



# CONQUERING CHALLENGES



LT GROUP, INC. | ANNUAL REPORT 2013



## The LT Group Logo

Strength and solidarity.

This is the essence of the LT Group (LTG) logo. The clean balanced lines and curves are the central elements -- a mystical symmetrical tree. Drawn in an Eastern-Oriental style, it gives hint to the Company's Chinese heritage.

Tree is life. Life is growth. Like a tree, a company with firm roots, properly nurtured, will continuously grow and give value.

The tree's trunk is upright, and the branches spread out -- a symbolic consolidation of the subsidiaries and stakeholders within two circles, one for continuity, the outer one for solidarity.

### VISION

A World-class conglomerate at the forefront of Philippine economic growth, successfully maintaining a strong presence and dominant position in key Philippine industries while ensuring continuous benefits to its consumers, communities, employees, business partners and shareholders.

### MISSION

Anchored to its Vision, the LTG Group commits: To increase stockholder values through long term growth in its major business groups.

To continuously improve the value of its products and services and to provide consumers with more and better choices.

To build the largest, most effective distribution network and widest customer reach in the Philippines.

To leverage on synergies between its various businesses to continuously improve revenues and cost structure.

*(The Mission and Vision statements were updated in 2012)*

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## THE LT Group

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ASIA BREWERY, INC.



ETON PROPERTIES PHILIPPINES, INC.



PMFTC, INC.



PHILIPPINE NATIONAL BANK



TANDUAY DISTILLERS, INC.

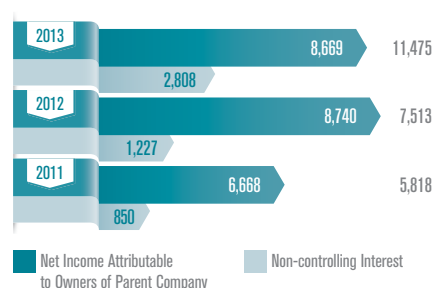
### Revenues (In Php Millions)



### EBITDA (In Php Millions)



### Net Income (In Php Millions)



### Per Share Data (In Php)

	2013	2012	2011
Earnings per share	0.85	0.85	0.68
Book value (at year end)	10.86	5.28	4.11

## FINANCIAL HIGHLIGHTS

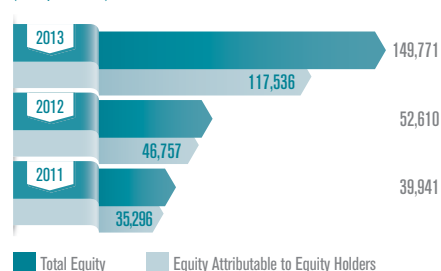
### Total Assets (In Php Millions)



### Total Liabilities (In Php Millions)



### Net Equity (In Php Millions)



### Ratios and Percentages

	2013	2012	2011
Current	0.63	1.52	1.38
Debt to Equity	3.53	0.86	0.87
Return on Assets	1.3%	7.7%	7.8%
Return on Equity	7%	16%	16%

## FINANCIAL SUMMARY

(in Php Millions)

### INCOME STATEMENT

	2013	2012 (Actual)	% change	2012 (Restated)	% change
Revenues	55,792	30,568	83%	62,657	-11%
Operating costs and expenses	50,480	27,605	83%	-56,344	-10%
Operating profit	5,312	2,964	79%	6,313	-16%
Equity in net earnings of an associate	3,704	6,499	-43%	6,499	-43%
Other income	4,568	215	2025%	5,425	-16%
Income before income tax	13,584	9,677	40%	18,237	-26%
Provision for income tax	-2,109	-937		-2,691	-22%
Net income before non-controlling interests	11,475	8,740	31%	15,546	-26%
Non-controlling interests	-2,806	-1,227	129%	-2,789	1%
Net income attributable to equity holders of the Company	8,669	7,513	15%	12,757	-32%

### EBITDA

	18,099	12,611	44%	22,464	-19%
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### FINANCIAL CONDITION

Total assets	678,450	97,599	595%	610,132	11%
Total liabilities	528,680	44,989	1075%	516,426	2%
Non-controlling interests	32,235	5,854	451%	31,051	4%
Equity attributable to equity holders of the Company	117,536	46,757	151%	62,655	88%

### RATIOS

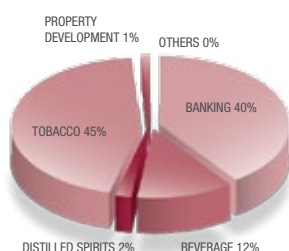
Per share (Php)

Earnings	0.85	0.85	0%	1.44	41%
Book value	10.86	5.21	108%	6.98	56%
Cash dividend	0.15	0.00		0.00	
Return on equity	7.4%	16.1%		20.4%	
Current ratio	0.63	1.52		0.54	
Debt/equity	3.53	0.86		5.51	
Debt/equity-without PNB	0.28	0.86		0.86	
Net debt/equity	0.12	0.20		0.24	

Note: Proforma includes LTG's stake in PNB

### Income Contribution (in Php Millions)

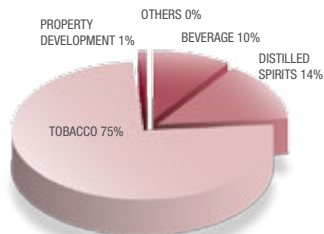
2013



BANKING	3,436
BEVERAGE	1,042
DISTILLED SPIRITS	185
TOBACCO	3,921
PROPERTY DEVELOPMENT	104
OTHERS	(19)

Php 8.669 Billion

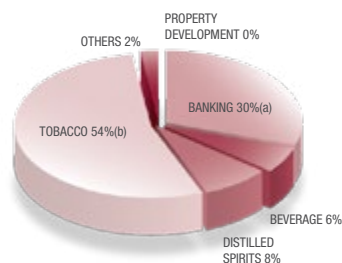
2012 (Actual)



BANKING	-
BEVERAGE	786
DISTILLED SPIRITS	1,021
TOBACCO	5,686
PROPERTY DEVELOPMENT	47
OTHERS	(27)

Php 7.513 Billion

2012 (Restated)



BANKING	3,771
BEVERAGE	786
DISTILLED SPIRITS	1,021
TOBACCO	6,881
PROPERTY DEVELOPMENT	47
OTHERS	251

Php 12.757 Billion

(a) In 2013, LTG acquired a stake in PNB, with beneficial ownership at 56.47% as of end-2013. The 2012 proforma figure is based on the pooling of interest method.

(b) LTG's ownership of Fortune Tobacco Corporation (tobacco segment) was at 100% as of end-2013 and 82.32% as of end-2012. The 2012 proforma figure is based on the pooling of interest method.



## MESSAGE FROM THE **CHAIRMAN**



*“We will persist in working toward a higher level of corporate governance.”*

– Dr. Lucio C. Tan

The year 2013 was a milestone for LT Group, Inc. (LTG) as it completed the consolidation of its businesses with the acquisition of a stake in Philippine National Bank (PNB). It was the first year of LTG as a publicly listed company after its offering in April that raised US\$920 million in fresh capital.

However, 2013 was also a year when our individual businesses faced numerous challenges -- from substantial increases in excise taxes to a highly competitive environment. These challenges impacted on our profitability, but our management team and employees will continue to work as a team to hurdle these and emerge a stronger and better LTG. We will focus on growing our five core businesses, coupled with the fiscal prudence that enabled us to get to where we are today.

The Philippine economy had a strong performance in 2013, growing by 7.2%, but it was also challenging because of the natural disasters that hit our country. A strong earthquake hit the Central Visayas Region in October, followed by Super Typhoon Yolanda (Haiyan) in November that devastated many parts of the Visayas. Many of our countrymen lost their homes and livelihood. Aside from providing relief goods, a lot still has to be done to rehabilitate the affected areas.

We are thankful for our blessings and we share these with our less fortunate countrymen through the Tan Yan Kee Foundation, Inc. (TYKFI). To date, the Foundation, through its HOPE Caravan, has helped some 50,000 families affected by the typhoon. We continue to support our advocacies in Education, Health Services, Social Welfare and the Environment.

We are mindful of our responsibilities to our stockholders, and we will strive even harder to preserve your trust and enhance our Company's value. We will persist in working toward a higher level of corporate governance.

Thank you for your trust and support.



**Dr. Lucio C. Tan**  
*Chairman & Chief Executive Officer*



## MESSAGE FROM THE **PRESIDENT**

The Philippine economy remained strong in 2013 with Gross Domestic Product (GDP) growing by 7.2%, while sustained consumer spending pushed Household Final Consumption Expenditure (HFCE) by 5.6%. The strong economic performance, coupled with robust corporate earnings, pushed the stock market to reach an all-time high in May 2013.

Amidst the bullish sentiment, LT Group, Inc. (LTG) was able to raise US\$920 million in fresh capital in April. LTG's offering was the Philippines' largest ever capital raising activity targeted at public investors. The offering also featured the country's first formal cornerstone tranche with eleven global long-only funds taking up the majority of the offering.

The offering followed LTG's year-long reorganization that created a consumer-focused conglomerate. The reorganization was completed in February with the merger of Philippine National Bank (PNB) and Allied Bank and LTG's acquisition of a stake in PNB.

LTG's financial performance remained robust in the earlier part of 2013, and enabled the Company to realize an attributable net income of Php6.1 billion in the first six months of 2013, about a billion pesos more than 1H12.



However, stiff competition in the various industries where we operate, exacerbated by the illicit trade in the tobacco business---your Company's biggest source of income--adversely affected earnings for the rest of the year. This was in an environment with unprecedented increases in excise taxes for tobacco, distilled spirits and fermented liquor.

For the whole of 2013, LTG's businesses reported a consolidated net income of Php11.5 billion, 31% more than the Php8.7 billion reported in 2012. The attributable net income to LTG was at Php8.7 billion, 15% higher than the Php7.5 billion generated in the same period in 2012, mainly due to the inclusion of PNB in the group.

#### **Tobacco business hit by sharp increase in excise tax and illicit trade**

The tobacco business faced an unprecedented increase in excise tax in 2013. The tax was doubled to Php25 per pack from Php12 per pack in the upper tier, and quadrupled to Php12 per pack from the Php2.71 per pack in the lower tier. At the start of the year, our partner, Philip Morris International (PMI) expected sales volume to go down by 20% to 25% due to higher cigarette prices, but expected earnings to remain flat year-on-year (y-o-y). In 1Q13, our equity in net earnings from PMFTC, Inc. (PMFTC) amounted to Php1.57 billion, slightly higher than 1Q12's Php1.51 billion.

However, the competitive environment changed due to the illicit trade that prevented us from operating in a level playing field. A competitor kept the price of super low cigarettes at an economically unsustainable level of Php1 per stick or a price to retailers of Php14.70 per pack. The Php12 excise tax plus the Php1.58 value added tax (VAT) left only Php1.12 per pack to cover the cost of production and distribution, which is unrealistic, when paying full taxes.

As a result, many consumers down traded to the more affordable Php1 per stick super-low priced cigarettes. To try to reverse the downward trend of our market share, PMFTC started lowering prices at the end of the first quarter, but moved up prices and reduced pricing support of the lowest-priced brands toward the end of the third quarter to tactically balance volume and profitability.

