | (₱21) | ₱44 | ₱15 |
| Net changes in fair value of derivatives not designated as accounting hedges | 10 | (44) | 44 |
| Fair value of settled instruments | 7 | (21) | (15) |
| Balance at end of year | (₱4) | (₱21) | ₱44 |

The fair value changes of the Company's derivative instruments as of December 31, 2009, 2008 and 2007 are presented as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| Derivative assets: | | | |
| Current portion *(see Note 17)* | ₱11 | ₱19 | ₱117 |
| Non-current portion *(see Note 13)* | 172 | 102 | 183 |
| Derivative liabilities: | | | |
| Current portion *(see Note 25)* | (28) | (35) | – |
| Non-current portion (included as part of "Other non-current liabilities" account) | – | (14) | – |
| | ₱155 | ₱72 | ₱300 |

**32. CATEGORIES OF FINANCIAL INSTRUMENTS**

The following tables set forth the categories of financial instruments of the Company as of December 31, 2009, 2008 and 2007:

| | 2009 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Loans and Receivables | Held to Maturity | Held for Trading | Assets Designated at FVPL | Derivatives | Available for Sale | Total |
| | *(Amounts in Millions)* | | | | | | |
| **ASSETS** | | | | | | | |
| Other non-current assets *(see Note 13)* | ₱54 | ₱– | ₱– | ₱– | ₱172 | ₱356 | ₱582 |
| Cash and cash equivalents *(see Note 14)* | 17,068 | – | – | – | – | – | 17,068 |
| Trade and other receivables – net *(see Note 15)* | 21,294 | – | – | – | – | – | 21,294 |
| Other current assets *(see Note 17)* | 13 | – | – | – | 11 | – | 24 |
| | ₱38,429 | ₱– | ₱– | ₱– | ₱183 | ₱356 | ₱38,968 |

| | 2008 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Loans and Receivables | Held to Maturity | Held for Trading | Assets Designated at FVPL | Derivatives | Available for Sale | Total |
| | *(Amounts in Millions)* | | | | | | |
| **ASSETS** | | | | | | | |
| Other non-current assets *(see Note 13)* | ₱115 | ₱– | ₱– | ₱– | ₱102 | ₱403 | ₱620 |
| Cash and cash equivalents *(see Note 14)* | 5,402 | – | – | – | – | – | 5,402 |
| Trade and other receivables – net *(see Note 15)* | 37,506 | – | – | – | – | – | 37,506 |
| Other current assets *(see Note 17)* | 13 | – | – | – | 19 | – | 32 |
| | ₱43,036 | ₱– | ₱– | ₱– | ₱121 | ₱403 | ₱43,560 |

| | 2007 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Loans and Receivables | Held to Maturity | Held for Trading | Assets Designated at FVPL | Derivatives | Available for Sale | Total |
| | (Amounts in Millions) | | | | | | |
| **ASSETS** | | | | | | | |
| Other non-current assets *(see Note 13)* | ₱49 | ₱– | ₱– | ₱– | ₱183 | ₱404 | ₱636 |
| Cash and cash equivalents *(see Note 14)* | 4,876 | – | – | – | – | – | 4,876 |
| Trade and other receivables – net *(see Note 15)* | 33,406 | – | – | – | – | – | 33,406 |
| Other current assets *(see Note 17)* | 11 | – | – | – | 117 | – | 128 |
| | ₱38,342 | ₱– | ₱– | ₱– | ₱300 | ₱404 | ₱39,046 |

| | 2009 | | | |
|---|---|---|---|---|
| | Liabilities at FVPL | Derivatives | Other Liabilities | Total |
| | (Amounts in Millions) | | | |
| **LIABILITIES** | | | | |
| Interest-bearing loans and borrowings *(see Note 20)* | ₱– | ₱– | ₱20,154 | ₱20,154 |
| CERA I and II over-recoveries, including carrying charges *(Note 25)* | – | – | 983 | 983 |
| Bill deposits *(Note 21)* | – | – | 24,459 | 24,459 |
| Meter deposits *(Note 21)* | – | – | 2,661 | 2,661 |
| Customers' refund *(Note 23)* | – | – | 9,147 | 9,147 |
| Liability arising from deferred pass-through fuel costs *(see Note 25)* | – | – | 433 | 433 |
| Notes payable *(Note 24)* | – | – | 513 | 513 |
| Trade and other payables *(Note 25)* | – | – | 24,408 | 24,408 |
| Derivative liabilities *(Note 25)* | – | 28 | – | 28 |
| | ₱– | ₱28 | ₱82,758 | ₱82,786 |

| | 2008 | | | |
|---|---|---|---|---|
| | Liabilities at FVPL | Derivatives | Other Liabilities | Total |
| | *(Amounts in Millions)* | | | |
| **LIABILITIES** | | | | |
| Interest-bearing loans and borrowings *(see Note 20)* | ₱– | ₱– | ₱15,493 | ₱15,493 |
| CERA I and II over-recoveries, including carrying charges *(Note 25)* | – | – | 3,925 | 3,925 |
| Bill deposits *(Note 21)* | – | – | 22,181 | 22,181 |
| Meter deposits *(Note 21)* | – | – | 2,879 | 2,879 |
| Customers' refund *(Note 23)* | – | – | 10,605 | 10,605 |
| Liability arising from deferred pass-through fuel costs *(see Note 25)* | – | – | 1,242 | 1,242 |
| Other non-current liabilities | – | – | 171 | 171 |
| Notes payable *(Note 24)* | – | – | 9,828 | 9,828 |
| Trade and other payables *(Note 25)* | – | – | 14,858 | 14,858 |
| Derivative liabilities *(Note 25)* | – | 49 | – | 49 |
| | ₱– | ₱49 | ₱81,182 | ₱81,231 |

| | 2007 | | | |
|---|---|---|---|---|
| | Liabilities at FVPL | Derivatives | Other Liabilities | Total |
| | *(Amounts in Millions)* | | | |
| **LIABILITIES** | | | | |
| Interest-bearing loans and borrowings *(see Note 20)* | ₱– | ₱– | ₱16,291 | ₱16,291 |
| CERA I and II over-recoveries, including carrying charges *(Note 25)* | – | – | 3,092 | 3,092 |
| Bill deposits *(Note 21)* | – | – | 20,041 | 20,041 |
| Meter deposits *(Note 21)* | – | – | 2,874 | 2,874 |
| Customers' refund *(Note 23)* | – | – | 12,770 | 12,770 |
| Liability arising from deferred pass-through fuel costs *(see Note 25)* | – | – | 2,735 | 2,735 |
| Other non-current liabilities | – | – | 239 | 239 |
| Notes payable *(Note 24)* | – | – | 10,748 | 10,748 |
| Trade and other payables *(Note 25)* | – | – | 19,109 | 19,109 |
| Derivative liabilities *(Note 25)* | – | – | – | – |
| | ₱– | ₱– | ₱87,899 | ₱87,899 |

**33. INCOME AND FRANCHISE TAXES**

**a. Income Tax**

Deferred tax as of December 31, 2009, 2008 and 2007 relates to the following:

| | Consolidated | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | *(Amounts in Millions)* | | |
| Deferred tax liabilities: | | | |
| Revaluation increment in utility plant and others *(see Note 18)* | ₱8,318 | ₱8,490 | ₱8,695 |
| Depreciation method differential | 1,402 | 1,669 | 1,730 |
| Capitalized interest | 866 | 843 | 875 |
| Capitalized duties and taxes deducted in advance | 728 | 741 | 779 |
| Present value of customers' refund | 68 | 234 | 530 |
| Net book value of capitalized/realized foreign exchange losses | 109 | 133 | 161 |
| Change in fair value of investment properties | 645 | 537 | 547 |
| Excess of effective interest rate amortization over straight line amortization of debt issue costs | (1) | 6 | 1 |
| Others | 528 | 140 | 242 |
| | 12,663 | 12,793 | 13,560 |
| Deferred tax assets: | | | |
| Unfunded pension cost and unamortized past service cost | 3,637 | 4,310 | 4,877 |
| Provision for probable losses from refund *(see Note 22)* | 1,257 | 1,229 | – |
| Allowance for nonrecovery of receivables | 758 | 758 | – |
| Allowance for doubtful accounts | 648 | 602 | 415 |
| Provisions *(see Note 22)* | 991 | 494 | 419 |
| Employee share-based payment plan | – | 81 | 36 |
| Allowance for excess of cost over net realizable value | 19 | 26 | 54 |
| Others | 833 | 532 | 923 |
| | 8,143 | 8,032 | 6,724 |
| | ₱4,520 | ₱4,761 | ₱6,836 |

| | Parent Company | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (Amounts in Millions) | | |
| Deferred tax liabilities: | | | |
| Revaluation increment in utility plant and others *(see Note 18)* | ₱8,117 | ₱8,204 | ₱8,380 |
| Depreciation method differential | 1,402 | 1,669 | 1,730 |
| Capitalized interest | 777 | 751 | 780 |
| Capitalized duties and taxes deducted in advance | 728 | 741 | 779 |
| Present value of customers' refund | 68 | 234 | 530 |
| Net book value of capitalized/realized foreign exchange losses | 109 | 133 | 161 |
| Change in fair value of investment properties | 42 | 53 | 60 |
| Excess of effective interest rate amortization over straight line amortization of debt issue costs | (1) | 6 | 1 |
| Others | 94 | 75 | 154 |
| | 11,336 | 11,866 | 12,575 |
| Deferred tax assets: | | | |
| Unfunded pension cost and unamortized past service cost | 3,406 | 4,289 | 4,860 |
| Provision for probable losses from refund *(see Note 22)* | 1,257 | 1,229 | – |
| Allowance for nonrecovery of receivables | 758 | 758 | – |
| Allowance for doubtful accounts | 643 | 598 | 412 |
| Provisions *(see Note 22)* | 991 | 494 | 419 |
| Employee share-based payment plan | 196 | 81 | 36 |
| Allowance for excess of cost over net realizable value | 18 | 23 | 54 |
| Others | 135 | 126 | 32 |
| | 7,404 | 7,598 | 5,813 |
| | ₱3,932 | ₱4,268 | ₱6,762 |

A reconciliation between the provision for (benefit from) income tax computed at statutory income tax rates of 30% in 2009 and 35% in 2008 and 2007, and the provision for (benefit from) income tax as shown in the consolidated statements of income is as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Amounts in Millions) | | |
| Income tax computed at statutory tax rate | ₱2,944 | ₱2,756 | ₱5,204 |
| Income tax effects of: | | | |
| Interest income subjected to a lower final tax rate | (113) | (105) | (113) |
| Non-deductible interest expense | 43 | 77 | 60 |
| Equity in net earnings of associates and a joint venture | (73) | (156) | (113) |
| Non-deductible expenses | 259 | 65 | 92 |
| Non-taxable income | (37) | (4) | (273) |
| Others | 22 | 448 | 251 |
| Provision for income tax | ₱3,045 | ₱3,081 | ₱5,108 |

**b. Franchise Tax**

Based on the March 20, 2003 Decision on ERC Case Nos. 2001-646 and 2001-900 on the Parent Company's consolidated petitions, franchise tax should be identified as a separate line item on the customer's bill and computed as a percentage of the sum of all charges, except taxes and the universal charge.

In an Order dated March 8, 2004, the ERC directed the Parent Company to modify the franchise tax component of the Parent Company's billings to customers to comply with Rule 7 of the IRR of RA No. 9136. The said IRR provides that a distribution utility shall pay franchise taxes only on its distribution wheeling and captive market supply revenues. At present, pending the promulgation of guidelines from the Department of Finance, the Parent Company is paying local franchise tax based on gross receipts, as provided for under the Local Government Code. The Parent Company's legal counsel believes that this is consistent with the aforesaid provision of the IRR, since open access and retail competition has not yet been declared.

In accordance with RA No. 9337, the Parent Company no longer collected the national franchise tax of 2% on electricity consumption starting November 1, 2005. The same law prescribes the collection of VAT on electricity generation, transmission, distribution, and supply. Implementation of the VAT on customers' bills is in accordance with ERC Resolution No. 20, Series of 2005 which prescribes the Guidelines Implementing the Recovery of VAT and Other Provisions of RA No. 9337 Affecting the Electric Power Industry.

## 34. CONTINGENCIES

**a. Contingent Assets**

*1. Advances for Pass-Through Costs*

As of December 31, 2009, the Parent Company has contingent assets related to pass-through costs amounting to ₱813 million, consisting of under-recoveries for Transmission Charge of ₱8 million, and for System Loss Charges of ₱805 million as discussed in Note 6(I)(b).

For system loss charges, the ERC also approved on November 23, 2005, the Guidelines for the Calculation of the Over or Under Recovery in the Implementation of the System Loss Rate by Distribution Utilities. Following this guideline, the Parent Company implemented the recovery of ₱284 million in unbilled system loss charges starting with the February 2006 billing month. The recovery is being implemented over a period of 17 months or until such time that the amount has been collected. However, in ERC's Decision dated June 4, 2008 on the ten consolidated generation cost under-recovery cases, the Parent Company was directed to file a new application for the recovery of the system loss adjustments after the ERC has confirmed and approved the average transmission rate to be used in computing the system loss adjustment (see Note 2II(a)).

*2. Overpayment in Income Taxes*

The Parent Company also has a contingent asset for overpaid income taxes for the years 1994 to 1998 and 2000 to 2001 estimated at ₱7,107 million as a result of SC's Decision ordering the Parent Company to refund ₱0.167 per kWh to affected customers in April 2003. The Parent Company has filed its claim for the recovery of the excess income taxes for the said taxable years. The BIR has issued the letters of authority for the examination of the Parent Company's books during the said period, including submission of the documents. The BIR audit established that the refundable amount is ₱6,690 million but denied the same on grounds of prescription of claim, except the claim amount of ₱894 million for the year 2001 which was recognized by the BIR as having been filed on time. The BIR is refunding this amount to the Parent Company through the issuance of Tax Credit Certificate (TCC) proportionate to its actual refund to utility customers. Unissued TCCs as of December 31, 2009, 2008 and 2007 amounted to ₱577 million (see Note 13).

To avoid the setting in of prescription to file claim in the CTA, the Parent Company filed a Petition in the Court of Tax Appeals (CTA) assailing the denial by the BIR of its tax refund claim in the same amount of ₱7,107 million. The Parent Company amended the petition to reflect the refundable amount audited by BIR of ₱6,690 million less the ₱894 million granted by the BIR for the year 2001. The Solicitor General filed the answer for the BIR. The Petition is now in trial stage in which the Parent Company is presenting evidence in support of its claim for tax refund.

On February 3, 2006, the Parent Company filed a letter-request with the BIR seeking a ruling or confirmation that the refund of rollback rates by the Parent Company to its customers as a consequence of the decision of the SC, is deductible from gross income as an ordinary and necessary business expenses under Section 34(A) (1) of the National Internal Revenue Code (NIRC) of 1997. In the event that the ruling is favorable to the Parent Company, it will perforce withdraw the petition filed with the CTA corresponding to the amounts that will be allowed as a business expense deduction.

**b. Contingent Liabilities**

*1. Real Property Tax Assessments*

The Parent Company is being assessed by seven (7) local governments units (LGUs) for real property taxes on certain properties of the Parent Company such as its electric poles, wires, insulators, and transformers.