The competitor has since raised its prices to Php1.25 per stick in mid-November 2013 and subsequently to Php1.50 per stick in mid-January 2014 for its major

brand but kept its flanker brand at an unreasonably low price of Php1.25 per stick or a price to retailers of Php18.30 per pack. This is below the cost of excise tax plus VAT of Php19.10 per pack starting 2014. This flanker brand is estimated to account for 30% of the competitor's portfolio and 6% to 7% share of total market volume.

It remains to be seen whether the price of this flanker brand will be raised. PMI has disclosed that until the flanker brand "goes to the right price point and price gaps," we are also obliged to maintain some presence in the segment.

There are some positive developments toward curtailing the illicit trade. In late January 2014, the Bureau of Customs (BoC) ordered the closure of a competitor's customs bonded warehouse, which was allegedly used to bring in tax-free raw materials to manufacture cigarettes for export. The BoC further demanded the competitor to pay Php853 million based on an initial re-assessment of duties and taxes for the customs bonded warehouse which was paid in February 2014.

Furthermore, the Government is expected to implement tax stamps toward the end of June 2014, which will require manufacturers to purchase and paste numbered stamps on each pack of cigarettes.

Meanwhile, the Congressional Oversight Committee (composed of members of the Senate and House of Representatives) on the Comprehensive Tax Reform Program has started hearings and has requested the Department of Finance (DoF) and the agencies under it, the BoC and Bureau of Internal Revenue (BIR) to provide information on sales, importations and excise tax payments of tobacco companies. This is to verify Nielsen reports that cigarette consumption did not go down despite the reported tax-paid industry sales volume decline of 16% in 2013.

By the end of the year, your Company's equity in net earnings from PMFTC decreased by 43% y-o-y as our sales volume declined by 26% and our market share dropped to an average of 79% for 2013 from 91% in 2012, based on PMI's estimates.

We remain hopeful that problems in the industry will be resolved over time.

#### **PNB becomes the country's fourth largest bank**

LTG acquired a stake in PNB in February 2013. From 45.5%, LTG increased its beneficial ownership to 56.47% by the end of 2013.

The year 2013 was significant for the bank, with its merger with Allied Bank. This pushed PNB's ranking to the fourth largest private bank in the country in terms of Total Assets, Total Deposits and Total Loans. The merger also increased the bank's number of domestic branches to 656 by the end of 2013, from 339 in 2012, and its ATM network to 859 from 480. PNB continues to corner the largest share of the remittance business with over a 20% share.

Like most Philippine banks in 2013, PNB generated substantial trading gains in the first four months of the year, and boosted earnings. PNB's trading gains amounted to Php7.2 billion in 2013.

Using the pooling method, the bank's income in 2013 would have settled at Php6.8 billion, Php318 million or 5% more than 2012. However, due to the Php868 million loss of the general insurance business arising primarily from Super Typhoon Yolanda (Haiyan) that was booked in the fourth quarter (Php608 million, net of tax), income was 4% lower than the previous year at Php6.2 billion.

PNB had a Stock Rights Offering in mid-February 2014 that raised a total of Php11.6 billion. Ten billion pesos of the proceeds will be used to recapitalize PNB Savings Bank, which will be used to grow the bank's consumer loan business. LTG subscribed to the Offering to the extent of its beneficial ownership.

#### **Asia Brewery's (ABI) products remain market leaders in their segments; enters into new partnerships**

Cobra, our carbonated energy drink, remains the highest contributor to ABI's revenues. It also continues to be the market leader with a share of over 70%. Our water brands, Absolute and Summit, also remain market leaders, with sales volume continuing to post double-digit growth. We are currently expanding our capacity to meet the increasing demand.

In the alcopop business, Tanduay Ice has more than 90% of the market. Vitamilk, ABI's soymilk drink under an exclusive distribution agreement with Green Spot of Thailand, is the country's leading soymilk brand, with around 70% market share.

The intensified competition in the beer market, and the overall decline of the industry, affected sales. Our beer volume was over 10% lower, but higher selling prices tempered the drop in revenues to 7%. Tanduay Ice, which competes with light beers, also saw volume decline by more than a third.

ABI currently has the broadest portfolio of beverage products in the Philippines, and has sustained its growth by introducing its own products like Cobra, Tanduay Ice, Absolute and Summit or by forming strategic partnerships with well-known brands.

ABI's partnership with Grupo Leche Pascual of Spain introduced long-life pasteurized yogurt in the Philippines in the fourth quarter of 2012 under the Creamy Delight brand, and is suitable for nationwide distribution, especially to the "sari-sari" stores (small neighborhood retail stores) as it does not require refrigeration. It already has a volume equivalent to 60% of the leading brand.

In 2013, ABI, started to manufacture under licensing agreements, ready-to-drink Nestea of Nestle and Sunkist carbonated softdrinks.

ABI will expand further to other types of beverages, both alcoholic and non-alcoholic, and take advantage of its exclusive nationwide distribution network, which reaches over 500,000 points of sale.

#### **Tanduay Distillers, Inc. (TDI) launches new products targeted for a wider range of consumers**

TDI operated in a difficult environment in 2013 as the distilled spirits industry suffered an overall 5% decline in sales volume based on Nielsen estimates. Aside from substantially higher excise taxes, TDI had to contend with stiff competition and higher alcohol prices.

In August of 2013, we launched a premium product, Tanduay Asian Rum in the United States. It comes in two variants, white and gold, which won the Best in Class Award in the Gold Rum Category by the International Rum Expert Panel in the 2013 Miami Rum Renaissance Festival. The product will soon be offered in selected shops in the Philippines. The Asian Rum is expected to further enhance the image of the "Tanduay" brand.

In mid-November 2013, TDI launched Compañero brandy blend in Metro Manila to compete with other brandy blends in the market, and appeal to a wider range of consumers. By the end of 2013, approximately a hundred thousand cases of Compañero had been sold.

TDI's overall market share dropped to 23% as of the end of 2013, from 26% in December 2012, but we continue to have the largest share of the Visayas-Mindanao market at 58% as of end-2013. Sales

volume dropped, but was partially offset by higher selling prices.

The Visayas-Mindanao area is the traditional market for TDI's products and accounts for 95% of sales volume, with Metro Manila and the rest of Luzon only accounting for the balance. TDI has less than 5% of the total market in Metro Manila and Luzon. Products like Compañero, targeted at the younger generation, should increase our presence in Metro Manila and have a positive impact on our overall market share.

#### **Eton Properties to increase recurring income**

Eton's revenues increased by 36% increase to Php3.7 billion, largely due to the construction completion of ongoing residential projects and resulted in a bottom line of Php105 million from Php47 million in 2012.

In 2013, Eton focused on re-master planning its two township projects, Eton City in Laguna and Eton Centris in Quezon City. The Company also put on hold the construction of some residential projects for redesign and enhancements.

The bulk of Eton's revenues currently comes from the sale of horizontal and vertical projects, with rental income accounting for about 12% in 2013. Eton plans to increase its leasing portfolio by developing more BPO office buildings to provide a recurring income stream and account for a larger portion of revenues in the future.

In January 2014, Eton started turning over the BPO office spaces in Three Cyberpod Centris at Eton Centris, in Quezon City, Metro Manila. This is the third BPO office building at Eton Centris, and has increased our leasing portfolio of office and retail space to over 150,000 square meters.

#### **Challenges remain in 2014**

Prospects for the Philippine economy remain bright as the country continues to benefit from strong domestic demand and inflows from remittances. GDP growth is expected to be sustained, although at lower levels, while inflation is forecast to be slightly higher.

For your Company, the challenges that started in 2013 will remain in 2014, making it a difficult environment to operate.

There have been some positive developments in

the tobacco industry, but the illicit trade that has kept prices abnormally low remains an obstacle to a level playing field that will enable us to grow our profitability over time. We look forward to the implementation of tax stamps toward the end of the second quarter of 2014, but will continue to work for the implementation of additional safeguards against the illicit trade that include CCTV cameras for the 24/7 monitoring and the third party audit of all cigarette factories.

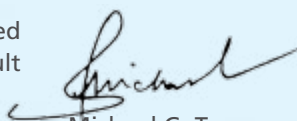
There is no increase in the excise tax for distilled spirits in 2014 which will help stabilize prices and the industry's volumes. We are working on increasing TDI's market share through intensified marketing efforts for our flagship five-year old rum and recently launched Compañero brandy blend.

The banking industry is operating in a low-interest rate regime and the absence of substantial trading gains will make it more difficult to grow earnings. Increasing our exposure in consumer loans while implementing our integration program should result in higher profitability and future cost savings for PNB.

Consumer spending is expected to remain strong, with the food and non-alcoholic beverage segments continuing to account for a large share of household expenditures. This augurs well for ABI's various products, and opens up opportunities to expand.

We are optimistic that we will be able to surpass these challenges as we work together and continue to innovate and expand our operations, improve on operating efficiencies and rationalize business processes. Our commitment to excellence by providing quality yet affordable products will sustain our future growth.

I would like to thank you, our stakeholders, for your continued support and trust in the Company, our Board of Directors, management team and staff.



Michael G. Tan  
Director / President



## MESSAGE FROM THE **CFO**

T Group, Inc.'s (LTG) attributable net income for 2013 amounted to Php8.7 billion, 15% or Php1.2 billion higher than the Php7.5 billion reported in 2012.

The tobacco business contributed Php3.9 billion or 45% of total, followed by Philippine National Bank (PNB) at Php3.4 billion or 40% of total. Asia Brewery, Inc. (ABI) accounted for Php1.0 billion or 12%, while Tanduay Distillers, Inc. (TDI) added Php185 million or 2%. Eton Properties Philippines, Inc. (Eton) provided the balance of Php104 million. Other Charges from Business Combination amounted to Php19 million.

Your Company's attributable net income was boosted by the acquisition of LTG's stake in PNB in February 2013, from an initial 45.5% and subsequently increased to 56.47% by the end of 2013. ABI's contribution to attributable net income increased by 32.6% or Php256 million, while Eton more than doubled its share from Php47 million. The tobacco segment attained a bottom line that was Php3.0 billion or 43% lower than 2012's Php5.7 billion, while TDI's contribution decreased by Php836 million or 82%.

On a restated basis, which includes LTG's stake in PNB, the attributable net income of Php8.7 billion is Php4.1 billion or 32% lower year-on-year (y-o-y) compared to Php12.8 billion in 2012.

Revenues reached Php55.8 billion, Php25.2 billion or 82% higher than 2012's Php30.6 billion, largely due to the inclusion of LTG's stake in PNB in 2013, which contributed Php28.9 billion or 52% of total revenues. ABI's revenues rose Php514 million y-o-y or 4% to Php12.7 billion on the back of higher revenues from Cobra energy drink and water brands Absolute and Summit. Eton's revenues likewise increased by 36% or Php971 million to Php3.7 billion as more revenues were booked from the construction completion of previously sold units. TDI's revenues declined by Php2.4 billion or 19% as sales volume dropped by 29% due to a substantial increase in excise taxes, as well as the effect of stiff competition. Revenues from Fortune Tobacco Corporation (FTC) decreased to Php152 million as only the remaining inventory of the former tobacco manufacturing operations were booked. FTC is currently the holding company of LTG's stake in PMFTC, which was formed by the combination of the cigarette manufacturing businesses of FTC and Philip Morris Philippines Manufacturing Inc. (PMPMI).

Equity in Net Earnings from LTG's 49.6% stake in PMFTC amounted to Php3.7 billion, Php2.8 billion or 43% lower than the Php6.5 billion reported in 2012. PMFTC's profitability was adversely affected by the doubling to quadrupling of excise taxes on cigarettes, worsened by the illicit trade that kept prices of the super low-end segment abnormally low, and resulted in sales volume dropping 26% y-o-y.


LTG's subsidiaries spent Php6.3 billion for capital expenditures (capex) in 2013. Eton accounted for Php3.2 billion for the completion of its third BPO office building in Eton Centris, as well as the construction of residential projects. ABI and TDI spent approximately a billion pesos each to upgrade existing plants. PNB also spent about Php1 billion, largely on integration costs following its merger with Allied Bank.

Your Company raised Php36.7 billion in net

proceeds from its re-IPO in April 2013 by selling 1.84 billion shares at Php20.50 each. Part of the proceeds, amounting to Php8.15 billion, was used to pay the advances of major shareholder Tangent Holdings arising from the reorganization and infusion of the four business units into the Company. LTG also disbursed Php3.5 billion to ABI, Eton and TDI to finance their capex requirements. An additional Php1.2 billion was paid to Tangent Holdings in January 2014.

In July 2013, your Company paid a cash dividend of Php0.15 per share, or a total of Php1.6 billion, equivalent to 22% of 2012's attributable net income of Php7.5 billion.

LTG's balance sheet remains strong, with the parent company's cash balance at Php27.6 billion as of end-2013. The consolidated Debt-to-Equity Ratio was at 3.53:1 as of end-2013, with the bank, and at 0.28:1 without the bank.



**Jose Gabriel D. Olives**  
Chief Financial Officer





## BEVERAGES ASIA BREWERY, INC.

Asia Brewery, Inc.'s (ABI) performance in 2013 was characterized by programs to strengthen its market leadership in key beverage segments. The Company also continues to create new markets to position for growth and consolidate its position in categories severely affected by regulatory and competitive changes.

Powered by its extensive network of exclusive distributors and strong brands, Asia Brewery was able to reinforce its leadership in the energy drinks, bottled water and soymilk segments and strengthen its product portfolio with the launch of Sunkist as its main entry in the carbonated softdrinks market. The beer and alcopop segments of the Company's portfolio, on the other hand, experienced significant drops in volumes and revenues as the industry and market reacted to the severe increases in specific taxes imposed during the year.

Cobra continued to dominate the energy drink segment with a market share of over 70% in 2013. Cobra's revenues sustained its growth momentum amidst an intense price war waged by indirect competitors in the carbonated softdrinks market. Cobra is the highest contributor to the revenue base of ABI. Absolute and Summit bottled water, likewise recorded exemplary growth in 2013 with a sales volume increase of nearly 20% over 2012 and maintained its leadership in the category garnering close to 30% of the market. Vitamilk





similarly continued to dominate the soymilk category with a market share of over 70% as the brand continues to expand customer acceptance nationwide.

The beer and alcopop segments were confronted with significant challenges in 2013. Higher excise taxes imposed in January 2013 forced steep industry-wide price increases. This, coupled with aggressive promotional and pricing activities by the competitor in its effort to stem the industry-wide volume decline adversely affected ABI's brands. Faced with these challenges, ABI is in the process of fine-tuning its various brands and promotional efforts while implementing operational efficiencies to improve its profitability.

The beverage market continues to provide strong growth potential with the continuous rise in young adult population, improving affluence in specific consumer segments and changes in preferences. A changed regulatory environment and an increasingly competitive market pose challenges. To meet these challenges, the Company is gearing toward more product innovation in existing product lines and opening up new categories with products designed to expand and lead such categories.

In 2013, ABI launched new Cobra and Tanduay Ice variants, namely Cobra Defense with Vitaboosters



and Tanduay Ice's "Yellow Paradise" variant, Tanduay Ice Light in pomelo and peach flavors, and Tanduay Black, a rum cola. ABI continued to expand distribution and brand building campaigns for Vitamilk and Creamy Delight, a long-life yoghurt product introduced in the market in partnership with Grupo Leche Pascual of Spain.

Asia Brewery continues to invest in research and development for new products and at the same time, strengthen operational and distribution efficiencies in order to focus on its strategy of product innovation and affordability. ABI will continue to seek out strategic partnerships to improve technological capabilities and penetrate new markets.



## PROPERTY DEVELOPMENT **ETON PROPERTIES PHILIPPINES, INC.**

Against the backdrop of strong economic and property sector growth, Eton Properties Philippines, Inc. aggressively embarked on a program to review its inventory plan and profitability performance, as well as revisit its strategic agenda. Total revenues in 2013 amounted to Php3.66 billion, an improvement of 35% from the previous year. Net income was Php105 million, 150% more than last year's Php42 million. The increase in revenues resulted from progress made in the construction of the company's residential projects.

Rental revenues climbed by 11% to Php449 million from Php406 million in 2012. Eton has five BPO office buildings that are fully leased out, namely, Cyberpod Centris One, Cyberpod Centris Two in Eton Centris, and three buildings in Eton Cyberpod Corinthian. Cyberpod Centris Three was completed by year-end and is now being leased out. Meanwhile, retail space from Centris Walk, Centris Station, E-Life and Green Podium have an average occupancy rate of 80%.



Construction of major residential developments, Eton Tower Makati, 8 Adriatico, and 68 Roces went full blast. Eton Tower Makati is a prime 41-storey development featuring executive residences, Small Office Home Office (SOHO) units and serviced apartments, located at the center of the Makati Central Business District, while 8 Adriatico is a 40-storey residential condominium in the City of Manila. 68 Roces is an upscale development along Roces Avenue in Quezon City.

Meanwhile, the construction of some of Eton's ongoing residential and commercial projects such as One Centris Place and First Homes Makati was put on hold to give way to design improvements and enhancements.

Eton focused on the re-master planning of its two township projects, Eton City and Eton Centris. Eton City is envisioned to be a world-class city South of Manila covering a thousand hectares. On the other hand, Eton Centris is a 12-hectare mixed-use development that is the gateway to Quezon City's Triangle Park Central Business District. The new master plans for both Eton City and Eton Centris shall be undertaken in phases, with office and commercial developments placed at the forefront of activities the coming years.





Eton plans to increase its recurring income stream from additional commercial developments with office and retail space, and on a selective basis, from the lease of residential units in certain projects. The Company continues to ride on the robust growth of the BPO sector, through the development of more office buildings in strategic locations with distinct accessibility.



PMFTC introduced innovations in its portfolio in 2013. The Marlboro Ice Blast, the brand's biggest innovation, was launched in the Philippines in March 2013. The country's leading cigarette brand and the world's number one single-market cigarette brand, Fortune, had a tipping upgrade in June 2013.

## TOBACCO **PMFTC, INC.**

**P**MFTC Inc. (PMFTC) remains the market leader in the cigarette manufacturing industry in the Philippines despite the many challenges the industry faced in 2013. PMFTC was created in 2010 as a result of the business combination between Philip Morris Philippines Manufacturing Inc. (PMPMI) and Fortune Tobacco Corporation (FTC). It produces 49 of the 111 cigarette brand variants in the Philippine cigarette market, and it has approximately 70 percent market share. PMFTC manufactures six of the top 10 cigarette brands of choice for 2013 led by Fortune, Marlboro and Jackpot.

PMFTC faced significant challenges in 2013. These include the drastic increase in excise tax under Republic Act 10351, several reported cases of illicit trade in cigarettes, and the questionable business practices of a local manufacturer that prevents PMFTC from operating on a level playing field.

As an organization, PMFTC grew bigger with over 6,000 employees after it completed the integration of employees from PMPMI and FTC. PMFTC went through a series of organizational and operational changes that made the Company better equipped in responding to the regulatory environment and became more cost-efficient.

As a vertically integrated company, PMFTC contracts tobacco farmers to supply quality Burley and flue-cured Virginia tobacco leaves. To date, PMFTC has over 6,000 contracted farmers from the tobacco-growing communities of the Ilocos region, Cagayan Valley, and Occidental Mindoro. PMFTC sustains high quality produce by promoting Good Agricultural Practices Guidelines & Assessment and the Agricultural Labor Practices (ALP) Code to ensure a safe working environment, standard farming techniques and productive farm practices.

Amidst the challenging business environment in 2013, PMFTC's strong partnership with industry partners, key accounts, wholesalers and general trade sustained its performance.

A notable program that garnered a prestigious award for the company was its effort to practice





projects were awarded in 2013 - the Silver and Bronze Stevie Awards by the International Business Awards for the Proficient Measures for Quality Education (PMQE) Project Year 2012 and Reforestation and Coop Organizing Initiative respectively; and the CSR Excellence Award by the American Chamber Foundation Philippines Inc. for the Reforestation and Plantation Management Project.

energy efficiency and reduce its carbon footprint. PMFTC managed to maintain its profitability with a 35% reduction in energy consumption by shifting from bunker fuel-fed generators and connecting to a commercial power grid. By doing so, the Company was awarded by Meralco as the top Corporate Industrial Luminary for 2013. This resulted to operational savings used to finance community development programs.

PMFTC supports local communities where it does business. Through its renowned corporate social responsibility (CSR) brand Embrace, the Company donated Php100 million worth of infrastructure and sustainable social development programs to families affected by Super Typhoon Yolanda (Haiyan). Embrace is a multi-awarded CSR initiative. Three CSR

## BANKING

# PHILIPPINE NATIONAL BANK

**P**hilippine National Bank (PNB) is the 4th largest private commercial bank in the country. It is a universal bank providing a full range of banking and other financial services to large corporate, middle market, small and medium enterprises (SMEs) and retail customers. It also maintains significant account relationships with the Philippine Government, national government agencies, local government units, and government owned and controlled corporations (GOCCs).

PNB was originally established as a government bank in 1916 but has been 100% privatized since 2007. For the year 2013, PNB posted a net profit of Php6.2 billion under the pooling method, 4% lower than the year-ago level of Php6.5 billion as the Bank's performance was weighed down by the calamity-related losses (Super Typhoon Yolanda, typhoons Santi and Maring; and the Bohol earthquake) incurred by its non-life insurance subsidiary amounting to Php868.4 million. Net interest income amounted to Php14.2 billion for 2013, higher than the Php13.9 billion registered

the previous year despite the squeeze in margins amidst a low interest environment as the Bank aggressively increased its loan portfolio across all customer segments. As of end-2013, the first year of PNB-Allied Bank merger, the Bank's consolidated assets expanded to Php602.1 billion, Php72.4 billion or 13.7% higher compared to Php529.7 billion as of end-2012. As of December 31, 2013, PNB had a total of 656 branches. The Bank's ATM network also expanded to 859. It likewise boasts of 7 branches in Hong Kong, Japan, Singapore, Guam, Los Angeles, New York and Bahrain, as well as 70 remittance centers worldwide.

### **CUTTING-EDGE PRODUCTS & SERVICES**

PNB expanded operations and continued to provide cutting-edge and tailor-fitted solutions in order to further cultivate its robust relationship



with its clients. PNB's Trust Banking Group launched the country's first comprehensive Unit Investment Trust Fund (UITF) Online facility in June 2013. The facility offered clients the convenience of investing in and redeeming from their UITFs, as well as managing and monitoring their investments, via the Internet.

PNB continued to innovate its remittance products and services with the launch of Phone Remit, a 24/7 toll-free phone remittance platform servicing the Europe and US market. The Bank also launched the PNB Web Remit in the last quarter of 2013 that enables customers to conduct on-line remittance transactions anywhere and anytime.