Of the seven (7) LGUs, only one has secured a favorable decision from the CA, in which the appellate court directed the LGU concerned to make a new assessment of the subject properties and collect the tax liabilities in accordance with the Local Government Code of 1991. In other words, no specific amount of real property tax liability of the Parent Company has been determined by the court. This decision is not yet final as it is the subject of pending petition for review with the SC. The other cases are still pending before the court, administrative bodies, or government offices concerned. An adverse decision on any of these cases may result in tax assessments by all LGUs within the franchise areas of the Parent Company. To date, there are 114 cities and municipalities under the Parent Company's franchise.

To address the possible liabilities for realty taxes, the Parent Company filed on December 23, 2004 an application with the ERC for a mechanism to recover all types of tax assessments by LGUs, excluding the local franchise tax. The first and only hearing on the application was conducted on May 23, 2005. This application was, however, overtaken by the issuance by the ERC of the Final Determination of the Parent Company's application for the approval of the annual revenue requirements under ERC Case No. 2006-045, where the ERC has removed, as part of the forecast operating and maintenance expenditures, the provision for real property taxes currently being challenged in court by the Parent Company, considering that "uncertainty exists around whether expenditure will occur at all." According to the ERC, "Article XI of the Rules for the setting of the Distribution Wheeling Rates allows for a tax event pass-through. However, in terms of the definition of Relevant Tax Events covered under this Article, most of the expenses covered under license fees, levies, duties and other taxes would not qualify. The ERC recognizes that uncertainty exists with regard to the current taxes discussed above, and that new taxes or levies could potentially arise that are not currently foreseen. It is therefore prepared to consider amending Article XI, after following due process, if material unforeseen expenses in this regard arise – including those currently recommended for exclusion."

On December 8, 2008, the ERC promulgated Resolution No. 20, Series of 2008, entitled "Resolution Modifying the Rules for Setting Distribution Wheeling Rates for Privately Owned Distribution Utilities Entering Performance Based Regulation (RDWR)." In the modified RDWR, the ERC has re-defined the term "Relevant Tax" to include any tax levied or imposed by the National Government or a Local Government, or any agency, department or instrumentality or other authority of the National Government or a Local Government, except those specified therein. Thus, real property taxes are now included in the definition of "Relevant Tax." Pursuant to the modified RDWR, a change in a Relevant Tax or the way in which a Relevant Tax is calculated, or the removal or imposition of a Relevant Tax, which results in a Regulated Entity incurring materially higher or lower costs than it would have incurred but for that event in the distribution of electricity, where the change in the relevant costs exceeds 1% of the total forecast operating and maintenance expenditure of the Regulated Entity, shall qualify as a Tax Change Event, which allows the pass-through of the Relevant Tax incurred by the Regulated Entity.

Management believes that any impact of an adverse decision from these cases will be mitigated by the filing of the Parent Company of the appropriate application with the ERC, for the recovery of these costs under the recovery mechanisms approved by the ERC.

2. *Local Franchise Tax Assessment*

The Parent Company was assessed by certain local governments for local franchise tax. In the opinion of the Parent Company's management and its legal counsel, the Parent Company has strong legal grounds to contest the assessments.

3. *Income Tax Assessment*

The SC's Decision ordering the Parent Company to refund ₱0.167 per kWh to affected customers became final in April 2003 has resulted in overpayment of income taxes estimated at that time at ₱8,900 million. The Parent Company exercised its option to amend its income tax return for the year 1999, which was then pending for audit by the BIR, to reflect an overpayment of income tax for that year in the sum of ₱977 million. The ₱977 million was carried over and credited to income tax liabilities in 2002, since the books of accounts of the Parent Company for the years 2000 and 2001 have already been audited by the BIR and their corresponding returns cannot be amended.

On March 16, 2007, the Parent Company received from the BIR-Large Taxpayers Division a Preliminary Assessment Notice dated January 2, 2007 disallowing the carryover and crediting of overpaid income tax of ₱977 million for the year 1999 to the year 2002. The BIR's preliminary notice of assessment shows the amount of ₱2,208 million including surcharge and interests.

BIR has explained that it is disallowing the carryover on the ground that the crediting of the 1999 overpayment of income tax was done beyond the two-year prescriptive period to ask for tax refund and that such carryover of tax credit can only be applied in the immediately succeeding year.

In February 2010, the Parent Company has already cleared this assessment with the BIR.

4. *NPC Settlement Agreement*

On November 21, 1994, the Parent Company entered into a 10-year Contract for the Sale of Electricity (CSE) with the government-owned firm, NPC, commencing on January 1, 1995. One of the provisions of RA No. 9136 is for NPC to submit to the ERC for approval Transition Supply Contracts (TSC) with distribution utilities before the year-end of 2001. The Parent Company, in a September 8, 2001 letter, signified its intention to enter into a TSC with NPC. NPC did not respond to the letter. Instead, it assessed the Parent Company starting January 2002 with a monthly billing adjustment based on the contracted volumes under the CSE which should have been already superseded by the TSC. The Parent Company in a letter dated February 20, 2002 cited its reasons for its refusal to pay the billing adjustment and also served notice that it is exercising its right to terminate as provided in the CSE. The Parent Company and NPC signed a TSC on November 16, 2006 (see Note 35(a)).

The disputed amount pertains to the difference between the cost of the contracted capacity and energy and the cost of the actual capacity and energy off-take from NPC. In October 2004, such disputed amount was allegedly estimated by NPC to accumulate to ₱42,000 million for the last three years of the CSE's term (from January 2002 to December 2004). In the Settlement Agreement described below, in the event that the Parent Company will be obliged to pay these amounts, these charges shall form part of the Parent Company's purchased power cost. The Parent Company did not pay the disputed amount as the grounds for which the billing adjustments may be imposed did not arise, among other reasons. The Parent Company did not accrue for these disputed bills nor did it set up a corresponding receivable from its customers.

Meanwhile, on March 24, 2003, the Parent Company served a written demand to NPC for payment of claims amounting to ₱9,787 million for the following: NPC's failure to provide timely transmission service to the Parent Company's IPPs, recovery of the 50% penalty for excess imbalance charges, imbalance charge adjustments, back-up energy rates, no-credit over-deliveries, NPC's failure to turn over directly-connected customers to the Parent Company, and delay in the commissioning of QPPL's power plant.

Following a mediation process undertaken between March to June 2003, the Parent Company signed a Settlement Agreement with NPC on July 15, 2003. Under the Settlement Agreement, the Parent Company shall pay NPC ₱27,515 million, representing the value of the difference between the aggregate contracted energy for the years 2002 to 2004 and the total energy the Parent Company has already bought from January 2002 until April 2003 plus the quantity it intended to buy until December 31, 2004 with the IPPs being dispatched at contract levels. This amount is subject to adjustment from the date of signing based on the energy that the Parent Company will purchase from NPC for the rest of 2003 and 2004. On the other hand, NPC shall credit the Parent Company for transmission delays as well as for energy corresponding to NPC's sales to directly-connected customers located in the Parent Company's existing franchise areas, totaling ₱7,465 million. The net payable of the Parent Company to NPC amounted to ₱20,050 million which the Parent Company expects to pass on to its customers (being generation costs) and settle with NPC based on the agreed terms of payment.

The Settlement Agreement shall take effect upon approval by the ERC for which both parties shall file a petition with the ERC. On November 24, 2003, the Parent Company and NPC filed with the ERC their respective applications for the approval of the Settlement Agreement. The following day, the Parent Company filed a motion for the consolidation of both cases.

On March 1, 2004, the Parent Company, TransCo and NPC entered into an Amendatory Dispatch Agreement whereby NPC warrants to reduce and/or accept a reduction of the nominated schedule of its IPPs to accommodate the Parent Company's own nominated schedule of its IPPs, thereby ensuring the dispatch of the Parent Company's IPPs to their respective MEQ levels up to midnight of December 31, 2004.

Through Motions filed on March 18 and 22, 2004 and granted by the ERC, the Parent Company and NPC, respectively, withdrew their separate applications for approval of the Settlement Agreement and re-filed it, along with the Amendatory Dispatch Agreement, through a joint petition on April 15, 2004.

In a joint compliance to the ERC dated January 20, 2006, the Parent Company and the NPC showed that since the Parent Company's actual off-take from NPC from the date of the signing and for the rest of 2003 and 2004 had been higher than the baseline quantities indicated in the Settlement Agreement, the net settlement amount payable to NPC and for collection from customers once approved by the ERC has been reduced from ₱20,050 million to ₱14,320 million. Since this amount forms part of the Parent Company's generation costs, it will be recognized as liability by the Parent Company only if the ERC or the Court, as the case may be, finally approves the Settlement Agreement and allows the pass-through of the said amount to the customers.

As of July 10, 2006, hearings on the joint application had already been completed and the case is still pending resolution by the ERC.

On April 17, 2008, NASECORE wrote to the Office of the Solicitor General (OSG) asking them to intervene in the case. In reaction thereto, on 8 May 2008, the OSG filed a Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between NPC and the Parent Company.

The Parent Company filed a Manifestation and Motion to Suspend Proceedings dated June 3, 2008 and Comment *Ad Cautelam* dated June 12, 2008 in reply thereto. In the said Manifestation and Motion to Suspend Proceedings, the Parent Company informed the ERC of the need to suspend this case in order to allow the Parent Company to obtain a ruling from the regular court on the civil and corporate law issues, before the ERC resolves the joint application on the merits. These issues are:

i. Whether or not the Settlement Agreement, being a compromise of reciprocal claims between the Parent Company and NPC, should have been submitted to the OSG for approval;

ii. Whether or not the NPC Board had authority to compromise the NPC claim mentioned in the Settlement Agreement between NPC and the Parent Company; and

iii. Whether or not the Settlement Agreement between NPC and the Parent Company is grossly prejudicial to the government.

In a September 14, 2009 Order, the ERC granted the Parent Company's petition for the suspension of proceedings on the joint petition of the NPC and the Parent Company for the approval of an SA. The SA resolved a dispute related to the 10-Year CSE between the Parent Company and NPC from January 1995 to December 2004. Under the SA, the Parent Company will pay NPC a net settlement amount of ₱14,320 million, which would be settled with NPC based on pre-agreed terms of payment. The SA shall take effect upon approval by the ERC.

The ERC Order dated September 14, 2009 stemmed from a May 8, 2008 motion filed by the OSG, which challenged the validity of the SA. On June 3, 2008, the Parent Company filed a motion for the ERC to suspend proceedings in order to allow the Parent Company to obtain a ruling from the regular court on the civil and corporate law issues arising from the OSG's motion. The ERC agreed with the Parent Company that the OSG's issues are not within the jurisdiction of the ERC and should be litigated before the regular courts. Accordingly, the ERC ordered that "the 'Joint Application' filed by NPC and the Parent Company be temporarily archived until further notice".

On November 23, 2009, the Parent Company filed a Petition for Declaratory Relief with the RTC of Pasig City ("RTC Pasig") against NPC, Power Sector Assets and Liabilities Management Corporation (PSALM) and the Republic of the Philippines as represented by the OSG. The case is docketed as SCA Case No. 3392. The petition seeks a declaration that the SA, independent of the pass-through provision which is reserved for approval by the ERC, is valid and binding. In an Order dated December 2, 2009, the RTC Pasig gave due course to the Petition and required the respondents to file their comments thereto. The Parent Company is awaiting the respective comments of PSALM, NPC and the OSG on the Petition as the parties filed motions for extension.

In the event that the SA is disapproved, both Parties shall revert to their respective positions before the mediation. If this happens, the remedy available to both parties, pursuant to the 10-year contract, is arbitration. In such a case, the Parent Company will continue to dispute any liability to NPC arising from the CSE, including the amount subject of the SA. On the other hand, in the event that the Settlement Agreement is approved, the Parent Company will recognize the liability to NPC with the corresponding receivable from customers.

5. *Deferred PPA*

On October 14, 2009, the ERC released its findings on the Parent Company's implementation of the collection of certain pass-through cost under-recoveries previously approved by the ERC. These amounts pertain to collections of the Deferred PPA, transmission line costs related to QPPL and Deferred Accounting Adjustments (DAA) incurred in 2004. According to the ERC's findings, the Parent Company over-recovered in its collection of the above items by ₱268 million. The Parent Company was directed to return the said amount to customers, along with ₱184 million in carrying charges, via a rate of ₱0.0169 per kWh beginning the next billing cycle after receipt of the ERC's ruling until the amount is fully refunded. The Parent Company is studying the ERC's findings for possible appeal.

6. *COA Audit*

In an SC Decision dated December 6, 2006 in G.R. Nos. 166769 and G.R. No. 166818 on the Parent Company's Unbundling case, the SC ruled that a COA audit was not a prerequisite for the determination of a utility's rates. However, while the SC affirmed the ERC's authority in rate-fixing, the SC also recognized the potential social impact of the matter. Thus, the SC directed the ERC to request the COA to undertake a complete audit of the books, records and accounts of the Parent Company. On January 15, 2007, in compliance with the SC directive, the ERC engaged the COA to conduct an audit covering test period calendar years 2004 and 2007 in accordance with the SC Decision dated December 6, 2006.

The COA audit, which began in September 2008, was completed in August 2009.

On February 17, 2010, the Parent Company received an order from the ERC under ERC Case No. 2001-900 RC, entitled "In the Matter of the Application for the Approval of the Unbundled Rates pursuant to the Provision of the Application for the Approval of the Unbundled Rates pursuant to the Provision of RA No. 9136, Manila Electric Company (Meralco), Applicant," directing all intervenors in the case to submit within fifteen (15) days from receipt of their respective comments on the COA's "Report No. 2009-01 Rate Audit Unbundled Charges" of the Parent Company for Calendar Years 2004 and 2007.

7. *Provision for Probable Refund*

The Parent Company provides for probable refund in relation to its transmission charge over-recoveries.

An additional provision for probable refund of the transmission cost over-recoveries in 2009 of ₱3,333 million was recognized and presented as part of "Provision for probable refund" account in the 2009 consolidated statement of income. The accumulated transmission charge over-recoveries decreased from ₱4,098 million in December 2008 to ₱2,514 million as of December 31, 2009.

8. *Other Claims*

The Parent Company is likewise contingently liable for lawsuits or claims filed by third parties, including labor related cases, which are pending decision by the courts, the outcome of which are not presently determinable. In the opinion of management and its legal counsel, the eventual total liability from these lawsuits or claims, if any, will not have a material effect on the financial information.

Related provisions amounted to ₱3,351 million, ₱318 million and ₱400 million in 2009, 2008 and 2007, respectively, while reversal of provisions amounted to ₱728 million in 2007 (see Note 22).

9. MIESCOR and Rockwell have contingent liabilities with respect to claims, lawsuits and taxes which are either pending decision by the courts or under negotiation, the outcome of which are not presently determinable. Management, after consultations with outside legal counsels, believes that the probable resolution of these issues will not materially affect the Company's financial position and results of operations.