### **A TRADITION OF BUSINESS EXCELLENCE**

PNB's achievements continued to receive several noteworthy awards. For the second consecutive year, the Bangko Sentral ng Pilipinas (BSP)







conferred upon PNB the Top Commercial Bank in Generating Remittances from Overseas Filipinos Award. On the same year, the BSP also recognized PNB as one of the Ten Best Performing Government Securities Eligible Dealers. Moreover, two of the products and services of the Bank's Retail Banking Group garnered accolades from industry peers in 2013. ATM Safe won the Best in Innovation Award in the 2013 Philippine Insurers and Reinsurance Association, Inc. (PIRA) Awards while the Healthy Ka Pinoy (HKP) Emergency Card won the award for Excellence in Business Model Innovation in the 2013 Asian Trailblazer Awards of Retail Banker International.

PNB's Institutional Banking Group played major roles in 13 landmark deals in 2013, with total deal size in excess of Php140 billion. Meanwhile, PNB fortified its bid to be a strong player in the consumer loans business as the Bank posted a 20% increase in its Consumer Loans Portfolio to Php28.7 billion from the year-ago level.

Likewise, PNB displayed ingenuity in minimizing the impact of the phase-out of the investment management account (IMA-SDA) facility in 2013 due to the BSP's mandate. The Bank continuously worked with its branches to convert these accounts into Money Market Unit Investment Trust Funds (UITFs). As a result of this initiative, PNB's Money Market UITF grew significantly to Php8.93 billion in 2013 from Php82 million in 2012.

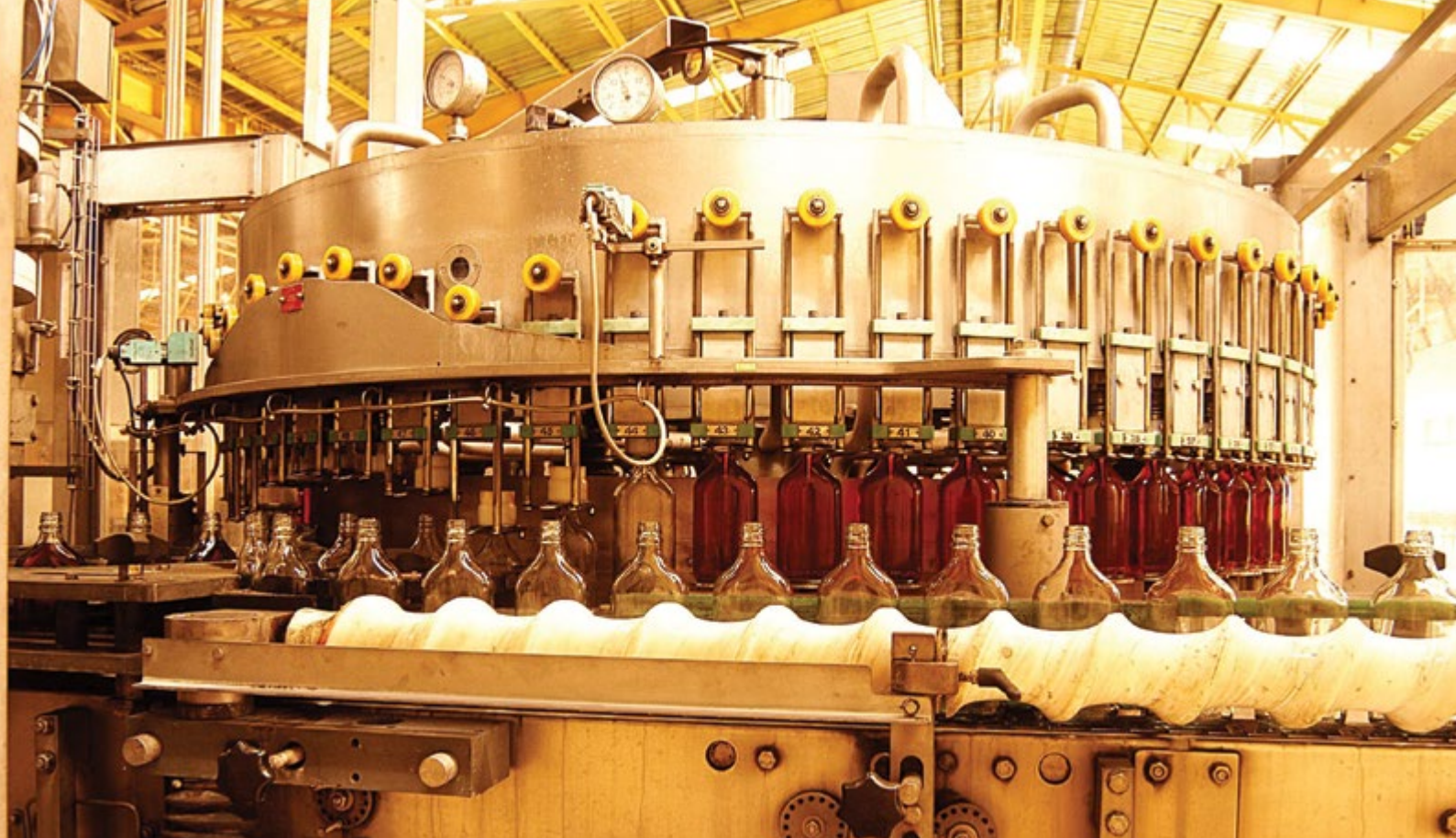
As part of PNB's efforts to shore up its source of long term funding to support its expansion plans, the Bank redeemed its high cost subordinated notes and replaced these funds through the issuance of five-year peso denominated long-term term negotiable certificates of deposits (LTNCDs). PNB successfully undertook two tranches of LTNCD offerings worth Php5 billion and Php4 billion in August and October, respectively, which were issued at the lowest rate in its asset class in the recent past. This was a testament to the trust that investors have on the Bank's long-term credit standing.

#### **MOVING FORWARD**

PNB successfully generated Php11.6 billion in fresh capital from a stock rights offering in February 2014. The Offer strengthened the Bank's capital position under the Basel III standards, effective January 1, 2014. The Offer also provided the capital infusion into Allied Savings Bank (to be renamed PNB Savings Bank) to build and refocus the Bank's consumer lending business. The success of the offering is a strong indication that the Bank's stockholders have full confidence on the long-term prospects of PNB.

The new PNB is now in a stronger position to serve its clients' deposit and investment interests, as well as in a better standing to provide enhanced and personalized customer service experience.





## DISTILLED SPIRITS TANDUAY DISTILLERS, INC.

Tanduay Distillers, Inc. (TDI) posted a consolidated net income of Php188 million in 2013, inclusive of a one-time Php105 million expense related to the closure of a plant. On a core basis, TDI's net income of Php262 million is 74% lower than the previous year's Php1.02 billion on the back of a challenging environment.

TDI closed down its old plant in Quiapo, Manila in April 2013 as this was no longer cost-efficient. Operations in Luzon are currently at the larger and more cost-efficient plant in Cabuyao, Laguna.

Stiff competition, higher selling prices resulting from higher excise taxes, and natural calamities that struck the Southern Philippines in the latter part of the year cut net sales by 19% to Php10.54 billion in 2013 from Php12.95 billion in 2012 and reduced sales volume by close to 30%.

TDI's national market share in terms of volume dropped to an average of 25% in 2013 from 29% in 2012, largely due to the penetration of brandy in the Visayas and Mindanao or VisMin region, TDI's stronghold. The VisMin region also bore the brunt of the calamities that hit the country in the past year, including Super Typhoon Yolanda (Haiyan) and a 7.2-magnitude earthquake.



TDI is taking steps to protect its existing market share in the VisMin region. To capture market share in Luzon, TDI launched its Compañero brandy blend in mid-November 2013. With its more superior taste, this brandy is targeted to appeal to a wider range of consumers. It is backed by an intensive ad campaign, especially on radio.

TDI has also intensified the media campaign for its flagship product, Tanduay Five Years. A new television ad has been unveiled, with the intention of making the image of TDI's flagship rum product more hip and appealing.

During the third quarter of 2013, TDI launched Tanduay Asian Rum, a premium product, in the United States, that comes in two variants,



Gold and Silver. Tanduay Gold Asian Rum won the Gold Medal and Best in Class Award in the Gold Rum Category in the 2013 Miami Rum Renaissance Festival. In March 2014, Tanduay Silver Asian Rum won a double gold medal in the San Francisco World Spirits Competition, which received a record 1,474 entries from around the world. Tanduay Silver Rum came out on top of all the white rums submitted.

These awards join the long list of awards garnered by TDI for the excellent quality of its rum products that have won worldwide acclaim.

In 2013, TDI's subsidiary, Absolut Distillers, Inc., completed the expansion of its distilling plant in Batangas, and is expected to supply up to 75% of TDI's distilled alcohol requirements. This complements TDI's ageing facility, with over 200,000 oak barrels, that makes the Company's rum distinct and world-class.



## CORPORATE GOVERNANCE REPORT

Compliance with the principles of good corporate governance is primary in the consciousness of each member of the Board of Directors and Management.

The Manual on Corporate Governance (the “Manual”) has undergone several reviews, revisions, and updating to ensure that it is compliant with the latest circulars issued by the Securities and Exchange Commission (SEC) and relevant rules issued by the Philippine Stock Exchange (PSE).

The Manual was last reviewed, revised and amended on March 11, 2011. However, in light of the impending ASEAN integration in 2015 and as a consequence of the reorganization and consolidation of several businesses in the Company, the Chairperson of the Corporate Governance Committee requested the review and updating of the Manual in order to make the same expansive and reflective of the current best practices that cover each unique requirement of the businesses that became part of the conglomerate.

The conglomerate includes the tobacco/cigarette business, a bank, a liquor company, a beverage company and a property company. The updated Manual was approved by the Corporate Governance Committee on July 12, 2013. Some of the significant changes or

amendment to the Manual include the merger of the Audit Committee and Risk Management Committee into one and renamed as Audit and Risk Management Committee. The duties and responsibilities of the two committees were merged and in the Board Meeting held on August 13, 2013, the Board approved the inclusion in the duties of the Committee the function to review related party transactions, in response to Revenue Regulation No. 02-2013 issued by the Bureau of Internal Revenue on January 23, 2013 and the related Financial Reporting Bulletin No. 13 of the SEC.

Additionally, the Manual set the minimum number of meetings for each committee and in view of the expanded businesses, likewise provided for the inclusion of the Executive Committee, consistent with the existing By-Laws.

The challenge of being a conglomerate and a publicly-listed company is to always obtain and secure compliance of timely, transparent and responsible disclosures from the subsidiaries. The Company has kept its subsidiaries informed and updated on material information that requires prompt and timely disclosures to the PSE and the SEC.

In order to ensure that all of the subsidiaries are in sync with the Company, the latter engaged the services of the Institute of Corporate Directors (ICD) to conduct a corporate governance seminar on October 22, 2013, where directors of the Company, and directors of the subsidiaries were present. Likewise invited were the Chief Finance Officers, deputies, and staff, who were all briefed and updated on the current developments in corporate governance.

ICD introduced the ASEAN Scorecard in anticipation of the ASEAN integration. They conducted a workshop wherein the group was given the preview on how companies will be rated by their ASEAN counterparts. It was a very engaging workshop, which gave a glimpse on how the Company will be measured by other ASEAN countries. Below are the members of the Company’s Board of Directors, Officers and staff who attended the Corporate Governance Seminar.

Michael G. Tan	President/Director
Wilson T. Young	Director
Juanita Tan Lee	Director
Florencia G. Tarriela	Independent Director
Antonino L. Alindogan, Jr.	Independent Director
Wilfrido E. Sanchez	Independent Director
Ma. Cecilia L. Pesayco	Corporate Secretary
Jose Gabriel D.Olives	Chief Financial Officer
Nestor C. Mendones	Deputy Chief Financial Officer
Erolyne C. Go	Assistance Corporate Secretary
Erwin C. Go	Chief Legal Counsel
Susan T. Lee	AVP-Finance
Annabelle D. Arceo	Investor Relations Officer



The concluded seminar is a statement of the Company's policy to encourage its Directors and Key Officers to attend trainings and/or programs that will strengthen corporate governance awareness in the Company. Further, in accordance with SEC Memorandum Circular No. 20, Series of 2013, the Company shall be organizing annually for its Directors and officers a seminar program on corporate governance conducted by an SEC-accredited training provider.

## BOARD OF DIRECTORS

The Board of Directors is the highest governing and decision-making body in the organization. It consists of eleven members, three of whom are independent directors. Headed by Dr. Lucio C. Tan, the members of the Board are businessmen with exemplary track records of achievements. Their combined experience and business acumen, as well as their knowledge of the market and business processes are the key factors that have propelled the Company to an enviable position of profitability and growth.

The Board is responsible for promoting and adhering to the principles and best practices of corporate governance, fostering the long-term success of the Company and ensuring its competitiveness in a manner consistent with its fiduciary responsibility, which it shall exercise in the best interests of the Company, its shareholders and other stakeholders. The Board in promoting the same, seeks to protect the Company's corporate governance policies, as stated in the Manual:

- The Board of Directors ensures that the Company is appropriately and effectively managed and controlled by providing strategic guidance to the Company and effectively monitoring the performance of Management. It is fully aware of its accountability to the Company and the stakeholders.
- There should be a timely and accurate disclosure on all material matters regarding the Company, including the financial situation, performance, ownership and governance of the Company.
- Independent audit mechanisms should be in place for monitoring the adequacy and effectiveness of the organization's governance, operations and information systems.
- The rights of stakeholders as established by law should be recognized and respected.

In the exercise of their fiduciary responsibilities, the Board, in choosing the directors of their subsidiaries, tries to include/elect Independent Directors,

notwithstanding that, except for the Bank, the rest are not listed public companies. The purpose is to engage the subsidiaries to the principles of corporate governance by electing Independent Directors to its Board. Further, in forming the compositions or memberships of the different committees, the Company consciously adheres to the requirements of appointing Independent Directors particularly in committees, which are considered sensitive.

### *Independent Directors*

Independence means having no ties with the Company's management and freedom from any business or other relationships which could, or could reasonably be perceived to, materially interfere with the exercise of independent judgment in carrying out one's responsibilities as a director of the Company.

The Company observes the term limit for Independent Directors, in accordance with SEC Memorandum Circular No. 9, Series of 2011, such that each independent director can serve as such for five (5) consecutive years, provided that a service for a period of at least six (6) months shall be equivalent to one (1) year. Thereafter, a "cooling-off" period of two (2) years is required to be undergone by the independent director before he/she may again be eligible for election as such after his/her five-year service period.

An independent director may only serve for a cumulative total of ten (10) years. After the tenth year, the independent director shall be perpetually barred from being elected in the Company or in any of its subsidiaries.

Elected to the Board are candidates from the Final List of Candidates that is prepared by the Company's Nomination and Compensation Committee, and which list is made available to the SEC and to all shareholders through the filing and distribution of the Definitive Information Statement, in accordance with Rule 20 of the Securities Regulation Code.

The Final List of Candidates is prepared by the Committee during the meeting held for that purpose, wherein the members thereof discuss the qualifications of each nominee. Any shareholder may nominate a candidate by proposing the same through a submission to the Corporate Secretary at least fifty (50) business days prior to the meeting of the Nomination and Compensation Committee. The said nomination should be signed by both the proponent shareholder and the nominee signifying his/her consent thereto.

During the Annual Shareholders' Meeting or ASM,

the shareholders of the Company elect members of the Board of Directors from the Final List of the candidates. The term of office of Directors begin immediately after election.

The Board of Directors of the Company are:

NAME	AGE	CITIZENSHIP	DATE FIRST ELECTED TO THE BOARD
Lucio C. Tan	80	Filipino	July 2, 1999
Carmen K. Tan	72	Filipino	May 5, 2010
Harry C. Tan	68	Filipino	May 28, 2008
Michael G. Tan	48	Filipino	February 21, 2003
Lucio K. Tan, Jr.	47	Filipino	February 21, 2003
Wilson T. Young	57	Filipino	March 31, 1999
Juanita Tan Lee	71	Filipino	May 2, 2012
Washington Z. Sycip	92	American	July 9, 2013
Antonino L. Alindogan, Jr.	75	Filipino	July 31, 2012
Wilfrido E. Sanchez	77	Filipino	July 31, 2012
Florencia G. Tarriela	67	Filipino	August 9, 2012

Below are summaries of the business experience and credentials of the Directors:

**Dr. Lucio C. Tan** is the Chairman of the Board of the Company. He is also Chairman of Philippine Airlines, Inc., Asia Brewery Inc., Eton Properties Philippines, Inc., Fortune Tobacco Corp., PMFTC Inc., Grandspan Development Corp., Himmel Industries Inc., Lucky Travel Corp., PAL Holdings, Inc., Tanduay Distillers, Inc., Tanduay Brands International, Inc., The Charter House, Inc., AlliedBankers Insurance Corp., Allied Leasing and Finance Corp., Asian Alcohol Corp., Absolut Distillers, Inc., Progressive Farms, Inc., Eton City, Inc., Belton Communities, Inc., First Homes, Inc., Manufacturing Services & Trade Corp., REM Development Corp., Foremost Farms, Inc., Basic Holdings Corp., Dominion Realty & Construction Corp., Shareholdings, Inc., Sipalay Trading Corp. and Fortune Tobacco International Corp. He is a Director of Philippine National Bank and Air Philippines Corporation. He holds a Bachelor of Science degree in Chemical Engineering from Far Eastern University and is an awardee of several honorary Doctorate degrees.

**Carmen K. Tan** is a Director of the Company. She is also a Director of Asia Brewery, Inc., The Charter House, Inc., Dominion Realty & Construction Corp., Eton City, Inc., Foremost Farms, Inc., Fortune Tobacco Corp., Fortune Tobacco International Corp., Himmel Industries, Inc., Lucky Travel Corp., MacroAsia Corp., Manufacturing Services & Trade Corp., Progressive Farms, Inc., REM Development Corp., PMFTC Inc., Shareholdings, Inc., and Sipalay Trading Corp.

**Harry C. Tan** is a Director of the Company. He previously held the positions of the Vice Chairman and Treasurer of the Company. Mr. Tan is also

Chairman of Air Philippines Corp. and Vice Chairman of Eton Properties Philippines, Inc., Eton City, Inc., Belton Communities, Inc., Pan Asia Securities, Inc., and Lucky Travel Corp. He is also the Managing Director of The Charter House, Inc., Director/Chairman for Tobacco Board of Fortune Tobacco Corp., Director/President of Century Park Hotel, and Landcom Realty Corp. He serves as Director of Asia Brewery Inc., AlliedBankers Insurance Corp., Asian Alcohol Corp., Absolut Distillers, Inc., Basic Holdings Corp., Foremost Farms, Inc., Himmel Industries, Inc., MacroAsia Corp., Manufacturing Services & Trade Corp., PMFTC Inc., Philippine Airlines Inc., Philippine National Bank, PAL Holdings, Inc., Progressive Farms, Inc., REM Development Corp., Grandspan Development Corp., Dominion Realty & Construction Corp., Fortune Tobacco International Corp., Shareholdings, Inc., Sipalay Trading Corp., Tanduay Brands International, Inc., and Tanduay Distillers, Inc. He holds a Bachelor of Science degree in Chemical Engineering from the Mapua Institute of Technology.

**Michael G. Tan** is the President of the Company. Since 2000, Mr. Tan has been the Chief Operating Officer of Asia Brewery, Inc.. Before then, he was a Management Trainee in Asia Brewery, then a Supervisor of Corporate Planning, subsequently a Manager of Corporate Planning and Finance, and finally a Vice President for Finance before assuming his present position. He is also Director of AlliedBankers Insurance Corp., Air Philippines Corp., Eton Properties Philippines, Inc., PMFTC Inc., Grandway Construct, Inc., Lucky Travel Corp., Philippine Airlines, Inc., Philippine Airlines Foundation, Inc., PAL Holdings, Inc., Philippine National Bank, Tanduay Brands International, Inc., Absolut Distillers, Inc., Eton City, Inc., Shareholdings, Inc., and Victorias Milling Company, Inc. He graduated as head of his class at the University of British Columbia in Canada with a Bachelor of Science degree in Applied Science in Engineering, major in Structural Engineering.

**Lucio K. Tan, Jr.** is a Director of the Company. He is also Director and President of Tanduay Distillers, Inc. and Eton Properties Philippines, Inc.; a Director/EVP of Fortune Tobacco Corp.; and a Director of AlliedBankers Insurance Corp., Philippine Airlines, Inc., Philippine National Bank, PAL Holdings, Inc., MacroAsia Corp., PMFTC Inc., Lucky Travel Corp., Air Philippines Corp., Tanduay Brands International, Inc., Asian Alcohol Corp., Absolut Distillers, Inc., Asia Brewery, Inc., Foremost Farms, Inc., Himmel Industries, Inc., Progressive Farms, Inc., The Charter House, Inc., Eton City, Inc., Belton Communities, Inc., FirstHomes, Inc., REM Development Corporation, Grandspan Development Corporation, Dominion Realty & Construction Corp., Manufacturing



Services & Trade Corp., and Fortune Tobacco International Corp., and Shareholdings, Inc. He graduated from the University of California, Davis in 1991 with a Bachelor of Science degree in Civil Engineering and has a Master's Degree in Business Administration from the Kellogg School of Management Northwestern University.

**Wilson T. Young** is a Director of the Company. He previously held the positions of President and Managing Director and Deputy Chief Executive Officer of the Company. He is also Chief Operating Officer of Tanduay Distillers, Inc.; Director/President of Tanduay Brands International, Inc.; Chief Operating Officer of Asian Alcohol Corp., Absolut Distillers, Inc.; and Director of Flor De Caña Shipping, Inc. He is the Chairman of Victorias Milling Co., Inc. He is also Vice Chairman of Total Bulk Corp., as well as that of the Board of Trustees of UERM Medical Center; and a Board of Trustees Member of the University of the East. He holds a Bachelor of Science degree in Accountancy from the University of the East and has a Master's degree in National Security from the National Defense College. He is a Certified Public Accountant and has worked with SGV & Co. before joining the Company.