## 35. SIGNIFICANT CONTRACTS AND COMMITMENTS

Significant contracts and commitments include:

### a. NPC

On November 16, 2006, NPC and the Parent Company signed a TSC which shall expire at the end of five (5) years from effectivity date or, if open access is introduced within this 5-year period, at the end of one (1) year from the introduction of open access. The schedule of Contracted Energy in gigawatt hours is 6,646 in 2007, 6,604 in 2008, 6,646 in 2009, 6,646 in 2010, and 6,646 in 2011 with the contract energy charge computed based on NPC's time-of-use (TOU) generation rate as approved by the ERC, plus adjustment in the NPC's tariff such as, but not limited to, DAA and the Incremental Currency Exchange Rate Adjustment (ICERA), the RA No. 9136 Mandatory Rate Reduction Adjustment, and an adjustment to reflect the incremental increase or decrease in the actual transmission line cost (charged in the WESM line rental cost) from the transmission line cost embedded in the ERC-approved TOU rate. Pursuant to the TSC, the Parent Company shall submit to NPC its month-ahead nomination of 720 hourly energy quantities in kilowatt hours but the commitment to buy shall be based on day-ahead nomination of 24-hourly energy quantities in kilowatt hours.

Among the salient features of the TSC are the following: (1) NPC will not impose any form of security deposit on the Parent Company; (2) the Parent Company can increase its monthly contracted energy if the increase is due to the non-availment by the Parent Company's customers of the One Day Power Sales and/or Customer Choice Program (CCP); (3) the Parent Company can reduce its monthly contracted energy if this is due to the transfer by the Parent Company's customer to NPC or to any other supplier during the advent of open access, or due to termination of electric service to or closure of a commercial or industrial customer of the Parent Company; (4) NPC may assign or transfer part or all of its rights and obligations to any entity after providing a written notice to the Parent Company at least 30 days prior to such assignment; (5) the Parent Company may assign, sell or transfer a part of or all its Contract Energy after the Parent Company has obtained prior clearance from TransCo and the Parent Company has submitted necessary proof that the buyer, assignee or transferee has no outstanding obligation to NPC; (6) the Parent Company may source power from NPC in excess of the Contract Energy by a quantity equivalent to not more than twenty percent (20%) of the Contract Energy subject to additional premium charge of twenty percent (20%) of TOU rates; and (7) upon request of the Parent Company within twenty four (24) hours from occurrence of shutdown or inability of any or all of the Parent Company's IPPs, NPC shall provide replacement power to the Parent Company priced at true cost of generating such replacement power plus ten percent (10%), in addition to all applicable ERC-approved charges and fees.

The Parent Company's energy off-take in excess of the TSC quantities shall be deemed to be taken from the WESM.

On July 20, 2007, the Parent Company and NPC signed an Addendum to the TSC, which increased the annual and monthly contract energy as specified in Annex 1 of the TSC, to address the load growth requirements of the Parent Company, and at the same time clarified section 5.6 of the TSC to mean the NPC may assign its TSC with the Parent Company or any portion of the contract energy, provided that if the Parent Company is prevented by any law, contract or competent authority to have a contractual relation with an assignee or successor generating company, no assignment of the TSC shall be made to such assignee. Accordingly, the schedule of Contracted Energy in gigawatt hours was increased to 7,156 in 2007, 7,624 in 2008, 7,666 in 2009, 7,666 in 2010, and 7,666 in 2011. On October 1, 2007, the Parent Company and NPC filed a Joint Motion for the approval of the Addendum. The joint motion is now submitted for the decision of the ERC.

In a Decision dated November 10, 2008 issued by the ERC, in connection with the Petition filed by the BTRCP-DTI against the Company (ERC Case No. 2008-016 RC), the ERC directed the Parent Company to negotiate and contract with NPC for an increase in the TSC contracted volume for it to match its updated demand forecast less the quantities under its IPP contracts. NPC and the Parent Company are currently in discussions to address the directive of the ERC.

On August 16, 2006, prior to the signing of the TSC, the Parent Company also signed an MOA with NPC for the implementation of the CCP for Large Industrial and Commercial Customers with an average peak demand of at least 1 MW for the preceding twelve (12) months, wherein the latter may avail of the TOU generation rates of NPC.

A joint application for the approval of the said MOA was filed by the Parent Company and NPC with the ERC on September 27, 2006. On November 17, 2006, the ERC provisionally approved the joint application enabling the Parent Company to implement the CCP. In relation to this, an application for the Approval of Rate Schedules for the CCP was filed by the Parent Company with the ERC on December 21, 2006. Said application sought to recover incremental charges that would be incurred by the Parent Company as a result of the implementation of the CCP. On March 14, 2007, a provisional authority was issued by the ERC, authorizing the imposition of the said incremental charges.

On March 8, 2007, the Parent Company and NPC filed a Second Joint Supplemental Motion with Manifestation aimed at lowering the threshold of the CCP to 750 kW, to enable more customers to avail of NPC's TOU rates. The ERC has yet to resolve the said motion.

In the meantime, upon mutual agreement by both the Parent Company and NPC, the term of the CCP was extended until otherwise directed by the ERC or when any of the grounds for the termination of the CCP MOA exist.

The Parent Company also executed an MOA with the NPC on September 17, 2007 for the provision of special ecozone rates to high load factor Philippine Economic Zone Authority (PEZA) -accredited industries. On September 21, 2007, the ERC gave clearance to the Parent Company to immediately proceed with the implementation of the said MOA.

In the course of the implementation of the ecozone MOA, the Parent Company and NPC agreed on an additional contract volume of 90 GWh for contract year 2008 and 296 GWh for contract year 2009, to accommodate additional ecozone customer consumption.

Total purchased power from NPC amounted to ₱42,779 million, ₱49,406 million and ₱54,998 million for the years ended December 31, 2009, 2008 and 2007, respectively. Prior to the implementation of NPC's unbundled charges on September 26, 2002, NPC's charges were not segregated between generation and transmission charges.

**b. TransCo/National Grid Corporation of the Philippines (NGCP)**

Pursuant to Section 8 of RA No. 9136, TransCo was created and assumed the electrical transmission function of NPC.

Total billings from TransCo for the years ended December 31, 2009, 2008 and 2007 amounted to ₱23,812 million, ₱25,009 million and ₱28,449 million, respectively, representing charges for transmission, ancillary, and other services starting September 26, 2002 upon the effectivity of the unbundled rate structure.

Beginning January 15, 2009, the NGCP assumed TransCo's operations from the government via a concession agreement and a franchise granted by Congress through RA No. 9511.

*Purchase of Subtransmission Assets (STAs)*

On June 30, 2008, the ERC approved the sale of various STAs of National Transmission Corporation to the Parent Company as covered by a Contract to Sell for ₱188 million, which was fully paid on September 2008.

The Parent Company began billing customers connected to the STAs from August 26, 2009 to September 25, 2009.

With respect to metering arrangement, NGCP will continue to be the meter service provider until NGCP is able to install its totalizing meters at the new delivery points. Thereon, it will be the Parent Company's obligation and responsibility to meter the customers. However, even if the Parent Company has the technical capability to meter all these customers, it can assume the metering function from NGCP for the customers with Electric Service Contract only upon securing a WESM Metering Provider License from the ERC.

A Memorandum of Agreement (MOA) which will cover in detail the protocol between the Parent Company, the NGCP, the Suppliers (NPC and Team Energy) and PEMC with regard to the foregoing arrangements is being finalized.

c. **FGPC and FGP Corp.**

The Department of Energy (DOE) in December 1994 asked the Parent Company to provide the 1,500 MW market for the expected 3,000 MW output of the Camago (Malampaya) gas field. The accelerated development of the field was in line with the government's energy self-reliance program and called for the simultaneous development of the field, the construction of the pipeline infrastructure, and the setting up of the downstream facilities (essentially gas-fired power plants) so that gas is landed in Luzon to supply a 2,000 MW market by 2000 and an additional 1,000 MW market by 2002. After a series of exchanges of communications, subject to certain conditions on the matter, the Parent Company in a letter to the DOE reiterated its commitment to absorb the 1,500 MW output of the Camago (Malampaya) field and nominated First Gas Holdings, Inc., a related party of the Parent Company, as the developer of the entire 1,500 MW capacity.

On March 14, 1995 and January 9, 1997, the Parent Company entered into power purchase agreements (Agreements) with IPPs, FGPC and FGP Corp. Under the terms of the Agreements, these IPPs are committed to sell and deliver electric power and energy to the Parent Company and the Parent Company is committed to buy electric power and energy from them, subject to certain terms and conditions specified therein. The Agreements shall individually terminate on the date of the 25th anniversary of the commercial operation dates of the power plants of these IPPs.

In compliance with Section 33 of EPIRA, which mandates distribution utilities to mitigate their potential stranded costs by making "reasonable best efforts" to reduce the costs of their existing contracts with IPPs, the Parent Company took the steps in renegotiating its contracts with QPPL, FGPC, and FGP Corp. To make the contract review process transparent and ensure that the renegotiations were done at arm's-length, the Parent Company's BOD created a three-man Independent Review Committee then composed of Messrs. Margarito Teves, Carlos Dominguez and Emilio Vicens.

On January 7, 2004, the Parent Company's IPP Independent Review Committee and FGPC/FGP Corp. signed the Amendment to the Power Purchase Agreement (Amendment) between the Parent Company and FGPC/FGP Corp. Concessions with immediate value include FGPC shouldering local business and community taxes, while conditional concessions include increasing discounts on excess generation, paying higher penalties for non-performance, and until 2011, not charging the Parent Company the capacity fee and fixed operations and maintenance fee for energy delivered beyond the contracted amount but within the 90% capacity factor level. The signed Amendment was submitted to the ERC for approval on March 12, 2004. After the conduct of public hearings, the ERC approved the Amendment on May 31, 2006.

The Parent Company entered into a Substation Interconnection Agreement with NPC and FGPC for: (a) the construction, ownership, operation and maintenance of a dedicated 35-kilometer transmission line from the power plant of FGPC to the NPC substation; (b) the interconnection of the power plant to the NPC Grid System; and (c) the receipt and delivery of energy and capacity from the power plant of FGPC to the Parent Company's point of receipt. Similarly, the Parent Company entered into an Interim Interconnection Agreement with NPC and FGP Corp. whereby NPC will be responsible for the delivery and transmission of all energy and capacity from the power plant of FGP Corp. to the Parent Company's point of receipt.

The total purchased power from both FGPC and FGP Corp. amounted to ₱48,519 million, ₱55,283 million and ₱44,976 million for the years ended December 31, 2009, 2008 and 2007, respectively.

d. **QPPL**

The Parent Company entered into a PPA with QPPL on August 12, 1994 and amended the same on December 1, 1996. Under the terms of the amended PPA, QPPL is committed to sell and deliver electric power and energy to the Parent Company and the Parent Company is committed to buy electric power and energy from QPPL, subject to certain terms and conditions specified therein. The PPA shall terminate on the date of the 25th anniversary of the commercial operation date of the power plant (Plant) of QPPL.

The Parent Company also entered into a TLA with QPPL on June 13, 1996 (amended on December 1, 1996). Pursuant to the PPA and the TLA, QPPL is responsible for obtaining all necessary rights-of-way for, and for the siting, design, construction, operation and maintenance of the Transmission Line while the Parent Company is obligated to pay all costs and expenses incurred by QPPL in connection with the siting, design and construction, operation and maintenance of the Transmission Line (including unforeseen cost increases, such as those due to new regulations or taxes) through payment of periodic transmission charges.

The term of the TLA will extend to the duration of the term of the PPA, commencing on the date of execution of the TLA and expiring on the 25th anniversary of the commercial operations date. The term of the TLA is subject to renewal on mutually acceptable terms in conjunction with the renewal of the term of the PPA. Under the TLA, the Parent Company is obligated to make a Monthly Capital Cost Recovery Payment and a Monthly Operating Payment to QPPL.

In mid 2001, the Parent Company and QPPL were in discussions regarding the amendment of certain provisions of the PPA. The changes to the PPA primarily relate to the reallocation of risks relating to the performance and dispatch of the Plant of QPPL. Pursuant to the amended terms of the PPA, the Parent Company will, in general, bear risks relating to the dispatch of the Plant of QPPL while QPPL, in general, will bear risks relating to the technical performance of its Plant. These negotiations led to the filing of an application for approval of the amendment to the PPA (Amendment No. 3) at the ERC. However, due to certain concerns raised by the ERC, this petition was withdrawn by the Parent Company on March 4, 2003. Thus, the amendment No. 3 to the PPA did not take effect.

On February 21, 2008, the Parent Company and QPPL amended their TLA to conform its terms to those already approved by the ERC. Based on the amendment, the Parent Company and QPPL acknowledged and confirmed that all claims that each may have against the other are resolved as of the date of the amendment. Accordingly, the Parent Company derecognized its liability to QPPL pertaining to the disallowed transmission line fee amounting to ₱839 million and is shown as part of "Recovery of probable losses on disallowed receivables" account in the 2007 consolidated statement of income.

On the same date, the Parent Company and QPPL also signed a side letter agreement to the PPA relating to excess generation arrangements. This side letter agreement sets out an arrangement that allows the Parent Company to dispatch the plant and increase QPPL's revenues based on sales of excess generation output at the discounted per kWh tariff for such generation. The Parent Company agreed to a base generation and a Target Excess Generation (TEG) of the plant from 2008 to 2017 (each a "Guarantee Year"). The TEG is equal to 74 million kWh per annum. The Parent Company will pay for each kWh of excess generation during the Guarantee Years in accordance with the existing terms of the PPA relating to excess generation. If the TEG is not reached in a Guarantee Year, the Parent Company will pay QPPL an amount (an "Advance Payment") reflecting the difference in the TEG and actual excess generation (AEG).

If the AEG is greater than or equal to the TEG for an Annual Period, the Parent Company shall not be obligated to pay any Advance Payment to QPPL for that Annual Period. Also, the Parent Company will receive one kWh credit for each kWh by which the AEG exceeds the TEG. At the Parent Company's option, the kWh credit may be added to the computation of the AEG in a subsequent Annual Period.

During the Annual Periods ending 2018 to 2025, QPPL will repay the aggregate Advance Payments of the Parent Company in eight approximately equal annual installments without interest.

The total power purchased from QPPL amounted to ₱15,477 million, ₱14,072 million and ₱12,813 million for the years ended December 31, 2009, 2008 and 2007, respectively.

**e. Masinloc Power Partners Co. Ltd. (MPPC), Aboitiz Power Renewable, Inc. (APRI), and Therma Luzon Inc. (THERMA), San Miguel Energy Corporation (SMEC), and Sem-Calaca Power Corporation (SCPC).**

The supply of energy to MPPC is covered by the TSC between the Parent Company and NPC, which provides for the full or partial assignment of the TSC contract energy volume to the new owners of the NPC generating assets. Upon the privatization of the Masinloc Coal-fired Power Plant and take-over of the assets by MPPC in 2008, the NPC assigned 14.89% of the contracted TSC energy volume to MPPC. Thereafter, the payment for the TSC volume assigned to MPPC is being made directly to MPPC by the Parent Company.

Likewise, the NPC assigned 9.63% of the contracted TSC energy volume to APRI, when the NPC's Tiwi-Makban geothermal power plants were privatized and APRI took over the assets in early 2009.

In the re-bidding for the 600-MW coal-fired Calaca power plant on July 8, 2009, DMCI Holdings won it, and formed the new company SCPC to operate and maintain the plant.

During the bidding conducted by PSALM on August 28, 2009 for the administration of NPC's IPP contracts, SMEC won the contract for the 1,000-MW Sual coal-fired power plant in Pangasinan.