**Juanita Tan Lee** is a Director and the Treasurer of the Company. She is also Director of Eton Properties Philippines, Inc.; Director/Corporate Secretary of Asia Brewery, Inc., Fortune Tobacco Corp., Dominion Realty and Construction Corp., and Shareholdings, Inc.; Corporate Secretary of Asian Alcohol Corp., Absolut Distillers, Inc., The Charter House, Inc., Far East Molasses Corp., Foremost Farms, Inc., Fortune Tobacco International Corp., Grandspan Development Corp., Himmel Industries, Inc., Landcom Realty Corp., Lucky Travel Corp., Manufacturing Services & Trade Corp., Marcuenco Realty & Development Corp., PMFTC Inc., Progressive Farms, Inc., REM Development Corp., Tanduay Distillers, Inc., Tanduay Brands International Inc., Tobacco Recyclers Corp., Total Bulk Corp., Zebra Holdings, Inc.; and Assistant Corporate Secretary of Basic Holdings Corp. She holds a Bachelor of Science degree in Business Administration major in Accounting from the University of the East.

**Washington Z. Sycip** is a Director of the Company. He is the founder of SyCip Gorres Velayo & Co.; Chairman Emeritus of the Board of Trustees and Governors of the Asian Institute of Management; Chairman of MacroAsia Corp., Cityland Development Corp., Chairman of MacroAsia Corp., Cityland Development Corp., Lufthansa Technik Philippines, Inc., STEAG State Power, Inc. and State Properties Corporation; Independent Director of Asian Eye Institute, Belle Corporation, Lopez Holdings Corp., Commonwealth Foods, Inc., First Philippine

Holdings, Corp., Highlands Prime Inc., Metro Pacific Investments Corp., Philippine Equity Management Inc., Philippine Hotelier, Inc., Philamlife, Inc., Realty Investment Inc., The PHINMA Group, State Land, Inc., and Century Properties Group Inc.; and Director of Philippine Airlines, Inc. and Philippine National Bank.

**Antonino L Alindogan Jr.** is an Independent Director of the Company. He is also the Chairman of the Board of An-Cor Holdings, Inc. He serves as Chairman/President of Landrum Holdings, Inc.; Independent Director of Philippine Airlines, Inc., Eton Properties Philippines, Inc., Rizal Commercial Banking Corp., PAL Holdings, Inc., House of Investments, Inc., Great Life Financial Assurance Corp., and Bankard Inc. He is the Former President of C55, Inc.; Former Chairman of the Board of Directors of Development Bank of the Philippines (DBP); Former Consultant for Microfinance of DBP; Former Member of the Monetary Board of Bangko Sentral ng Pilipinas where he contributed his efforts and insights on a wide range of concerns, such as the pursuit of good governance, strengthening inflation targeting as an effective tool in price stability, and crafting innovative solutions to problem banks. He also took part in the BSP reorganization, upgrading and modernization of facilities and bank-wide planning and budgeting process. He is a Certified Public Accountant and holds a Bachelor of Science in Commerce degree in Accounting (Magna Cum Laude) from De La Salle College.

**Wilfrido E. Sanchez** is an Independent Director of the Company. He is the Tax Counsel of Quiason Makalintal Barot Torres Ibarra & Sison Law Offices; Vice Chairman of Center for Leadership & Change, Inc.; Independent Director of Adventure International Tours, Inc., Amon Trading Corp., EEI Corporation, Grepalife Asset Management Corp., Grepalife Fixed Income Fund Corp., House of Investments, Inc., JVR Foundation, Inc., Kawasaki Motor Corp., Magellan Capital Holdings, Corp., Omico Corporation; PETNET, Inc., PETPLANS, Inc., Transnational Diversified Corp., Transnational Diversified Group, Inc., Transnational Financial Services, Inc., and Universal Robina Corp.; Independent Director of Eton Properties Philippines, Inc. and Rizal Commercial Banking Corporation. He holds a Bachelor of Arts degree from the Ateneo de Manila University and has a Post-Graduate degree in Bachelor of Laws from Ateneo De Manila University and Masters of Law from Yale Law School.

**Florencia G. Tarriela** is an Independent Director of the Company. She is the Chairman of the Board of Directors and an Independent Director

of Philippine National Bank. She also serves as Chair of PNB Global Remittance and Financial Co., HK Ltd. She is a Trustee/Advisor/Director of Foundation for Filipino Entrepreneurship, Inc., Summer Institute of Linguistics, and Tulay sa Pagunlad, Inc.; and a Columnist of Manila Bulletin. She obtained her Bachelor of Science in Business Administration, Major in Economics, at the University of the Philippines and her Masters in Economics from the University of California, Los Angeles, where she topped the Masters Comprehensive Examination. She is a Life Sustaining Member of the Bankers Institute of the Philippines (BAIPHIL) and the Financial Executive Institute (Finex), a Trustee of Finex Foundation, TSPI Development Corporation, Kilosbayan and the Summer Institute of Linguistics (SIL). She was formerly an Independent Director of the Philippine Depository and Trust Corporation, the Philippine Dealing and Exchange Corporation and the Philippine Dealing System Holding Corporation. Ms. Tarriela was a former Undersecretary of Finance, and an alternate Member of the Monetary Board of the BSP, Land Bank of the Philippines and the Philippine Deposit Insurance Corporation. She was formerly Deputy Country Head, Managing Partner and the first Filipino lady Vice President of Citibank N. A., Philippine Branch.

## BOARD MEETINGS

Board meetings are scheduled monthly. The members present during every Board meeting set the date of the next month's meeting, taking into consideration quorum requirement and public holidays.

The Board held thirteen (13) meetings for the year 2013.

BOARD	NAME	DATE OF ELECTION	NO. OF MEETINGS HELD DURING THE YEAR (2013)	NO. OF MEETINGS ATTENDED	%
Chairman	Lucio C. Tan	06/19/2013	13	8	62
Member	Carmen K. Tan	06/19/2013	13	4	31
Member	Harry C. Tan	06/19/2013	13	12	92
Member	Michael G. Tan	06/19/2013	13	13	100
Member	Lucio K. Tan, Jr.	06/19/2013	13	11	85
Member	Wilson T. Young	06/19/2013	13	13	100
Member	Juanita Tan Lee	06/19/2013	13	13	100
Member	Washington Z. Sycip*	07/09/2013	13	2	40
Independent	Florencia G. Tarriela	06/19/2013	13	12	92
Independent	Antonino Alindogan, Jr.	06/19/2013	13	10	77
Independent	Wilfrido E. Sanchez	06/19/2013	13	9	69

\*First elected on July 9, 2013

The latest ASM was on June 19, 2013 and the following Directors were present during the meeting: Harry C. Tan, Michael G. Tan, Lucio K. Tan, Jr., Wilson T. Young, Juanita Tan Lee, Wilfrido E. Sanchez, and Florencia G. Tarriela

## BOARD COMMITTEES

To ensure comprehensive supervision of policies under good corporate governance, the Board has formed four committees in aid of the performance of its duties.

### Executive Committee

The Board's Executive Committee, which has seven members, meets regularly or may call for special meetings to exercise all duties delegated to it by the Board, except with respect to (1) approval of any action for which shareholders' approval is also required; (2) the filling of vacancies in the Board; (3) the amendment or repeal of By-Laws or the adoption of new By-Laws; (4) the amendment or repeal of any resolution of the Board, which by its express terms is not so amendable or repealable; and (5) a distribution of cash dividend to shareholders.

The Board has the power to change members of the Executive Committee at any time, or to fill vacancies therein. The Chairman of the Executive Committee is Dr. Lucio C. Tan. The other members of the Executive Committee are Harry C. Tan, Michael G. Tan, Lucio K. Tan Jr., Juanita Tan Lee, Florencia G. Tarriela (independent director) and Antonino L. Alindogan Jr. (independent director)

### Audit and Risk Management Committee

The Company's Audit and Risk Management Committee is composed of six directors, who have accounting and finance backgrounds. The Chairman of the Audit Committee, Antonino L. Alindogan Jr., is an independent director. The other members of Audit Committee are Lucio K. Tan, Jr., Michael G. Tan, Wilfrido E. Sanchez (independent director), Wilson T. Young and Janet Tan Lee.

The Committee's duties and responsibilities include, but are not limited to, the following:

- Ensure the integrity of the Company's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law, rules and regulations;
- Consider the independence and objectivity of the External Auditor, including reviewing the range of services provided in the context of all consulting services brought by the Company;
- Review the effectiveness of the financial management systems and information technology security including internal control of the entire accounting process from documentation of financial transactions to the preparation, interpretation and analysis of financial reports of Management and the External Auditor;



d. Monitor the risk environment of the Corporation, inclusive of its subsidiaries, and provide direction for the activities that will mitigate, to an acceptable level, the risks that may adversely affect the Corporation's ability to achieve its goals.

e. The Committee shall likewise review and pass upon related party transactions before these are elevated to the Board.

#### Nomination and Compensation Committee

The Company has a Nomination and Compensation Committee composed of five members. The Chairman of the Nomination and Compensation Committee is Dr. Lucio C. Tan. The other members of the Nomination and Compensation Committee are Harry C. Tan, Michael G. Tan, Lucio K. Tan, Jr., and Wilfrido E. Sanchez (independent director).

The Nomination and Compensation Committee's duties and responsibilities include, among others, the pre-qualification and short-listing of candidates for election to the Board of Directors, nominating at least two (2) independent directors or such as to constitute at least twenty percent (20%) of the members of the Board; re-nominating directors considering the director's contribution and performance; establishing a formal and transparent procedure for fixing the remuneration packages of individual directors; designating the amount of remuneration, which shall be in a sufficient level to attract and retain directors and officers; and evaluating existing business interests or shareholdings of all incoming officers, that may directly or indirectly conflict with the performance of duties, once hired.

#### Corporate Governance Committee

The Company has a Corporate Governance Committee composed of five members, two of whom are independent directors. The Chairman is Florencia G. Tarriela one of the three independent directors. The other members of the Committee are Michael G. Tan, Lucio K. Tan, Jr., Antonino L. Alindogan Jr. (Independent Director) and Juanita Tan Lee.

The Corporate Governance Committee is responsible for ensuring the Board's and the Board committees' effectiveness and compliance with good corporate governance principles and guidelines. It periodically reviews performance of the Board and the Company's subsidiaries, including their respective boards and management. The Corporate Governance Committee also evaluates and recommends whether or not a Director is able to and has been adequately carrying out his duties as Director,

bearing in mind the Director's contribution and performance.

### COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

The Directors of the Company receive an allowance of Php30,000.00 a month and a per diem of Php25,000.00 for every Board meeting and Php15,000.00 for every Committee meeting attended. Other than the stated allowance and the per diem of the Directors, there are no other standard arrangements to which the Directors of the Company are compensated, or are to be compensated, directly or indirectly, for any services provided as a Director, including any additional amounts payable for Committee participation or special assignments, for the last completed fiscal year and the ensuing year.

Since 2012, the Directors and Executive Officers of the Company have been receiving the following compensation:

**Summary Compensation Table:  
Annual Compensation**

	YEAR	SALARY	BONUS	OTHERS*
Four (4) most highly compensated executive officers (see below)	2014 (Estimate)	Php 9,470,780	Php 807,565	Php 2,249,500
	2013	Php 8,609,800	Php 734,150	Php 2,045,000
	2012	Php 6,341,500	Php 534,150	Php 2,175,000
All other officers and directors as a group unnamed	2014 (Estimate)	Php 7,315,000	Php 605,000	Php 7,188,500
	2013	Php 6,650,000	Php 734,150	Php 6,535,000
	2012	Php 6,790,000	Php 605,000	Php 3,090,000

\* Others – includes per diem of directors

The following constitute the Company's four (4) most highly compensated Executive Officers (on a consolidated basis):

1. Dr. Lucio C. Tan, Chairman of the Board of Directors and Chief Executive Officer;
2. Mr. Michael G. Tan, President;
3. Mr. Nestor C. Mendones, Deputy Chief Finance Officer; and
4. Atty. Ma. Cecilia Pesayco, Corporate Secretary.