NPC assigned 22.04% of the Parent Company's TSC volume to THERMA, 5.253% to SMEC, and 7.34% to SCPC.

While PSALM has already assigned a portion of the TSC volume to these third parties, these are still within the provisions of the TSC. The only difference is that invoicing and payment (including VAT and other taxes as applicable) are directly to the third parties. But the Parent Company has no separate contract with MPPC, APRI, THERMA, SMEC and SCPC.

The first payment for TSC energy made directly by the Parent Company to THERMA was for the supply month of October 2009, while that to SMEC was for the supply month of November 2009, and to SCPC, for December 2009.

**f. Montalban Methane Power Corporation (MMPC)**

On April 3, 2009, the Parent Company signed a Contract for the Sale of Electricity (CSE) with MMPC. MMPC's power plant is a renewable energy generation facility located in the Municipality of Rodriguez (formerly Montalban), Rizal, which utilizes the landfill gas extracted from Montalban's sanitary landfill. The plant has an installed capacity of eight (8) megawatts (MW) while its designed capacity is 11 MW.

MMPC was granted a Certificate of Compliance by the ERC on February 9, 2009.

The contract is for a period of two years, extendible by mutual agreement of the parties. Energy is sold on a "take and pay" basis. Thus, there is no minimum energy volume that the Parent Company is obligated to purchase. Pricing of the energy is on an hourly basis, using the ERC-approved TOU rates of the NPC. MMPC's TOU rates consist only of NPC's basic TOU rates plus ₱0.01 per kWh for the Franchise and Benefits to Host Communities (FBHC) charge. Among the price advantages of MMPC are the following:

i. The GRAM and ICERA components of NPC's rates do not form part of MMPC's TOU rates.

ii. Being located within the Parent Company franchise area, the energy deliveries from MMPC's plant are exempt from the Power Delivery Service charge billed by the NGCP.

iii. In accordance with RA No. 9513, "An Act of Promoting the Development, Utilization and Commercialization of Renewable Energy Sources and For Other Purposes", the energy purchased by the Parent Company from the plant is classified as zero-VAT rated sales.

On May 13, 2009, the Parent Company filed an application for approval of such CSE with the ERC, with prayer for provisional authority. On June 1, 2009, the ERC provisionally approved the CSE, subject to the following conditions: (1) any subsequent amendments to the CSE, including the imposition of Capacity Recovery Fee, shall first be filed with the ERC for approval and the implementation of which shall be prospective, and (2) in the event that the rates provisionally approved are found to be higher than the final rates, the amount corresponding to the excess shall be refunded by the Parent Company to its customers.

MMPC started delivering electricity to the Parent Company on June 11, 2009.

The hearings on the CSE have been completed and the CSE is pending final approval by the ERC.

**g. Acquisition of Carmelray Industrial Park's existing Distribution System and concession agreement to provide electricity to the park**

On March 6, 2009, the Parent Company submitted to PEZA an application to register as a power utilities-enterprise to provide electric service within the Carmelray Industrial Park 2 (CIP2) in Calamba, Laguna.

On March 26, 2009, a Memorandum of Agreement executed among Carmelray-JTCI Corporation (CJC) and the Parent Company was executed. The latter agreed to take over the 13.8-kV distribution line facilities and switching stations of CIP2 in order to ensure adequate supply of electricity to the park and its locators for a period of nineteen (19) years from the effective date until June 28, 2028.

On April 7, 2009, the Parent Company was advised by PEZA that it had no objection to the integration of CIP2 into the Parent Company's distribution system. Thus, on April 11, 2009, the Parent Company took over the electric distribution system of CIP2 from CIP Power Corporation, the ecozone's previous electric service provider. Soon after, the PEZA Board during its meeting on April 17, 2009 approved the Parent Company's application to register as a PEZA-registered utilities enterprise subject to certain conditions.

Details of the purchased power are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | *(Amounts in Millions)* | |
| FGPC and FGP Corp. | ₱48,519 | ₱55,283 | ₱44,976 |
| NPC/PSALM | 42,779 | 49,406 | 54,998 |
| TransCo | 23,811 | 25,009 | 28,449 |
| QPPL | 15,477 | 14,072 | 12,813 |
| WESM (PEMC) | 11,284 | 13,083 | 31,578 |
| Duracom and others | 19 | 19 | 23 |
| AP Renewables | 1,645 | – | – |
| Therma Luzon | 1,700 | – | – |
| SMEC | 233 | – | – |
| SEM | 192 | – | – |
| MPPC | 5,258 | – | – |
| MMPC | 11 | – | – |
| | ₱150,928 | ₱156,872 | ₱172,837 |

Total commitments for the purchase of power from FGPC, FGP Corp. and QPPL, including transmission line fees, are estimated as follows:

| Year | Minimum Energy Quantity (MEQ) | Equivalent Amount |
|---|---|---|
| | *(In Million Kilowatt Hours)* | *(Amounts in Millions)* |
| 2010 | 14,295 | ₱63,574 |
| 2011 | 14,295 | 62,236 |
| 2012 | 14,325 | 72,258 |
| 2013 | 14,295 | 79,019 |
| 2014 | 14,295 | 83,124 |
| 2015 | 14,295 | 89,994 |

**h. Operating Lease Commitments**

*As Lessor*

Rockwell has entered into commercial property leases on its investment property portfolio. These non-cancellable leases have remaining terms of between 2 and 10 years. All leases include a clause to enable upward revision of the rental charge on an annual basis according to prevailing market conditions. Future minimum lease revenues are as follows:

| | Amount |
|---|---|
| | *(In Millions)* |
| 2009 | ₱207 |
| 2010 | 57 |
| 2011 | 17 |
| 2012 and after | 2 |
| | ₱283 |

*Capital Commitments*

(1) Rockwell entered into a contract with DATEM Incorporated in April 2008 for the superstructure works of the "One Rockwell" project. The contract amounted to a fixed fee of ₱2,500 million, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the works. Superstructure works commenced in December 2008 and is currently ongoing. As of December 31, 2009, ₱1,200 million has been incurred and was already paid.

(2) Rockwell entered into contract covering superstructure works related to the Meralco BPO project with Hilmarc's Construction Corporation. The contract sum for the works amounted to ₱1,200 million but was adjusted to ₱886 million for approved variations, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the works. Rockwell completed the project in July 2009. As of December 31, 2009, the total amount paid related to this contract is ₱872 million.

(3) Rockwell entered into a contract with Advanced Foundation Construction Systems Corp. for the piling works of The Grove project. The contract amounted to ₱77 million, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all costs necessary for the proper execution of the works. The works were completed in November 2009 and has been paid as of December 2009.

**36. EARNINGS PER SHARE**

Earnings per share is calculated by dividing the net income for the year attributable to equity holders of the parent by the weighted average number of common shares outstanding during the year.

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| | *(Amounts in Millions, Except Shares and Per Share Data)* | | |
| Net income attributable to equity holders of the parent (a) | ₱6,576 | ₱4,100 | ₱9,562 |
| Shares: | | | |
| Common shares at beginning of year | 1,103,768,012 | 1,103,342,882 | 998,812,167 |
| Weighted average common shares – issuances | 4,282,979 | 303,714 | 61,350,763 |
| Weighted average common shares – basic (b) | 1,108,050,991 | 1,103,646,596 | 1,060,162,930 |
| Number of shares under option | – | 9,767,651 | 10,382,537 |
| Weighted average number of shares that would have been issued at fair value | – | (7,738,824) | (5,931,999) |
| Adjusted weighted average common shares – diluted (c) | 1,108,050,991 | 1,105,675,423 | 1,064,613,468 |
| Per Share Amounts: | | | |
| Basic earnings per share (a/b) | ₱5.93 | ₱3.71 | ₱9.02 |
| Diluted earnings per share (a/c) | ₱5.93 | ₱3.71 | ₱8.98 |

## 37. DIRECTORS' AND SENIOR EXECUTIVES' REMUNERATION

The table below shows the remuneration of the Parent Company's directors, senior executives and officers on a group basis:

| Position | Year | Salary | Variable Pay | Total |
|---|---|---|---|---|
| | | *(Amounts in Millions)* | | |
| Chief Executive Officer and Senior Executive Officers | 2009 | ₱108 | ₱22 | ₱130 |
| | 2008 | 91 | 20 | 111 |
| | 2007 | 82 | 14 | 96 |
| All Officers and Directors as a group unnamed | 2009 | 161 | 31 | 192 |
| | 2008 | 171 | 33 | 204 |
| | 2007 | 148 | 21 | 169 |

## 38. OTHER MATTERS

### a. Revised System Loss Caps

On September 29, 2004, the ERC issued the "Guidelines for the Application and Approval of Caps on the Recoverable Rate of Distribution System Losses" requiring the submission of segregated system loss caps for technical, non-technical and administrative losses and the Parent Company estimates for the succeeding five years.

On January 31, 2007, the Parent Company filed with the ERC, an Application for the Approval of System Loss Cap, in accordance with the above-mentioned Guidelines. In the said Application, the Parent Company asked the ERC: (i) to retain the current method of recovering a consolidated rate of recoverable system losses for technical and non-technical losses and to fix the consolidated cap on the recoverable rate of distribution system losses at 11.27% for the years 2007 to 2011, based on the current practice of computing total distribution system loss where administrative loss is considered as part of sales, (ii) to retain the current method of recovering administrative losses (i.e., 1% of net system input or actual company usage in kWh, whichever is lower), and (iii) that in determining the non-technical system loss, the amount of pilferage recoveries, which are required to be returned to the customers in the form of a generation charge discount, in accordance with Rule 10, Section 2, of the Implementing Rules and Regulations of RA No. 7832, should not be deducted from the total distribution system loss.

On June 7, 2007, the ERC issued Resolution No. 19, Series of 2007, which dismissed all applications for approval of system loss caps filed by the DUs. According to the Resolution, the "ERC's new policies on the treatment of system loss and the setting of new caps for private DUs shall be incorporated in the ERC's evaluation of their respective applications as entrants to the PBR." On August 6, 2007, the Parent Company filed a motion with the ERC seeking to clarify what would be the procedure for the setting of the cap for the system loss and what particular rules, guidelines or mechanism under the RDWR or any other ERC issuances, would govern the same. The said motion for clarification is still pending resolution by the ERC.

On December 8, 2008, the ERC promulgated Resolution No. 17, Series of 2008, entitled "A Resolution Adopting a New System Loss Cap for Distribution Utilities," where it resolved to lower the maximum rate of system losses (technical and non-technical) that a utility can pass on to its customers. In the said Resolution, the new system loss cap shall be the actual but not to exceed eight and a half (8.5%) percent for private utilities, effective starting the January 2010 billing. This is one (1%) percentage point lower than the current system loss cap of nine and a half (9.5%) percent. The actual company use (administrative loss) shall be treated as part of the Operation and Maintenance Expense in the next reset for utilities under the PBR. The manner by which the utility will be rewarded for their efforts in system loss reduction shall be addressed by the ERC in the Performance Incentive Scheme (PIS) under the PBR.

In a letter dated August 11, 2009, the Parent Company wrote to the ERC to appeal for a deferment of the imposition of the 8.5% system loss cap in 2010. In the letter, the Parent Company said that the confluence of certain developments that are beyond the Parent Company's control will make it difficult for the Parent Company to comply with the new cap in 2010. In particular, the abrupt and substantial decline in industrial energy sales brought about by the economic downturn has reduced the Parent Company's high voltage sales. This is being aggravated by the continued increase in residential sales, which has pushed up the share of low voltage energy sales to the total consumption in the Parent Company's franchise area. The Parent Company had further proposed that "if there has to be a reduction in the cap, we propose that it be set at no less than 9.0 percent, consistent with Republic Act No. 7832, until such time that caps based on the technical considerations identified in RA No. 9136 can be determined."

In a letter dated November 23, 2009, while agreeing with the adverse impact on system loss of the reduced share of high voltage sales, the ERC replied that "both the existing and the proposed new caps were set regardless of whether or not the franchise area is highly urbanized". The letter further said that there are "more than sufficient means and incentives" for DUs like the Parent Company to deter or curb electricity pilferage. As a result, the Commission denied the Parent Company's request for a deferment of the cap.

On December 8, 2009, the Parent Company filed a Petition to Amend the said Resolution with an urgent prayer for the immediate suspension of the implementation of the new system loss cap of 8.5% starting January 2010. The proposed amendment is aimed at making the Resolution consistent with the provisions of RA No.9136 and RA No. 7832, by increasing the level of system loss cap to not less than 9%. As of February 22, 2010, The ERC has yet to act on the Petition.

**b. Retail Competition**

On February 9, 2007, through its Resolution No. 3, Series of 2007, the ERC set out its timeline for the implementation of retail competition and open access. According to the Resolution, retail competition shall commence upon the fulfillment of the preconditions of EPIRA's Section 31 and of two other "vital requirements," i.e., the establishment of necessary infrastructures (such as a customer switching system) and the promulgation of pertinent regulations. The ERC shall also announce the commencement of retail competition six months before its actual implementation.

On December 3, 2009, the PSALM turned over the 600-MW Calaca Coal-Fired Power Plant to Sem-Calaca Power Corp., after the conduct of a negotiated sale of the power plant. According to PSALM, with the privatization of Calaca, more than 70% of NPC's generating capacity will have been privatized, which would be in compliance with one of EPIRA's preconditions for the implementation of Open Access and Retail Competition (OARC).

Meanwhile, as of December 15, 2009, with the successful bidding out of NPC's contracted capacities for the San Roque, Bakun and Benguet hydroelectric power plants, it has been estimated that PSALM has already bid out 43.75% of NPC's IPP contracts in the Luzon and Visayas Grids. PSALM is targeting to hurdle the 70% threshold for the privatization of NPC's IPP contracts within 2010.

For its part, the ERC has already promulgated its "seven pillars of retail competition," referring to a set of regulations that embody a framework for implementing retail competition and open access, as envisioned in EPIRA. These are the Retail Electricity Supplier (RES) Licensing Guidelines, the amended Business Separation Guidelines, the Code of Conduct for Competitive Retail Market Participants, the Competition Rules, the Supplier of Last Resort Rules, the Distribution Services and Open Access Rules, and the Uniform Business Practices (UBP). The UBP has since been renamed the Rules for Customer Switching.

The ERC also promulgated the Rules for Contestability, which would provide for more detailed guidelines on end-user eligibility for retail competition, and is working on the Guidelines of the Business-to-Business information system that would facilitate customer switching and similar procedures in a competitive environment. In accordance with EPIRA, retail competition will begin with end-users with an average peak demand of 1MW. After two years, the second phase of retail competition will begin with the threshold of contestability going down to 750kW, for both single and aggregated loads. Thereafter, the threshold will go down gradually until it reaches the household level within a period of seven years following the second phase of retail competition.

On May 23, 2008, the Parent Company, together with other industry players, filed a Petition with the ERC for the approval of Interim Open Access (IOA) in the Luzon and Visayas grids and its implementation in accordance with the proposed "Terms of Reference of the Interim Implementation of Open Access" which was adopted by the industry players and stakeholders during the Energy Summit 2008. The approval of the Petition would have allowed customers with an average peak demand of 1 MW and up to contract and purchase their electricity requirements from Eligible Generating Companies and Retail Electric Suppliers. Eligible Generation Companies are generation companies which meet the mandated generation market share caps of EPIRA. In a Decision dated November 10, 2008, the ERC renamed IOA as the Power Supply Option Program (PSOP) and approved the implementation thereof subject to the following conditions:

i. The distribution utilities shall act as the default supplier and be accountable for the accounting and settlement of imbalances.

ii. The PSOP shall initially be implemented within the Luzon Grid.

iii. The implementation of the PSOP shall commence from the transfer of the operation of the Calaca privatized NPC generation assets.

iv. The PSOP shall cease to be operational upon commencement of actual OARC. All contracts and transactions related thereto shall automatically terminate once actual OARC is declared by the ERC.

v. The PSOP shall be strictly implemented in accordance with the program rules to be promulgated and approved by the ERC.

The Parent Company filed a Motion for Partial Reconsideration/Clarification of the Decision. The Parent Company sought clarification on the (a) adjustment of the TSC contracted volumes to account for the movement of customers in and out of the PSOP; (b) participation of the DU as a local RES; and (c) treatment of distribution system losses.

In an Order dated 14 September 2009, the ERC clarified that (a) adjustment of the TSC should be made based on the provisions thereof; (b) there is no cogent reason to allow the local RES to operate under the PSOP; and (c) the DU shall be responsible for procuring all energy related to distribution system losses. In the said Order, the ERC further stated that the PSOP shall commence ninety (90) days after completion of either of the following conditions, whichever comes earlier: (a) transfer of the operation of the Calaca NPC Generation Asset to the private generation companies concerned or its equivalent in terms of capacity or (b) the privatization of at least 70% of the total capacity of generating assets of NPC in Luzon and Visayas.

In December 2009, the ERC released the third draft Rules for the Power Supply Option Program. The said Rules were intended to provide the regulatory framework for the implementation of the PSOP. The said draft rules have been released for comments of all interested parties.

**c. PEZA – ERC Jurisdiction**

On May 9, 2007, the Parent Company, together with the Private Electric Power Operators Association, Inc. (PEPOA), filed before the RTC-Pasig (Branch 71) a Petition for Declaratory Relief questioning the regulatory authority of PEZA over electric services in ecozones. Subsequently, the Parent Company converted its Petition to that of a "Complaint for the Declaration of Nullity of the PEZA Guidelines with Prayer for Temporary Restraining Order (TRO) and Preliminary Injunction" to restrain PEZA from implementing its Guidelines for the "Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones," and "Supply of Electric Power in the Ecozones."

The Parent Company and PEPOA believe that the said Guidelines are contrary to EPIRA and therefore null and void. The ERC likewise filed a motion to intervene in support of the complaint against PEZA.

PEZA's Guidelines effectively give PEZA franchising powers in ecozones. PEZA, thus, can potentially carve out ecozones from a DU's service coverage and allow entities other than the franchised DU to provide distribution service within ecozones. PEZA may also set the tariffs and operating parameters of such electric distribution service providers within ecozones. The situation may be aggravated by PEZA declaring additional ecozones in the DU's franchise areas.

On November 9, 2007, the Court granted the Parent Company's Motion for Conversion of the Petition into a Complaint for Injunction with a TRO. It also issued a TRO and Preliminary Injunction restraining PEZA from implementing the Guidelines. The case is now pending hearing on the main case before the RTC-Pasig.

After a series of negotiations among PEPOA, the Parent Company and PEZA, the parties agreed to settle their differences which brought about the filing of the complaint before the Court. Thus, through a letter dated June 6, 2008 signed by PEZA Director General Lilia B. De Lima, PEZA has proposed the following to address the concerns of PEPOA and the Parent Company:

i. "In the case of power utilities or entities currently operating a power distribution system inside the ecozone, the PEZA Board shall approve the registration of such entities upon compliance of all registration requirements.

ii. The franchised distribution utility operating immediately outside a newly proclaimed ecozone shall have the right of first refusal to operate a power distribution system subject to compliance with all registration requirements.

iii. Until such time that PEZA has fixed the appropriate Electric Power Distribution Charge, the current distribution and other distribution related charges shall prevail."

The aforesaid proposals were accepted by the Parent Company through a letter dated June 30, 2008 with clarification on item No. 3 thereof. In particular, the Parent Company proposed that item No. 3 be rephrased as follows:

"Until such time that PEZA and ERC have agreed on principles of asset recognition and boundaries for rate-setting and PEZA has fixed the appropriate distribution charge, the prevailing distribution and other distribution-related charges, as may be adjusted in accordance with the ERC's guideline, shall apply."

In a response letter dated July 3, 2008, PEZA Director General Lilia De Lima stated that PEZA has no objection to the above-quoted counter-proposal of the Parent Company.

As a direct result of the agreement between the Parent Company and PEZA of the aforesaid terms contained in the above letters, the Parent Company decided to withdraw as plaintiff in the case filed before the RTC of Pasig, through a Motion to Withdraw filed on July 7, 2008. Thereafter, PEPOA, after considering the terms offered by PEZA, also filed its own Motion to Withdraw as plaintiff on August 1, 2008.

Pending resolution of both motions, the Philippine Independent Power Producers Association filed a Motion for Intervention, which was granted by the Court on September 2, 2008.

Currently, both motions to withdraw by the Parent Company and PEPOA are still pending resolution.

Since the implementation of the Guidelines has been stopped by the Court, the Parent Company cannot ascertain or provide an estimate of the amount of revenues or income it stands to lose as a result of the Guidelines. Meantime, in support of the government's objectives, primarily of providing least cost power to ecozone consumers, the Parent Company entered into a Memorandum of Agreement with the NPC on September 17, 2007 for the provision of special ecozone rates to high load factor PEZA-accredited industries. The program was allowed for immediate implementation by the ERC.

**d. Sucat-Araneta Transmission Line**

The Sucat-Araneta-Balintawak 230kV Transmission Line Project was conceptualized in the early 1990s to improve the overall electric system reliability and efficiency in Metro Manila. The construction of the said transmission line started in 1994 and was finished and energized in July 2000. This line will complete the 230kV line loop within Metro Manila to urgently address the congesting electricity traffic in the metropolis due to ever growing demand for electricity. The project has two main parts: (1) the Araneta to Balintawak leg; and (2) the Sucat to Araneta leg, which is near Dasmariñas Village, Makati.

Prior to 2001, the authority and responsibility to operate and develop the nationwide grid belongs to the NPC. Upon the effectivity of the EPIRA in June 2001, this authority and responsibility were transferred to TransCo.

The distribution lines of the Parent Company are "physically connected" to the transmission grid of TransCo. More importantly, the Parent Company's distribution facilities are configured to operate in synchronization with the lines of TransCo. The subject Sucat-Araneta-Balintawak 230kV Transmission Line is one of the significant lines of TransCo and is located in the heart of the Parent Company's franchise area. Thus, the unrestrained operation of the said line is very vital to Parent Company's operation to deliver continuous electricity to every household within its franchise area.

On March 10, 2000, the residents of Tamarind Road, Dasmarinas Village, Makati (plaintiffs) filed a case with the RTC-Makati against NPC to enjoin the latter from further preparing and installing high voltage cables to the steel pylons erected near the plaintiffs' homes and from energizing and transmitting high voltage electric current through the said cables because of the alleged health risks and danger posed by the same. The trial court initially issued on March 13, 2000 an Order directing the parties to maintain the status quo and then later granted the preliminary injunction prayed for by the plaintiffs on April 3, 2000. On May 3, 2000, the Court of Appeals reversed the said orders of the trial court. On Appeal, the Supreme Court, in its Order issued on March 23, 2006, reinstated the orders of the trial court restraining NPC.

When the aforesaid Order of the Supreme Court became final, the plaintiffs then moved for the execution of the orders rendered by the trial court. Subsequently, the trial court issued a writ of execution on October 13, 2008. The Parent Company, although initially not a party to the case, was constrained to file an Omnibus Motion (1) for Leave to Intervene and to admit Answer in Intervention (2) to lift orders and (3) to maintain status quo due to the significant impact of the de-energization of the Sucat-Araneta line to the public and the economy. In the said Omnibus Motion, the Parent Company manifested and argued that the shutdown of the 230 kV line would result in widespread and rotating brownouts affecting millions of its customers across its franchise area, including the major financial districts in Metro Manila. Likewise, as much as 505 MW capacity from power plants from the south would be prevented from running their full capacities, resulting in a much higher additional purchased power cost for the Parent Company which, in turn, would translate to significant increase in the price of electricity to be charged to its customers.

On November 28, 2008, the trial court issued an Order accepting the Parent Company's Omnibus Motion and holding in abeyance the writ of execution until after the trial court finally rules on the Parent Company's Omnibus Motion for intervention and other incidents.

On September 11, 2009, the trial court issued an Omnibus Order dated September 8, 2009, granting the motions for intervention filed by the Parent Company and the National Grid Corporation of the Philippines (NGCP) and dissolved the Writ of Preliminary Injunction issued pursuant to the Orders of the trial court dated April 3, 2000 and October 13, 2008 upon the posting of a counter bond by defendant NPC in the amount of) ₱10 million, intervenor Meralco in the amount of ₱2.5 million, and intervenor NGCP in the amount of ₱2.5 million subject to the condition that defendant NPC and intervenors will pay all damages which the plaintiffs may suffer by the dissolution of the Writ of Preliminary Injunction.

**e. Petition for Dispute Resolution**

On September 9, 2008, the Parent Company filed a Petition for Dispute Resolution with the ERC, against PEMC, TransCo, NPC and PSALM. The filing of the case was brought about by the congestion of TransCo's transmission system resulting from the outage of the San Jose-Tayabas 500kV Line 2 on June 22, 2008, followed by the outage of the 500kV 600 MVA Transformer Bank #2 of TransCo's San Jose, Bulacan substation on July 11, 2008. The Parent Company believes that said congestions adversely and materially affected the supply and prices of electricity and posed a significant threat to system security during the relevant period.

In the said petition, the Parent Company asked the ERC to, among other things:

i. direct PEMC to adjust the WESM price for the period from June 26 to July 26, 2008 by adopting the NPC-TOU rate as basis for its billing;

ii. direct PEMC to adopt the NPC-TOU rate or the new price determined through the price substitution methodology of PEMC as approved by the ERC, as basis for its billing during the period of the congestion;

iii. direct NPC and PSALM to refund the transmission line loss components of the line rentals associated with NPC/PSALM bilateral transactions from the start of WESM operation on June 26, 2006; and

iv. impose appropriate fines and sanctions on TransCo, pursuant to section 46 of the EPIRA and the pertinent provisions of the EPIRA-IRR.

In relation to the said petition, PEMC has agreed to implement the segregation of the line rental amounts associated with the Parent Company's bilateral contracts from the WESM energy trading amount in accordance with the WESM Rules, as requested by the Parent Company.

Hearings on the petition have been completed and the case has been submitted for the resolution of the ERC.

**f. PSALM versus PEMC and the Parent Company (Pending at the CA)**

Due to the significant increases in WESM prices during the third and fourth months of WESM operations, the Parent Company wrote two separate letters dated September 22, 2006 and November 14, 2006, addressed to Mr. Lassi-Matti A. Holopainen of the PEMC, requesting for an immediate investigation to determine whether there was a breach of the WESM rules or an anti-competitive behavior has occurred.

Acting on the said letters, PEMC conducted an investigation of the third and fourth billing periods and came up with the findings that PSALM "behaved anti-competitively and abused its market power." As a consequence, PEMC, through a Resolution No. 2006-70 dated November 22, 2006, directed that the settlement amounts for the third and fourth WESM billing periods be adjusted to the administered prices, which were below the NPC-TOU rates.

Upon receipt of PEMC's Resolution, NPC elevated the issue to the ERC and asked the latter to reconsider the price adjustments. In its Order dated December 13, 2006, the ERC provisionally ordered the adjustment of the third and fourth WESM month settlement amounts using the ERC-approved NPC-TOU rates.

On June 6, 2007, the ERC adopted the findings of its Investigatory Unit (IU), which found no prima facie case against PSALM for anti-competitive behavior or market power abuse. On August 14, 2007, the ERC issued its Decision confirming its earlier Order dated December 13, 2006 and declaring the action of the Philippine Electricity Market (PEM) Board in adjusting the WESM settlement prices for the third and fourth billing periods to have been carried out beyond the scope of its authority. It also directed the adjustment of the WESM settlement prices for the third and fourth billing months to be the resulting settlement prices.

Considering the impact of the ERC Decision dated August 14, 2007 to the consumers, the Parent Company filed a Motion for Reconsideration on September 17, 2007. In said Motion, the Parent Company emphasized that the use of WESM settlement prices would result in additional imposition of ₱6.00 per kWh, which would translate to an increase in the generation charge of its customers of about 90 centavos and ₱2.05 per kWh, for the supply months of September 2006 and October 2006, respectively. Thus, the Parent Company asked the ERC to exercise its authority to intervene for the greater interest of the industry and the consumers, and set the WESM settlement prices for the aforesaid period at NPC-TOU rates.

On January 30, 2008, the ERC issued a Decision granting the Parent Company's MR and set the WESM settlement prices for the third and fourth billing periods at the ERC-approved NPC-TOU rates.

On July 11, 2008, PSALM filed a Motion for Partial Reconsideration dated July 8, 2008, which was denied by the ERC in its Order dated October 20, 2008. As a result, PSALM elevated the case to the Court of Appeals impleading PEMC and the Parent Company as respondents. On January 28, 2009, the Parent Company received a copy of the Resolution of the Court of Appeals directing the respondents to file their respective Comment on the Petition. The Parent Company filed its Comment to the Petition of PSALM on March 9, 2009.

In a Decision dated August 28, 2009 in C.A. G.R. SP No. 106322, the Court of Appeals dismissed the Petition and affirmed the Order of the ERC. PSALM filed its Motion for Reconsideration but the same was denied by the Court of Appeals in a Resolution dated November 6, 2009 saying that the arguments were mere rehash and no new argument was raised. On December 4, 2009, the Parent Company received a copy of the Petition for Review on Certiorari filed by PSALM with the Supreme Court. The Parent is still awaiting for the Resolution of the Supreme Court whether it will entertain the same or not.

**g. Petition for Dispute Resolution with NPC on Premium Charges**

On June 2, 2009, the Parent Company filed a Petition for Dispute Resolution against NPC and PSALM regarding NPC's imposition of premium charges for the alleged excess energy it supplied to the Parent Company covering the billing periods of May 2005 to June 2006. The same was docketed as ERC Case No. 2009-052 MC. The premium charges amounted to ₱315 million (May-June 2005 billing periods) and ₱318 million (November 2005, February 2006 and April-June 2006 billing periods).

It is the Parent Company's contention that there is no basis in fact and in law for the imposition of the premium charges as there was no ERC-approved TSC between petitioner and NPC and the premium charges imposed by NPC has not been approved by the ERC.

Hearings on the Petition are ongoing at the ERC.

**39. SUBSEQUENT FINANCIAL STATEMENTS**

No audited financial statements of Meralco have been made up in respect of any period subsequent to December 31, 2009.