### DEALINGS IN COMPANY SHARES

The Company observes the disclosure rule of the PSE requiring a publicly listed company to disclose to the Exchange the direct and indirect ownership of its Directors and Principal Officers in the company's securities within five (5) trading days after a Director is first elected or an Officer is appointed; and/or after any acquisition, disposal or change in the shareholdings of such Directors and Officers. However, the

Company endeavors to shorten the period within which to disclose the above information to three (3) trading days.

A Director or a Principal Officer of the Company must not also deal in the Company's shares during the period within which material non-public information is obtained, up to two (2) full trading days after the price sensitive information is disclosed.

## SHAREHOLDERS' RIGHTS

As one of the core principles of good governance is the proper treatment of shareholders, the Company commits to extend equitable rights to all shareholders.

### Voting Right

Since the Company is directed and run by the Board of Directors, shareholders are given the right to elect, remove and replace directors. In addition to

this, shareholders are also given the right to vote on certain corporate acts in accordance with the Corporation Code. As protection to the minority shareholders, a director elected by the minority vote shall not be removed without reasonable cause.

### Power of Inspection

Any shareholder may inspect the corporate books and records including minutes of Board meetings and stock registries during business hours. Further, all shareholders will be furnished with annual reports, including financial statements, without cost or restrictions.

### Right to Information

Being a publicly-listed Company, relevant information as required by law are promptly disclosed to the public through the PSE Edge System and the Company's website. For other information that shareholders may require, they are welcome to directly connect with the Office of the Investor Relations.

TYPE OF REPORT	Number of Filings
<b>Financials</b>	
Annual Report (17-A)	1
Quarterly Report (17-Q)	3
<b>Ownership</b>	
Annual List of Stockholders – for stockholder's meeting	1
Foreign Ownership Monitoring Report	12
Initial Statement of Beneficial Ownership of Securities (23-A)	3
Public Ownership Report	8
Report of Number of Shareholders and Board Lot	12
Statement in Changes of Beneficial Ownership of Securities (23-B)	3
Top 100 Stockholders' List	4
<b>Notices for Stockholders' Meetings/Dividends</b>	
Notice of Annual Stockholders' Meeting	1
Dividend Notice	1
<b>Other Disclosures</b>	
Certification – Qualifications of Independent Directors	3
Certification – Attendance of Directors in Board Meetings	1
Certification – Compliance with Manual on Corporate Governance	1
Clarifications of New Articles	4
Definitive Information Statement (20-IS)	1
General Information Sheet	1
Preliminary Information Statement (20-IS)	1
<b>SEC Form 17-C (Current Report)</b>	
Results of Annual Stockholders' Meeting/Board Meetings	1
Press Releases	6
Other Matters	
i. Change of business address	1
ii. Acquisitions of shares of stock of certain companies	7
iii. Approval of Dividend Policy	1
iv. Placing and Subscription Transaction	1
v. Nominees to the Board of Directors	1
vi. Subscription to subsidiary's Stock Rights Offering	2

Further, the minority shareholders shall be granted the right to propose the holding of a meeting, and the rights to propose items in the agenda of the meeting, provided the items are for legitimate business purposes. The minority shareholders shall be furnished with relevant information as required by law about the Company on a timely and regular basis.

The table below summarizes the disclosures of the Company for the year 2013.

#### **Right to Dividends**

The Company intends to declare dividends of approximately twenty percent (20%) of the previous year's net earnings whenever there are unrestricted retained earnings available subject to various factors. In 2013, the Board declared a cash dividend of Php0.15 per share or a total payout of Php1,623,208,333.00.

On April 8, 2014, the Board approved the proposal to declare a cash dividend of Php0.16 per share or a total payout of Php1,731 Billion. The cash dividend was approved to be paid not later than May 22, 2014 to all shareholders of record of the Company as of April 25, 2014, in compliance with existing issuances or rules of the PSE and the SEC.

#### **Appraisal Right**

The shareholders shall have appraisal right or the right to dissent and demand payment of the fair value of their shares under any of the circumstances set forth in Section 81 of the Corporation Code of the Philippines, and in the manner provided for under Section 82 of the said Code.

#### **Duty of Directors**

The duty of the Board to every shareholder is to endeavor to be transparent and fair in the conduct of every annual and special shareholders' meetings of the Company; to promote shareholder rights, remove impediments to the exercise of such rights and provide adequate avenue for them to seek redress for breach of their rights. It is the duty of the Board to be instrumental in removing excessive costs and other administrative or practical impediments to shareholders participating in meetings and/or voting in person.

Shareholders present during a stockholders' meeting may ask questions directed to the Board and Key Officers. During the last shareholders' meeting held on June 19, 2013, the only question raised was about the decision of the Company to lease an office space in Taguig City as its principal office. The President replied that the Company has changed its principal place of business from Makati City to Taguig City and therefore needed to lease a space in Taguig.

## **INVESTOR RELATIONS**

LTG maintains open communications with the investing community to promote greater understanding of the Company. SEC and PSE reports are disclosed on time, and are available for viewing and downloading in the Company's website.

LTG conducts regular meetings with investors and analysts to keep them updated on developments with LTG and its subsidiaries. The Company also arranges teleconferences and site visits and participates in non-deal roadshows and conferences in various locations, and also communicates through emails and telephone calls. In 2013, LTG met with around 200 investors and analysts in one-on-one or group meetings where they had access to Senior Management.





## TAN YAN KEE FOUNDATION, INC.

The Tan Yan Kee Foundation, Inc. (TYKFI), the corporate social responsibility arm of the Lucio Tan Group of Companies, established in honor of the late Tan family patriarch, successfully closed 2013 with projects that highlighted its Education, Health, Social Welfare and Environment advocacies.

Established in 1986, the Foundation sought to help those who could not afford social services. In the words of Dr. Lucio C. Tan, the Foundation "was established for those who can't afford a good education, those who suffer from lack of medical care, and those who lack opportunities for a better life."

TYKFI is supported by both financial and human resources from the Chairman himself and members of the LT Group of companies.

Highlighting the advocacy on Education in 2013 was the establishment of the Chua King Ha Educational Centers in the mountain peaks of Nueva Vizcaya in Luzon with the Tan Yan Kee Elementary School (TYKES) as pilot project. The project focused on a complete package of tools and resources to improve

the quality of education for educators, students, and the community to translate to excellence in the many facets of educating generations.

Scholarship programs as in previous years, accounted for a major portion of the Foundation's annual budget commitment. To date, the U.E.-TYKFI Scholarship Program and Allied Banking Corporation-Tan Yan Kee Scholarship Program have benefitted over 2,000 scholars. Meanwhile, the PNB-Tan Yan Kee Scholarship Program currently has 12 scholars.

The Asia Brewery Medical Specialty Scholarship Program has helped more than 100 physician-scholars since it began more than 20 years ago.

Continuing programs and projects of the Foundation in Education include the following:

- 1) Adopt-a-School program where 17 public schools







in the provinces of Ilocos Norte, Ilocos Sur, Nueva Vizcaya and Rizal have either been given classrooms or assistance in renovating existing facilities, among others since 2004.

2) Teachers' training through its Foundation for Upgrading the Standards of Education (FUSE) that has benefitted over 17,000 principals and teachers to date. These programs cover the fields of English, Mathematics, Chemistry, Physics and Elementary Science.

3) Storybook Drive that has reached over 140 schools nationwide with more than 69,000 books donated.

4) School Supplies Distribution Project where school supplies as well as slippers and raincoats have been given out for the past three years, with over 10,000 recipients for school year 2013-2014.

5) Sci-Fun Caravan Traveling Science Exhibits that have been visited by pupils and students from 587 schools in Vigan City and Ilocos Sur Division (1st District) in 2013.

In the area of Health Services, the Asia Brewery Medical Forum, held in partnership with the Foundation covered various topics related to better health information and medical options. This was conducted every month for the whole year.

TYKFI has distributed 661 nebulizers since 2003 that continues to benefit an estimated 7,000 patients daily in 392 cities and municipalities.

It has continued to conduct medical and dental missions in partnership with the University of the East Ramon Magsaysay Memorial Medical Center and the University of the East College of Dentistry.

Another focus for the year was the Foundation's advocacy on Social Welfare as a large portion of the



country suffered when one of the strongest typhoons in history battered parts of the Visayas region in November 2013. Through its HOPE Caravan, the Foundation has helped more than 50,000 families affected by Super Typhoon Yolanda (Haiyan).

TYKFI's Small Water Impounding Project continued to rehabilitate small dams to provide irrigation to farmers through weather changes. To date, 960 hectares have been covered by the project in Regions 1 and 2, with the most recent one completed in Balungao, Pangasinan in Region 1.

For the environment, the TYKFI continues to work on revitalizing and protecting the fragile ecosystem of Boracay's mangroves. With Tanduary Distillers, Inc., the "Roots for Boracay" project has the aim of planting 2,000 mangrove trees. The Foundation also plans to plant 10,000 mangrove trees in Sta. Cruz, Ilocos Sur.

The accomplishments of the Foundation were made possible through networking and strong partnerships with the members of the Lucio Tan Group of Companies, the Department of Education, Local Government Units (LGUs), the Department of Social Welfare and Development and the University of the East Ramon Magsaysay Memorial Medical Center.

Despite the often difficult task of bringing programs and projects to far-flung areas of the country, the Foundation, with the help of its partners, continues to accomplish its goals.

The Foundation remains committed to its vision for caring for the Filipino -- where needed, when needed.

# STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of LT Group, Inc. is responsible for the preparation and fair presentation of the consolidated financial statements for each of the three years in the period ended December 31, 2013, including the additional components attached therein, in accordance with the Philippine Financial Reporting Standards. This responsibility includes designing and implementing internal controls relevant to the preparation and fair presentation of consolidated financial statements 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.

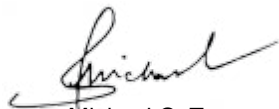
The Board of Directors reviews and approves the consolidated financial statements and submits the same to the stockholders.

SyCip Gorres Velayo & Co., the independent auditors, appointed by the stockholders, has examined the consolidated financial statements of the Company in accordance with Philippine Standards on Auditing and in its report to the stockholders, has expressed its opinion on the fairness of presentation upon completion of such examination.

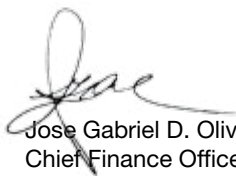
Signed under oath by the following:



Lucio C. Tan  
Chairman and Chief Executive Officer



Michael G. Tan  
President



Jose Gabriel D. Olives  
Chief Finance Officer

Signed this 18<sup>th</sup> day of March 2014

# INDEPENDENT AUDITORS' REPORT



Sycip Gorres Velayo & Co.  
6760 Ayala Avenue  
1226 Makati City Philippines

Phone: (632) 891•0307  
Fax: (632) 819•0872  
www.sgv.com.ph

BOA/PRC Reg. No. 0001,  
December 28, 2012, valid until December 31, 2015  
SEC Accreditation No. 0012-FR-3 (Group A),  
November 15, 2012, valid until November 16, 2015

The Stockholders and the Board of Directors  
LT Group, Inc.