Yours faithfully,
**SyCip Gorres Velayo & Co.**

The Directors
First Pacific Company Limited
24th Floor, Two Exchange Square
8 Connaught Place
Central
Hong Kong

13 March 2010

Dear Sirs,

**ACCOUNTANTS' REPORT ON THE UNAUDITED PRO FORMA FINANCIAL INFORMATION**

We report on the unaudited consolidated pro forma assets and liabilities (the "Unaudited Pro Forma Financial Information") of First Pacific Company Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group"), as set out in Appendix III to the circular of the Company dated 13 March 2010 (the "Circular"), which has been prepared by the directors of the Company (the "Directors") for illustrative purposes only, to provide information about how the proposed/ possible transactions, including (1) the proposed acquisition by Beacon Electric Asset Holdings, Inc. ("Beacon Electric", a subsidiary of the Group as at the date of this report) of shares in Manila Electric Company ("Meralco") from Pilipino Telephone Corporation ("Piltel", an associate of the Group) and the subscription of new shares in Beacon Electric by Piltel; and (2) the possible acquisition of 74,700,000 shares in Meralco by Beacon Electric through the exercise of a call option, might have affected the assets and liabilities of the Group. The basis of preparation of the Unaudited Pro Forma Financial Information is set out in Appendix III to the Circular.

**Respective Responsibilities of the Directors and Reporting Accountants**

It is the responsibility solely of the Directors to prepare the Unaudited Pro Forma Financial Information in accordance with paragraph 4.29 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and with reference to Accounting Guideline 7 "Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

It is our responsibility to form an opinion, as required by paragraph 4.29(7) of the Listing Rules, on the Unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the Unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

**Basis of Opinion**

We conducted our engagement in accordance with Hong Kong Standard on Investment Circular Reporting Engagements 300 "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" issued by the HKICPA. Our work consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments, and discussing the Unaudited Pro Forma Financial Information with the Directors. This engagement did not involve independent examination of any of the underlying financial information.

Our work did not constitute an audit or a review made in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the HKICPA, and accordingly, we do not express any such audit or review assurance on the Unaudited Pro Forma Financial Information.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Unaudited Pro Forma Financial Information has been properly compiled by the Directors on the basis stated, that such basis is consistent with the accounting policies of the Group and that the adjustments are appropriate for the purposes of the Unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

The Unaudited Pro Forma Financial Information is for illustrative purposes only, based on the judgements and assumptions of the Directors, and, because of its hypothetical nature, does not provide any assurance or indication that any event will take place in the future and may not be indicative of the financial position of the Group as at 31 December 2008 or any future dates.

**Opinion**

In our opinion:

(a) the Unaudited Pro Forma Financial Information has been properly compiled by the Directors on the basis stated;

(b) such basis is consistent with the accounting policies of the Group; and

(c) the adjustments are appropriate for the purposes of the Unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29(1) of the Listing Rules.

Yours faithfully,

**Ernst & Young**
*Certified Public Accountants*
18/F Two International Finance Centre
8 Finance Street
Central, Hong Kong

## UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE ENLARGED GROUP

The unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group is prepared based on the Group's audited consolidated financial position as at 31 December 2008, as extracted from the 2008 annual report of the Company. Shareholders should note that given the Group's acquisition of its existing 14.5% interest in Meralco only completed in October 2009, the pro forma financial information of the Group stated in this Appendix III does not reflect the Group's existing 14.5% interest in Meralco.

### Base Case: Completion of the Piltel Investment and Exercise of the Call Option

The following is a summary of the unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group, which has been prepared on the basis of the notes set out below and assuming that the proposed/possible transactions, including (1) the proposed acquisition by Beacon Electric of shares in Meralco from Piltel and the subscription of new shares in Beacon Electric by Piltel (the "Piltel Investment"); and (2) the possible acquisition of 74,700,000 shares in Meralco by Beacon Electric through the exercise of a call option (the "Call Option") had been completed as at 31 December 2008 for the purpose of illustrating how the Piltel Investment and the exercise of the Call Option might have affected the consolidated assets and liabilities of the Group at that date.

The unaudited consolidated pro forma statement of assets and liabilities has been prepared to provide financial information on the enlarged Group as a result of the Piltel Investment and the exercise of the Call Option. As it is prepared for illustrative purposes only, and because of its hypothetical nature, it may not purport to represent what the assets and liabilities of the enlarged Group shall be on the actual completion of the Piltel Investment and exercise of the Call Option.

| *(US$ millions)* | **The Group** | **Completion of Piltel Investment** | **Exercise of the Call Option** | **The enlarged Group after the completion of the Piltel Investment and exercise of the Call Option** |
|---|---|---|---|---|
| | | *(a)* | *(b)* | |
| Property, plant and equipment | 808.4 | – | – | 808.4 |
| Plantations | 744.5 | – | – | 744.5 |
| Associated companies and joint ventures | 1,202.3 | – | 142.9 | 1,345.2 |
| Goodwill | 675.6 | – | – | 675.6 |
| Other intangible assets | 1,538.5 | – | – | 1,538.5 |
| Accounts receivable, other receivables and prepayments | 3.0 | – | – | 3.0 |
| Prepaid land premiums | 153.2 | – | – | 153.2 |
| Available-for-sale assets | 1.7 | – | – | 1.7 |
| Deferred tax assets | 38.7 | – | – | 38.7 |
| Other non-current assets | 217.1 | – | – | 217.1 |
| | 5,383.0 | – | 142.9 | 5,525.9 |

| *(US$ millions)* | The Group | Completion of Piltel Investment *(a)* | Exercise of the Call Option *(b)* | The enlarged Group after the completion of the Piltel Investment and exercise of the Call Option |
|---|---|---|---|---|
| **Current assets** | | | | |
| Cash and cash equivalents | 625.9 | – | (142.9) | 483.0 |
| Pledged deposits | 12.0 | – | – | 12.0 |
| Available-for-sale assets | 56.9 | – | – | 56.9 |
| Accounts receivable, other receivables and prepayments | 435.5 | – | – | 435.5 |
| Inventories | 557.4 | – | – | 557.4 |
| Assets of a disposal group classified as held for sale | 128.3 | – | – | 128.3 |
| | 1,816.0 | – | (142.9) | 1,673.1 |
| **Current liabilities** | | | | |
| Accounts payable, other payables and accruals | 667.4 | – | – | 667.4 |
| Short-term borrowings | 1,207.0 | – | – | 1,207.0 |
| Provision for taxation | 55.8 | – | – | 55.8 |
| Current portion of deferred liabilities and provisions | 39.4 | – | – | 39.4 |
| Liabilities directly associated with the assets classified as held for sale | 106.1 | – | – | 106.1 |
| | 2,075.7 | – | – | 2,075.7 |
| **Net current liabilities** | (259.7) | – | (142.9) | (402.6) |
| **Total assets less current liabilities** | 5,123.3 | – | – | 5,123.3 |
| **Non-current liabilities** | | | | |
| Long-term borrowings | 1,951.7 | – | – | 1,951.7 |
| Deferred liabilities and provisions | 432.4 | – | – | 432.4 |
| Deferred tax liabilities | 364.0 | – | – | 364.0 |
| | 2,748.1 | – | – | 2,748.1 |
| **Net assets** | 2,375.2 | – | – | 2,375.2 |

Notes to unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group

(a) No adjustment is required for the acquisition of 13.7% interest in Meralco from Piltel and the disposal of 50% interest in Beacon Electric to Piltel because Beacon Electric will still be accounted for as a jointly-controlled entity of the Group. Therefore, the existing investment cost of MPIC in Meralco will be transferred to the investment in Beacon Electric and there will not be any gain or loss arising from the Piltel Investment.

(b) Adjustment to illustrate the impact of the possible exercise of the Call Option by Beacon Electric in the event that the board of Beacon Electric decides to exercise the Call Option. The exercise price of Pesos 22.41 billion (equivalent to approximately US$485.1 million or HK$3,783.5 million) will be funded by a combination of bank loans of approximately Pesos 15.81 billion (equivalent to approximately US$342.2 million or HK$2,669.2 million) and cash from the Group in the form of subscription of preferred shares in Beacon Electric in the amount of Pesos 6.6 billion (equivalent to approximately US$142.9 million or HK$1,114.3 million).

**Scenario One: Completion of the Piltel Investment but without exercise of the Call Option**

The following is a summary of the unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group, which has been prepared on the basis of the notes set out below and assuming that the Piltel Investment (without the exercise of the Call Option) had been completed as at 31 December 2008 for the purpose of illustrating how the Piltel Investment might have affected the consolidated assets and liabilities of the Group at that date.

The unaudited consolidated pro forma statement of assets and liabilities has been prepared to provide financial information on the enlarged Group as a result of the completion of the Piltel Investment (without the exercise of the Call Option). As it is prepared for illustrative purposes only, and because of its hypothetical nature, it may not purport to represent what the assets and liabilities of the enlarged Group shall be on the actual completion of the Piltel Investment (without the exercise of the Call Option).

| *(US$ millions)* | **The Group** | **Completion of the Piltel Investment** *(a)* | **The enlarged Group after the completion of the Piltel Investment** |
|---|---|---|---|
| Property, plant and equipment | 808.4 | – | 808.4 |
| Plantations | 744.5 | – | 744.5 |
| Associated companies and joint ventures | 1,202.3 | – | 1,202.3 |
| Goodwill | 675.6 | – | 675.6 |
| Other intangible assets | 1,538.5 | – | 1,538.5 |
| Accounts receivable, other receivables and prepayments | 3.0 | – | 3.0 |
| Prepaid land premiums | 153.2 | – | 153.2 |
| Available-for-sale assets | 1.7 | – | 1.7 |
| Deferred tax assets | 38.7 | – | 38.7 |
| Other non-current assets | 217.1 | – | 217.1 |
| | 5,383.0 | – | 5,383.0 |

| *(US$ millions)* | **The Group** | **Completion of the Piltel Investment** *(a)* | **The enlarged Group after the completion of the Piltel Investment** |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | 625.9 | – | 625.9 |
| Pledged deposits | 12.0 | – | 12.0 |
| Available-for-sale assets | 56.9 | – | 56.9 |
| Accounts receivable, other receivables and prepayments | 435.5 | – | 435.5 |
| Inventories | 557.4 | – | 557.4 |
| Assets of a disposal group classified as held for sale | 128.3 | – | 128.3 |
| | 1,816.0 | – | 1,816.0 |
| **Current liabilities** | | | |
| Accounts payable, other payables and accruals | 667.4 | – | 667.4 |
| Short-term borrowings | 1,207.0 | – | 1,207.0 |
| Provision for taxation | 55.8 | – | 55.8 |
| Current portion of deferred liabilities and provisions | 39.4 | – | 39.4 |
| Liabilities directly associated with the assets classified as held for sale | 106.1 | – | 106.1 |
| | 2,075.7 | – | 2,075.7 |
| **Net current liabilities** | (259.7) | – | (259.7) |
| **Total assets less current liabilities** | 5,123.3 | – | 5,123.3 |
| **Non-current liabilities** | | | |
| Long-term borrowings | 1,951.7 | – | 1,951.7 |
| Deferred liabilities and provisions | 432.4 | – | 432.4 |
| Deferred tax liabilities | 364.0 | – | 364.0 |
| | 2,748.1 | – | 2,748.1 |
| **Net assets** | 2,375.2 | – | 2,375.2 |

Notes to unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group

(a) No adjustment is required for the acquisition of 13.7% interest in Meralco from Piltel and the disposal of 50% interest in Beacon Electric to Piltel because Beacon Electric will still be accounted for as a jointly-controlled entity of the Group. Therefore, the existing investment cost of MPIC in Meralco will be transferred to the investment in Beacon Electric and there will not be any gain or loss arising from the Piltel Investment.

**Scenario Two: Exercise of the Call Option without completion of the Piltel Investment**

The following is a summary of the unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group, which has been prepared on the basis of the notes set out below and assuming that the exercise of the Call Option (without completion of the Piltel Investment) had been completed as at 31 December 2008 for the purpose of illustrating how the exercise of the Call Option might have affected the consolidated assets and liabilities of the Group at that date.

The unaudited consolidated pro forma statement of assets and liabilities has been prepared to provide financial information on the enlarged Group as a result of the exercise of the Call Option (without completing the Piltel Investment). As it is prepared for illustrative purposes only, and because of its hypothetical nature, it may not purport to represent what the assets and liabilities of the enlarged Group shall be on the actual exercise of the Call Option (without completing the Piltel Investment).

| *(US$ millions)* | **The Group** | **Possible exercise of the Call Option** *(a)/(b)* | **The enlarged Group after the possible exercise of the Call Option** |
|---|---|---|---|
| Property, plant and equipment | 808.4 | – | 808.4 |
| Plantations | 744.5 | – | 744.5 |
| Associated companies and joint ventures | 1,202.3 | 485.1 | 1,687.4 |
| Goodwill | 675.6 | – | 675.6 |
| Other intangible assets | 1,538.5 | – | 1,538.5 |
| Accounts receivable, other receivables and prepayments | 3.0 | – | 3.0 |
| Prepaid land premiums | 153.2 | – | 153.2 |
| Available-for-sale assets | 1.7 | – | 1.7 |
| Deferred tax assets | 38.7 | – | 38.7 |
| Other non-current assets | 217.1 | – | 217.1 |
| | 5,383.0 | 485.1 | 5,868.1 |

| *(US$ millions)* | **The Group** | **Possible exercise of the Call Option** *(a)/(b)* | **The enlarged Group after the possible exercise of the Call Option** |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | 625.9 | (142.9) | 483.0 |
| Pledged deposits | 12.0 | – | 12.0 |
| Available-for-sale assets | 56.9 | – | 56.9 |
| Accounts receivable, other receivables and prepayments | 435.5 | – | 435.5 |
| Inventories | 557.4 | – | 557.4 |
| Assets of a disposal group classified as held for sale | 128.3 | – | 128.3 |
| | 1,816.0 | (142.9) | 1,673.1 |
| **Current liabilities** | | | |
| Accounts payable, other payables and accruals | 667.4 | – | 667.4 |
| Short-term borrowings | 1,207.0 | – | 1,207.0 |
| Provision for taxation | 55.8 | – | 55.8 |
| Current portion of deferred liabilities and provisions | 39.4 | – | 39.4 |
| Liabilities directly associated with the assets classified as held for sale | 106.1 | – | 106.1 |
| | 2,075.7 | – | 2,075.7 |
| **Net current liabilities** | (259.7) | (142.9) | (402.6) |
| **Total assets less current liabilities** | 5,123.3 | 342.2 | 5,465.5 |
| **Non-current liabilities** | | | |
| Long-term borrowings | 1,951.7 | 342.2 | 2,293.9 |
| Deferred liabilities and provisions | 432.4 | – | 432.4 |
| Deferred tax liabilities | 364.0 | – | 364.0 |
| | 2,748.1 | 342.2 | 3,090.3 |
| **Net assets** | 2,375.2 | – | 2,375.2 |

Notes to unaudited consolidated pro forma statement of assets and liabilities of the enlarged Group

(a) Since the Piltel Investment was not completed, Beacon Electric will still be a wholly-owned subsidiary of MPIC and hence a subsidiary of the Company.

(b) Adjustment to illustrate the impact of the possible exercise of the Call Option by Beacon Electric in the event that the board of Beacon Electric decides to exercise the Call Option. The exercise price of Pesos 22.41 billion (equivalent to approximately US$485.1 million or HK$3,783.5 million) will be funded by a combination of bank loans of approximately Pesos 15.81 billion (equivalent to approximately US$342.2 million or HK$2,669.2 million) and cash from the Group in the form of subscription of preferred shares in Beacon Electric in the amount of Pesos 6.6 billion (equivalent to approximately US$142.9 million or HK$1,114.3 million).

## 1. RESPONSIBILITY STATEMENT

This Circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this Circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

## 2. DISCLOSURE OF INTERESTS

### (i) Interests of Directors in the Company and its associated corporations

As at the Latest Practicable Date, the interests and short positions of the Directors and chief executive of the Company in the shares of the Company, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which: (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO); or (b) were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein; or (c) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (Model Code), to be notified to the Company and the Stock Exchange were as follows:

*(a) Long positions in shares in the Company*

| Name | Ordinary share | Approximate percentage of issued shares capital *(%)* | Ordinary shares options |
|---|---|---|---|
| Anthoni Salim | 1,706,947,154 (C)(i) | 44.22 | – |
| Manuel V. Pangilinan | 7,887,309 (P) | 0.20 | 65,349,552 |
| Edward A. Tortorici | 39,590,557 (P) | 1.03 | 19,183,256 |
| Robert C. Nicholson | 12,914 (P) | 0.00 | 31,093,739 |
| Ambassador Albert F. del Rosario | 720,000 (P) | 0.02 | 6,324,150 |
| Benny S. Santoso | – | – | 6,324,150 |
| Graham L. Pickles | – | – | 3,330,719 |
| Prof. Edward K.Y. Chen, *GBS, CBE, JP* | – | – | 4,743,113 |
| Sir David W.C. Tang, *KBE* | – | – | 3,330,719 |
| Napoleon L. Nazareno | – | – | 3,330,000 |
| Jun Tang | – | – | 3,330,000 |

(C) = Corporate interest, (P) = Personal interest

(i) Anthoni Salim indirectly owns 100% of First Pacific Investments (BVI) Limited and Mega Ring Investments Limited which, in turn, are interested in 632,226,599 shares and 284,491,191 shares respectively in the Company. Anthoni Salim's indirect interests in First Pacific Investments (BVI) Limited and Mega Ring Investments Limited are held through Salerni International Limited (a company which Anthoni Salim directly holds 100% of the issued share capital). Anthoni Salim also owns 56.8% of First Pacific Investments Limited which, in turn, is interested in 790,229,364 shares in the Company. Of this, 10.0% is held by Anthoni Salim directly, and 46.8% by Salerni International Limited. The remaining 43.2% interest in First Pacific Investments Limited is owned as to 30.0% by Sutanto Djuhar, 10.0% by Tedy Djuhar and 3.2% by a company controlled by Ibrahim Risjad, all of whom are Non-executive Directors of the Company.

*(b) Long positions in shares in associated corporations*

- Manuel V. Pangilinan owned 5,242,404 common shares[P] and 15,000,000 share options in Metro Pacific Investments Corporation (MPIC), 210,033 common shares[P] in Philippine Long Distance Telephone Company (PLDT) and 360 preferred shares[P] in PLDT as beneficial owner and a further 15,417 common shares in PLDT as nominee, as well as 155,000 common shares[P] in Philex Mining Corporation (Philex).

- Edward A. Tortorici owned 69,596 common shares[C] and 660,000 common shares[P] as well as 10,000,000 share options in MPIC, 104,874 common shares[P] in PLDT and 100 common shares[P] in Philex.

- Robert C. Nicholson owned 1,250 common shares[P] in Philex.

- Sutanto Djuhar owned 15,520,335 ordinary shares[C] in PT Indofood Sukses Makmur Tbk (Indofood).

- Tedy Djuhar owned 15,520,335 ordinary shares[C] in Indofood.

- Ibrahim Risjad owned 6,406,180 ordinary shares[C] in Indofood.

- Anthoni Salim owned 632,370 ordinary shares[C] in Indofood and a direct interest of 2,007,788 shares in Indofood Agri Resources Ltd. (IndoAgri) through his controlled corporations other than First Pacific and an indirect interest of 998,200,000 IndoAgri shares through First Pacific group companies.

- Ambassador Albert F. del Rosario owned 140,005 common shares(P) and 1,560 preferred shares(P) in PLDT, 6,516,624 common shares(P) and 5,000,000 share options in MPIC, 100 common shares(P) in Philex, 32,231,970 preferred shares in Prime Media Holdings, Inc. (PMH) as nominee, 4 common shares(P) in PMH as beneficial owner, 4,922 common shares(P) in Costa de Madera Corporation, 15,000 common shares(P) in Metro Pacific Land Holdings Inc., and 80,000 common shares(P) in Metro Strategic Infrastructure Holdings, Inc.

- Napoleon L. Nazareno owned 6,648 common shares(P) in MPIC, 13,927 common shares(P) in PLDT and 495 preferred shares(P) in PLDT.

(P) = Personal interest, (C) = Corporate interest

As at the Latest Practicable Date, other than as disclosed, none of the Directors and chief executive of the Company were interested, or were deemed to be interested in the long and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of the SFO) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO; or (b) were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein; or (c) were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange.

**(ii) Interests of Substantial Shareholders and other persons**

The register of interests in shares and short positions of substantial shareholders maintained under Section 336 of the SFO shows that at the Latest Practicable Date, the Company had been notified that the following persons were interested in 5% or more of the Company's issued share capital:

(a) Salerni International Limited (Salerni), which was incorporated in the British Virgin Islands, was interested in 1,706,947,154 shares (long position) at the Latest Practicable Date, representing approximately 44.22% of the Company's issued share capital, by way of its 46.80% interest in First Pacific Investments Limited (FPIL-Liberia) and its 100% interest in First Pacific Investments (B.V.I.) Limited (FPIL-BVI).

(b) FPIL-Liberia, which was incorporated in the Republic of Liberia, beneficially owned 790,229,364 shares at the Latest Practicable Date, representing approximately 20.47% of the Company's issued share capital. FPIL-Liberia is owned by the Chairman (Anthoni Salim) and three Non-executive Directors (Sutanto Djuhar, Tedy Djuhar and Ibrahim Risjad), in the proportion specified in note (i) of the table on page 305. Anthoni Salim is taken to be interested in the shares owned by FPIL-Liberia.

(c) FPIL-BVI, which was incorporated in the British Virgin Islands, beneficially owned 632,226,599 shares at the Latest Practicable Date, representing approximately 16.38% of the Company's issued share capital. Anthoni Salim, the Chairman of the Company, beneficially owns the entire issued share capital of FPIL-BVI and, accordingly, is taken to be interested in the shares owned by FPIL-BVI.

(d) Mega Ring Investments Limited (Mega Ring), which was incorporated in the British Virgin Islands, beneficially owned 284,491,191 ordinary shares as at the Latest Practicable Date, representing approximately 7.37% of the Company's issued share capital. Anthoni Salim, the Chairman of the Company, beneficially owns the entire issued share capital of Mega Ring and, accordingly, is taken to be interested in the shares owned by Mega Ring.

(e) Marathon Asset Management Limited (Marathon), a UK incorporated company, notified the Company that it held 208,871,173 shares of the Company in August 2008, representing approximately 6.48% of the Company's issued share capital at that time. At the Latest Practicable Date, the Company has not received any other notification from Marathon of any change to such holding.

(f) Lazard Asset Management LLC (Lazard), a US incorporated company, notified the Company that it held 232,267,400 shares of the Company as at 29 December 2009, representing approximately 6.02% of the Company's issued share capital at that time. At the Latest Practicable Date, the Company has not received any other notification from Lazard of any change to such holding.

As at the Latest Practicable Date, so far as was known to the Directors and chief executive of the Company, the following parties (other than the Directors or the chief executive of the Company) were, directly or indirectly, interested in ten per cent or more of the nominal value of any class of share capital (including any options in respect of such capital) carrying rights to vote in all circumstances at general meetings of any other member of the Group:

| Name of members of the Group | Name of shareholder | Approximate percentage of issued share capital held |
|---|---|---|
| PT Indofood Fritolay Makmur | Seven-Up Netherland B.V | 49.0% |
| DMCI-MPIC Water Company Inc. | DMCI Holdings, Inc. | 44.6% |
| PT Mentari Subur Abadi | PT Giat Sembada Sentosa | 40.0% |
| PT Mega Citra Perdana | PT Purwa Wana Lestari | 40.0% |
| PT Surya Rengo Containers | Rengo Company Ltd. | 40.0% |
| PT Swadaya Bhakti Negaramas | PT Giat Sembada Sentosa | 40.0% |
| Lucena Commercial Land Corporation | Landco Pacific Corporation | 35.0% |
| PT Laju Perdana Indah | PT Bangun Sriwijaya Sentosa | 32.0% |
| PT Indolakto | PT Perusahaan Dagang dan Industries Marison NV | 29.5% |
| PT Putridaya Usahatama | Pandi Kusuma | 22.5% |
| PT Putridaya Usahatama | Siti Sundari Rita | 12.5% |
| PT Multi Agro Kencana Prima | Koperasi Perkebunan Karet Panca Usaha Mitra | 20.0% |
| Manila North Tollways Corporation | Globalfund Holdings Inc. | 16.5% |
| Manila North Tollways Corporation | Egis Projects S.A. | 13.9% |

| Name of members of the Group | Name of shareholder | Approximate percentage of issued share capital held |
|---|---|---|
| Metro Pacific Investments Corporation | The Board of Trustees for the Account of The Beneficial Trust Fund Created Pursuant to the Benefit Plan of PLDT | 15.7% |
| PT Argha Giri Perkasa | PT Minamas Eramustika | 13.6% |
| Indofood Singapore Holdings Pte. Ltd. | PT Mandiri Investama Sejati | 12.9% |
| First Pacific Communications Holdings B.V. | Excella Trading Limited | 12.5% |
| Pacsari Pte. Ltd. | Grace Shipping Ltd. | 10.0% |
| PT Tani Andalas Sejahtera | Agus Suherman | 10.0% |
| First Pacific Realty Partners Corporation | PCI Limited | 18.9% |

Save as disclosed above, as at the Latest Practicable Date, none of the Directors nor the chief executive of the Company was aware of any other person, other than a Director or a chief executive of the Company, who had an interest or short position in the Shares or underlying Shares of equity derivatives and debentures of the Company which would fall to be disclosed to the Company under the provisions of the Divisions 2 and 3 of Part XV of the SFO, or who was, directly or indirectly, interested in ten per cent or more of the nominal value of any class of share capital (including any option in respect of such capital) carrying rights to vote in all circumstances at general meetings of any other member of the Group.

**(iii) Interests in Share Options**

Particulars of the share options of the Company and its subsidiary company granted to the Directors and senior executives of the Company and its subsidiary company at the Latest Practicable Date are set out below.

*(A) Particulars of the Company's Share Option Scheme*

| | Share options held at the Latest Practicable Date | Share options exercise price *(HK$)* | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | |
| Manuel V. Pangilinan | 33,517,996 | 1.6698 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 31,831,556 | 5.0569 | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Edward A. Tortorici | 19,183,256 | 5.0569 | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| Robert C. Nicholson | 14,756,351 | 1.6698 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 16,337,388 | 5.0569 | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Non-Executive Directors** | | | | | | |
| Ambassador Albert F. del Rosario | 2,993,431 | 1.6698 | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,330,719 | 5.0569 | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Benny S. Santoso | 2,993,431 | 1.6698 | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,330,719 | 5.0569 | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Napoleon L. Nazareno | 3,330,000 | 5.0569 | 11 December 2009 | December 2010 | December 2010 | December 2019 |
| **Independent Non-Executive Directors** | | | | | | |
| Graham L. Pickles | 3,330,719 | 5.0569 | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Prof. Edward K.Y. Chen *GBS, CBE, JP* | 1,412,394 | 1.6698 | 1 June 2004 | June 2005 | June 2005 | May 2014 |
| | 3,330,719 | 5.0569 | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Sir David W. C. Tang *KBE* | 3,330,719 | 5.0569 | 5 September 2007 | September 2008 | September 2008 | September 2017 |
| Jun Tang | 3,330,000 | 5.0569 | 11 December 2009 | December 2011 | December 2011 | December 2019 |
| **Senior Executives** | 30,600,455 | 1.6698 | 1 June 2004 | December 2008 | June 2005 | May 2014 |
| | 4,743,113 | 3.1072 | 7 June 2006 | December 2010 | June 2007 | June 2016 |
| | 44,500,938 | 5.0569 | 5 September 2007 | September 2012 | September 2008 | September 2017 |
| **Total** | 226,183,904 | | | | | |

*(B) Particulars of MPIC's Share Option Scheme*

| | Share options held at the Latest Practicable Date | Share options exercise price (₱) | Grant date | Fully vested by | Exercisable from | Exercisable until |
|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | |
| Manuel V. Pangilinan | 7,500,000 | 2.12 | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | 7,500,000 | 2.73 | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| Edward A. Tortorici | 5,000,000 | 2.12 | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | 5,000,000 | 2.73 | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| Ambassador Albert F. del Rosario | 2,500,000 | 2.12 | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | 2,500,000 | 2.73 | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| **Senior Executives** | 36,135,000 | 2.12 | 9 December 2008 | January 2010 | January 2009 | January 2013 |
| | 37,870,000 | 2.73 | 10 March 2009 | March 2010 | March 2009 | March 2013 |
| **Total** | 104,005,000 | | | | | |

## 3. DIRECTORS' INTERESTS

### (a) Service Contracts

As at the Latest Practicable Date, none of the Directors had any existing or proposed service contract with any member of the Group which was not expiring or determinable by the employer within one year without payment of compensation, other than statutory compensation.

### (b) Assets of the Group

As at the Latest Practicable Date, none of the Directors had any interest, direct or indirect, in any assets which have, since 31 December 2008 (being the date to which the latest published audited consolidated financial statements of the Company were made up), been acquired or disposed of by, or leased to, the Company or any member of the Group, or were proposed to be acquired or disposed of by, or leased to, the Company or any member of the Group.

### (c) Contracts of the Group

As at the Latest Practicable Date, save for Mr. Anthoni Salim's interests in the underlying contracts of the continuing connected transactions referred to in the Shareholders' Circular dated 13 June 2008 and the continuing connected transactions referred to in the Company's announcements dated 6 January 2009 and 23 February 2010, respectively none of the Directors were materially interested in any contract or arrangement entered into by any member of the Group subsisting at such date and which is significant in relation to the business of the Group.

## 4. DIRECTORS' INTERESTS IN COMPETING BUSINESS

As at the Latest Practicable Date, so far as the Directors are aware, none of the Directors or their respective associates have a controlling interest in a business which competes either directly or indirectly with the business of the Company.

## 5. LITIGATION

As at the Latest Practicable Date, neither the Company nor any of its subsidiaries is engaged in any litigation or arbitration of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened by or against any member of the Group.

## 6. MATERIAL CONTRACTS

The following contracts have been entered into by the Group (not being contracts entered into in the ordinary course of business) within the two years immediately preceding the date of this Circular and are or may be material:

(a) the Omnibus Agreement entered into on 1 March 2010 between MPIC, Beacon Electric and Piltel in relation to the reorganisation of the current shareholdings of MPIC and Piltel in Meralco with a view to consolidating their Meralco shareholdings in Beacon Electric;

(b) the Option Agreement entered into on 1 March 2010 between FPHC and Beacon Electric in respect of the grant of the Call Option by FPHC to Beacon Electric;

(c) the sale and purchase agreement entered into on 1 March 2010 between Piltel and Beacon Electric which documents the Meralco Share Acquisition from Piltel for a total consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million), which is equal to PhP150 (equivalent to approximately US$3.25 and approximately HK$25.3) per common share of Meralco;

(d) the subscription agreement entered into on 1 March 2010 between Piltel and Beacon Electric which documents the Piltel-Beacon Electric Subscription at the subscription price of PhP20 (equivalent to approximately US$0.43 and approximately HK$3.38) per common share of Beacon Electric, which results in an aggregate subscription consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million);

(e) the conditional sale agreement dated 21 January 2010 by Two Rivers Pacific Holdings Corporation ("Two Rivers") with the Government Service Insurance System relating to Two Rivers' acquisition of an approximately 5.9% interest in the capital stock of Philex Mining Corporation ("Philex") for a consideration of PhP6,022,450,350 (equivalent to approximately US$130.9 million or approximately HK$1,021.2 million) (i.e. PhP21 (equivalent to approximately US$0.46 or approximately HK$3.56) per common share of Philex);

(f) the share purchase agreement dated 2 December 2009 by Two Rivers and a group of sellers led by Mr. Roberto V. Ongpin relating to acquisition of an approximately 9.2% interest in the capital stock of Philex for a consideration of PhP9,493,851,360 (equivalent to approximately US$202.0 million or approximately HK$1,575.6 million) (i.e. PhP21 (equivalent to approximately US$0.45 or approximately HK$3.5) per common share of Philex);

(g) the underwriting agreement, comprising the underwriting agreement dated 15 October 2009 entered into between the Company and the Underwriters, as amended by amendment agreements dated 4 November 2009 and 10 November 2009 entered into between the same parties;

(h) the term sheet between MPIC and FPHC on 5 November, 2009 relating to a PhP11.2 billion loan and a right to acquire a Call Option over 74,700,000 common shares of in Meralco;

(i) the extension agreement dated 22 January 2010 and a further extension agreement dated 29 January 2010 relating to the 5 November 2009 term sheet in (h) above;

(j) agreement dated 2 October 2009 between MPIC and Beneficial Trust Fund established for the benefit of qualified employees of Philippine Long Distance Telephone Company ("BTF") relating to the sale and transfer to MPIC of 113,313,389 common shares in Meralco for a total consideration of PhP14,277,487,014 (approximately US$303.8 million and approximately HK$2,369.5 million);

(k) subscription agreement dated 2 October 2009 by MPIC and BTF relating to subscription by and issue to BTF of 3,159,162,338 MPIC shares at the aggregate consideration of PhP9,477,487,014 (approximately US$201.6 million and HK$1,572.9 million) (i.e. PhP3.00 (approximately US$0.0638 and HK$0.498) per share) from the unissued capital stock of MPIC;

(l) placement agreement dated 19 September 2009 by MPIC and MPHI with CLSA Singapore Pte Ltd and UBS AG covering 4,150,000,000 common shares of MPIC, with an overallotment option ("Over-Allotment Option") covering an additional 620,000,000 common shares of MPIC at the offer price of PhP3.00 (approximately US$0.0629 and approximately HK$0.4906) per common share of MPIC;

(m) greenshoe agreement dated 19 September 2009 between MPHI and CLSA Limited as overallotment agent to regulate the exercise of the Over-Allotment Option;

(n) subscription agreement dated 19 September 2009 by MPHI and MPIC relating to top up subscription under the re-launch of the listed shares of MPIC at the subscription price of PhP3.00 (approximately US$0.0629 and approximately HK$0.4906) per common share of MPIC;

(o) agreement dated 19 June 2009 between MPIC, AB Holdings Corporation ("ABHC") with the conformity of Landco Pacific Corporation ("Landco") and Alfred Xerez-Burgos, Jr. in relation to ABHC's Disposal from MPIC of 1,330,247 fully paid common shares of Landco for a consideration of PhP203,279,377 (approximately US$4,199,987 and approximately HK$32,759,900);

(p) sale and assignment agreement dated 21 November 2008 between PT Salim Ivomas Pratama and Lyminton Pte Ltd in relation to the Disposal of 29.98% interest in PT Sarana Inti Pratama for a cash consideration of US$16.4 million (approximately HK$127.9 million);

(q) sale and purchase agreement dated 21 November 2008 between PT Salim Ivomas Pratama, PT Mulia Abadi Lestari and PT Indoagri Inti Plantation in relation to the purchase of the remaining 30% interest of PT Mitra Inti Sejati Plantation for a cash consideration of Indonesian Rupiah 28.5 billion (approximately US$2.3 million and approximately HK$18.0 million);

(r) term sheet dated 3 October 2008 entered into between the Company and Philex relating to an acquisition of an approximate aggregate 20.16% interest in Philex by a wholly owned subsidiary of the Company at the Offer Price of PhP7.92 (approximately US$0.1676 and approximately HK$1.31) per share for a consideration of approximately PhP6.167 billion (approximately US$130.5 million and approximately HK$1,017.8 million) and a letter agreement dated 15 October 2008 supplementing the same;

(s) agreement dated 22 September 2008 between PT Indofood Sukses Makmur Tbk ("Indofood") and Pastilla Investment Limited ("Pastilla") in relation to the Disposal of share capital in Drayton Pte. Ltd. ("Drayton") and the assignment to Indofood of a loan owing by Drayton to Pastilla for a consideration of US$350 million (approximately HK$2,730 million);

(t) agreement dated 9 September 2008 between MPIC, ABHC, Alfred Xerez-Burgos, Jr. and Landco in relation to certain call option;

(u) share purchase agreement dated 26 August 2008 between Benpres Holdings Corporation as Seller ("Benpres"), FPHC as Seller and MPIC in respect of shares in First Philippine Infrastructure, Inc for a consideration of PhP12.262 billion (approximately US$278.7 million and approximately HK$2.2 billion);

(v) agreement dated 27 June 2008 by Asset Holder PCC No.2 Limited in respect of Ashmore Asian Recovery fund, EMDCD Ltd., Ashmore Global Special Situations Fund 4 Limited Partnership, Ashmore Global Special Situations Fund 2 Limited, Ashmore Global Special Situations Fund 3 Limited Partnership as Assignors and Salient Holdings Limited, a wholly owned subsidiary of the Company, as Assignee for purchase of DMCI-MPIC Water Company Inc.'s convertible notes and agreement dated 27 June 2008 on repayment of the exchangeable notes (exchangeable into shares of Maynilad Water Services, Inc.) by Metro Pacific Investments Corporation to Inframetro Investments Pte Ltd, for a total consideration of US$140 million (approximately HK$1,092 million); and

(w) share subscription agreement dated 9 May 2008 by PT Salim Ivomas Pratama with (i) PT Bangun Sriwijaya Sentosa, (ii) PT Lajuperdana Indah (the "Target Company") and (iii) the minority shareholders of the Target Company in relation to subscription of 60% new equity in the Target Company for an aggregate cash consideration of Indonesian Rupiah 375 billion (which is equivalent to approximately US$40.6 million and HK$316.6 million).

## 7. MISCELLANEOUS

(a) The Company Secretary of the Company is Ms. Nancy L.M. Li, MSc (Corporate Governance and Directorship), BA, FCS(PE), FCIS.

(b) The registered office of the Company is at Canon's Court, 22 Victoria Street, Hamilton HM12, Bermuda. The principal office of the Company is at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong.

(c) The principal share registrar and transfer office is Butterfield Fulerum Group (Bermuda) Limited, Rosebank Centre, 11 Bermuda Road, Pembroke, HM08, Bermuda.

(d) The share registrar and transfer office (Hong Kong Branch) is Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong.

## 8. QUALIFICATIONS OF EXPERTS

The following is the qualification of the experts who have given opinions or advice which are contained in this Circular:

| Name | Qualification |
|---|---|
| SGV | A firm of certified public accountants as registered with the Philippine Regulatory Board of Accountancy to practice in the Philippines. |
| Ernst & Young | Certified Public Accountants. |

## 9. EXPERTS' INTERESTS IN ASSETS

As at the Latest Practicable Date, SGV and Ernst & Young did not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

As at the Latest Practicable Date, SGV and Ernst & Young did not have any direct or indirect interests in any assets or any securities of the Company or any member of the Group which have since 31 December 2008 (being the date to which the latest published audited accounts of the Company were made up) been acquired or disposed of by, or leased to, the Company or any member of the Group, or which are proposed to be acquired or disposed of by, or leased to, the Company or any member of the Group.

## 10. CONSENT OF EXPERTS

As at the Latest Practicable Date, SGV and Ernst & Young have given and have not withdrawn their written consents to the issue of this Circular with the inclusion herein of their reports/letters and/or references to their name, as the case may be, in the form and context in which it appears.

## 11. GENERAL

In case of discrepancy or differences in interpretation, the English text of this Circular prevails over the Chinese text.

## 12. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong, on any weekday, except public holidays, for 14 days from the date of this Circular:

(a) this Circular;

(b) the memorandum of association and Bye-laws of the Company;

(c) the annual reports of the Company for the two years ended 31 December 2007 and 31 December 2008;

(d) interim report of the Company for the period ended 30 June 2009;

(e) the accountants' report on Meralco referred to in Appendix II to this Circular;

(f) the pro forma financial information of the enlarged Group as set out in Appendix III to this Circular;

(g) the material contracts referred to in the section headed "Material Contracts" in this Appendix IV;

(h) the written consents from SGV and Ernst & Young referred to in the section headed "Consent of Experts" in this Appendix IV; and

(i) the prospectus dated 4 November 2009 and the supplementary prospectus dated 10 November 2009 relating to the Company's rights issue.

# FIRST PACIFIC COMPANY LIMITED

*(Incorporated with limited liability under the laws of Bermuda)*

*Website: http://www.firstpacific.com*

**(Stock Code: 00142)**

**NOTICE IS HEREBY GIVEN** that a special general meeting of First Pacific Company Limited ("the **Company**") will be held at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong on Tuesday, 30 March 2010 at 9:00 a.m. for the purpose of considering and, if thought fit, passing (with or without modification) the following resolutions as ordinary resolutions of the Company:

(1) "**THAT:**

(a) the purchase, by Beacon Electric Asset Holdings, Inc ("**Beacon Electric**") from Pilipino Telephone Corporation ("**Piltel**") of 154,200,000 common shares of Manila Electric Company ("**Meralco**") for a total consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million), which is equal to PhP150 (equivalent to approximately US$3.25 and approximately HK$25.3) per common share of Meralco, pursuant to an agreement entered into on 1 March 2010 between (1) Metro Pacific Investments Corporation ("**MPIC**"), (2) Beacon Electric and (3) Piltel in relation to the reorganisation of the current shareholdings of MPIC and Piltel in Meralco with a view to consolidating their Meralco shareholdings in Beacon Electric (the "**Omnibus Agreement**") be and is hereby approved;

(b) the subscription by Piltel of 1,156,500,000 common shares of Beacon Electric at the subscription price of PhP20 (equivalent to approximately US$0.43 and approximately HK$3.38) per common share of Beacon Electric, for an aggregate subscription consideration of PhP23,130,000,000 (equivalent to approximately US$500.6 million and approximately HK$3,905.1 million), pursuant to the Omnibus Agreement, be and is hereby approved;

(c) the sale by MPIC to Piltel of 12,500 common shares of Beacon Electric for a consideration per common share equal to their par value of PhP1.00 (equivalent to approximately US$0.02 and approximately HK$0.17) per common share of Beacon Electric, resulting in Beacon Electric becoming a 50:50 joint venture of MPIC and Piltel, pursuant to the Omnibus Agreement be and is hereby approved;

((a), (b) and (c) above shall collectively be known as the "**Piltel Investment**")

(d) the entry into of the Omnibus Agreement by MPIC and Beacon Electric and the performance of their respective obligations under the Omnibus Agreement be and are hereby approved; and

(e) that any executive director of the Company be and is hereby authorized to arrange for the execution of such documents in such manner as he may consider necessary or desirable and to do, or authorize the Company and/or any subsidiary(ies) to do, whatever acts and things he may consider necessary or desirable or expedient for the purpose of, or in connection with, the implementation of the Piltel Investment and the transactions contemplated by the Omnibus Agreement and/or any matter related thereto, to ratify any documents executed in relation to the Piltel Investment and/or the Omnibus Agreement, and to make or agree, or authorize the Company and/or any subsidiary(ies) to make or agree, such amendments or variations thereto, and to grant, or authorize the Company and/or any subsidiary(ies) to grant, any waivers of any conditions precedent or other provisions of such documents as any executive director of the Company in his discretion considers to be desirable and in the interests of the Company."

(2) "**THAT**:

(a) the exercise of a call option granted by First Philippine Holdings Corporation ("**FPHC**") to Beacon Electric Asset Holdings Inc. ("**Beacon Electric**") as grantee, to acquire 74,700,000 common shares of Meralco owned by FPHC (the "**Option Shares**" and each an "**Option Share**") at an exercise price of PhP300 (equivalent to approximately US$6.49 or approximately HK$50.65) per Option Share, which equates to an aggregate price of PhP22,410,000,000 (equivalent to approximately US$485.1 million and approximately HK$3,783.5 million) for all the Option Shares pursuant to the terms of the option agreement entered into on 1 March 2010 between FPHC and Beacon Electric (the "**Call Option**") be and is hereby approved;

(b) the entry into of the Option Agreement by Beacon Electric and the performance of its obligations under the Option Agreement arising in the event of a possible exercise of the Call Option be and are hereby approved; and

(c) any executive director of the Company be and is hereby authorized to arrange for the execution of such documents in such manner as he may consider necessary or desirable and to do, or authorize the Company and/or any subsidiary(ies) to do, whatever acts and things he may consider necessary or desirable or expedient for the purpose of, or in connection with, the implementation of a possible exercise of the Call Option and/or any matter related thereto, to ratify any documents executed in relation to a possible exercise of the Call Option, and to make or agree, or authorize the Company and/or any subsidiary(ies) to make or agree, such amendments or variations thereto, and to grant, or authorize the Company and/or any subsidiary(ies)

to grant, any waivers of any conditions precedent or other provisions of such documents as any executive director of the Company in his discretion considers to be desirable and in the interests of the Company."

By order of the Board
**First Pacific Company Limited**
**Nancy L.M. Li**
*Company Secretary*

Dated: 13 March 2010

*Notes:*

1. Any shareholder entitled to attend and vote at the special general meeting convened by the above notice is entitled to appoint one or more proxies to attend and vote on his behalf. A proxy need not be a shareholder of the Company.

2. A form of proxy for the special general meeting is enclosed. In order to be valid, the form of proxy together with the power of attorney or other authority, if any, under which it is signed or a notarially certified copy of the power of attorney or other authority must be deposited at the Company's principal office (Attention: Corporate Secretarial Department) at 24th Floor, Two Exchange Square, 8 Connaught Place, Central, Hong Kong, not less than 48 hours before the time appointed for holding the special general meeting or any adjournment thereof (as the case may be). Completion and return of the form of proxy will not preclude shareholders from attending and voting in person at the meeting or any adjourned meeting should they so wish.