We have audited the accompanying consolidated financial statements of LT Group, Inc. (a subsidiary of Tangent Holdings Corporation) and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2013 and 2012, and the consolidated statements of income, statements of comprehensive income, statements of changes in equity and statements of cash flows for the three years in the period ended December 31, 2013, and a summary of significant accounting policies and other explanatory information.

## **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Philippine Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **OPINION**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of LT Group, Inc. and its subsidiaries as at December 31, 2013 and 2012 and their financial performance and their cash flows for the three years in the period ended December 31, 2013, in accordance with Philippine Financial Reporting Standards.

## **SYCIP GORRES VELAYO & CO.**

Josephine H. Estomo  
Partner  
CPA Certificate No. 46349  
SEC Accreditation No. 0078-AR-3 (Group A),  
February 14, 2013, valid until February 13, 2016  
Tax Identification No. 102-086-208  
BIR Accreditation No. 08-001998-18-2012,  
April 11, 2012, valid until April 10, 2015  
PTR No. 4225170, January 2, 2014, Makati City

March 18, 2014



**LT GROUP, INC.**

(a Subsidiary of Tangent Holdings Corporation)

**AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Amounts in Thousands)

	December 31, 2013	December 31, 2012 (As Restated, Note 36)	January 1, 2012 (As Restated, Note 36)
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents (Note 5)	P 188,319,662	P 126,620,890	P 132,405,098
Financial assets at fair value through profit or loss (Notes 6 and 21)	12,556,152	15,140,351	8,938,448
Available for sale (AFS) investments (Note 7)	2,926,104	5,315,452	13,470,573
Loans and receivables (Note 8)	83,185,666	75,763,578	69,160,140
Due from related parties (Note 23)	2,710,185	11,269,627	4,111,401
Inventories (Note 9)	10,279,959	10,238,455	8,931,159
Other current assets (Note 10)	5,627,293	3,896,091	3,424,742
<b>Total Current Assets</b>	<b>305,605,021</b>	<b>248,244,444</b>	<b>240,441,561</b>
<b>Noncurrent Assets</b>			
Loans and receivables - net of current portion (Note 8)	204,749,366	178,818,367	167,286,705
AFS investments (Note 7)	78,029,572	93,158,186	81,038,501
Investment in an associate and a joint venture (Note 11)	13,664,449	13,906,189	11,623,387
Property, plant and equipment (Note 12):			
At appraised values	37,834,527	38,080,668	37,423,270
At cost	4,846,852	5,159,758	5,138,124
Investment properties (Note 13)	26,187,597	25,119,022	28,117,761
Net retirement plan assets (Note 24)	243,793	1,173,073	1,044,554
Deferred income tax assets (Note 29)	2,681,327	1,645,814	2,434,459
Other noncurrent assets (Note 14)	4,607,718	4,826,120	3,554,829
<b>Total Noncurrent Assets</b>	<b>372,845,201</b>	<b>361,887,197</b>	<b>337,661,590</b>
<b>TOTAL ASSETS</b>	<b>P 678,450,222</b>	<b>P 610,131,641</b>	<b>P 578,103,151</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current Liabilities</b>			
Deposit liabilities (Note 15)	P 415,690,524	P 353,942,590	P 361,044,305
Financial liabilities at fair value through profit or loss (Notes 16 and 21)	192,195	4,129,393	1,627,421
Bills and acceptances payable (Note 17)	11,423,153	18,113,598	12,319,199
Short-term debts (Note 19)	300,000	1,620,000	1,220,000
Accounts payable and accrued expenses (Note 18)	13,360,700	11,805,052	11,582,350
Income tax payable	164,045	424,739	413,454
Current portion of long-term debts (Note 19)	1,009,915	4,777,872	543,650
Current portion of due to related parties (Note 23)	8,036,519	40,319,226	35,451,980
Other current liabilities (Note 20)	33,077,731	23,329,454	21,855,340
<b>Total Current Liabilities (Carried Forward)</b>	<b>483,254,782</b>	<b>458,461,924</b>	<b>446,057,699</b>
(Forward)			



		December 31, 2012 (As Restated, Note 36)	January 1, 2012 (As Restated, Note 36)
	December 31, 2013		
<b>Total Current Liabilities (Brought Forward)</b>	<b>P 483,254,782</b>	P 458,461,924	P 446,057,699
<b>Noncurrent Liabilities</b>			
Deposit liabilities - net of current portion (Note 15)	10,451,554	24,805,196	21,923,074
Financial liabilities at fair value through profit or loss (Notes 16 and 21)	7,882,700	6,196,070	6,479,170
Bills and acceptances payable (Note 17)	1,748,844	328,654	1,391,525
Long-term debts - net of current portion (Note 19)	16,879,755	15,801,329	16,337,192
Due to related parties (Note 23)	—	—	1,350,332
Accrued retirement benefits (Note 24)	4,346,262	5,358,016	6,142,023
Deferred income tax liabilities (Note 29)	1,815,777	1,603,972	2,399,171
Other noncurrent liabilities (Note 20)	2,299,948	3,870,370	1,756,306
<b>Total Noncurrent Liabilities</b>	<b>45,424,840</b>	57,963,607	57,778,793
<b>Total Liabilities</b>	<b>528,679,622</b>	516,425,531	503,836,492
<b>Equity</b>			
Attributable to equity holders of the Company (Notes 1, 3, 12, 24 and 30):			
Capital stock	10,821,389	8,981,389	3,583,250
Capital in excess of par	35,906,231	1,173,772	—
Deposits for future stock subscription	6,048,534	—	1,639,401
Preferred shares of subsidiaries issued to Parent Company	7,405,000	—	—
Other comprehensive income, net of deferred income tax effect	6,070,799	9,257,162	10,421,017
Other equity reserves	790,136	987,057	1,162,223
Retained earnings	50,505,944	42,268,202	28,901,385
Shares of the Company held by subsidiaries	(12,518)	(12,518)	(163,407)
	117,535,515	62,655,064	45,543,869
Non-controlling interests (Notes 1, 7, 12 and 30)	32,235,085	31,051,046	28,722,790
<b>Total Equity</b>	<b>149,770,600</b>	93,706,110	74,266,659
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>P 678,450,222</b>	P 610,131,641	P 578,103,151

See accompanying Notes to Consolidated Financial Statements.

**LT GROUP, INC.**

(a Subsidiary of Tangent Holdings Corporation)

**AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Amounts in Thousands, Except for Basic/Diluted Earnings Per Share)

	Years Ended December 31		
	2013	2012 (As Restated, Note 36)	2011 (As Restated, Note 36)
<b>REVENUE (Note 25)</b>			
Banking	P 28,855,871	P 32,040,683	P 29,498,704
Beverage	12,701,784	12,188,007	11,938,021
Distilled spirits	10,425,603	12,767,679	12,256,165
Tobacco (Note 11)	151,722	2,974,897	3,350,002
Property development	3,656,950	2,685,795	5,191,651
	55,791,930	62,657,061	62,234,543
<b>COST OF SALES AND SERVICES (Note 25)</b>	26,021,935	30,439,722	32,615,372
<b>GROSS INCOME</b>	29,769,995	32,217,339	29,619,171
<b>EQUITY IN NET EARNINGS OF AN ASSOCIATE (Note 11)</b>	3,704,117	6,498,972	4,117,904
	33,474,112	38,716,311	33,737,075
<b>OPERATING EXPENSES</b>			
Selling expenses (Note 26)	2,776,946	2,716,118	3,040,944
General and administrative expenses (Note 27)	21,681,011	23,187,897	21,233,381
	24,457,957	25,904,015	24,274,325
<b>OPERATING INCOME</b>	9,016,155	12,812,296	9,462,750
<b>OTHER INCOME (CHARGES)</b>			
Finance costs (Note 22)	(480,892)	(548,187)	(543,804)
Finance income (Note 22)	139,093	158,244	104,524
Foreign exchange gains - net	1,260,899	824,036	1,390,856
Others - net (Note 28)	3,648,639	4,991,086	4,693,867
	4,567,739	5,425,179	5,645,443
<b>INCOME BEFORE INCOME TAX</b>	13,583,894	18,237,475	15,108,193
<b>PROVISION FOR INCOME TAX (Note 29)</b>			
Current	2,509,506	2,645,034	2,123,176
Deferred	(400,676)	46,214	113,200
	2,108,830	2,691,248	2,236,376
<b>NET INCOME</b>	P 11,475,064	P15,546,227	P12,871,817
<b>NET INCOME ATTRIBUTABLE TO:</b>			
Equity holders of the Company	P 8,669,220	P12,757,189	P10,030,717
Non-controlling interests	2,805,844	2,789,038	2,841,100
	P 11,475,064	P15,546,227	P12,871,817
<b>Basic/Diluted Earnings Per Share (Note 31)</b>	P 0.85	P1.44	P1.17

See accompanying Notes to Consolidated Financial Statements.





**LT GROUP, INC.**

(a Subsidiary of Tangent Holdings Corporation)

**AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Amounts in Thousands)

	Years Ended December 31		
	2013	2012 (As Restated, Notes 2 and 36)	2011 (As Restated, Notes 2 and 36)
<b>NET INCOME</b>	<b>P 11,475,064</b>	<b>P 15,546,227</b>	<b>P 12,871,817</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>			
<i>Other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods:</i>			
Accumulated translation adjustment	1,607,973	(1,130,819)	136,441
Net changes in fair value of AFS financial assets (Note 7)	(5,561,739)	(790,115)	4,732,451
Income tax effect	84,034	110,067	12,077
	(5,477,705)	(680,048)	4,744,528
Net other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods	(3,869,732)	(1,810,867)	4,880,969
<i>Other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods:</i>			
Re-measurement gains (losses) on defined benefit plans (Note 24)	(369,329)	513,336	(1,509,903)
Income tax effect	24,318	46,455	34,566
	(345,011)	559,791	(1,475,337)
Revaluation increment on property, plant and equipment (Note 12)	1,300,593	184,572	4,853,904
Income tax effect	(390,178)	(55,372)	(1,456,171)
	910,415	129,200	3,397,733
Share in re-measurement gains on defined benefit plans of an associate (Note 11)	27,453	—	—
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	592,857	688,991	1,922,396
<b>OTHER COMPREHENSIVE INCOME (LOSS) -</b>			
Net of income tax effect	(3,276,875)	(1,121,876)	6,803,365
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>P 8,198,189</b>	<b>P 14,424,351</b>	<b>P 19,675,182</b>
<b>TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO:</b>			
Equity holders of the Company	P 6,702,822	P 12,209,440	P 14,668,397
Non-controlling interests	1,495,367	2,214,911	5,006,785
	P 8,198,189	P 14,424,351	P 19,675,182

See accompanying Notes to Consolidated Financial Statements.



**LT GROUP, INC.**  
(a Subsidiary of Tangent Holdings Corporation)

Attributable to Equity Holders of the Company (Notes 1, 7, 12, 24, 30 and 36)

Attributable to Equity Holders of the Company (Notes 1, 7, 12, 24, 30 and 36)

Other Comprehensive Income (Loss)																
	Revaluation Increment on Property, Plant and Equipment Transferred to Associate (Notes 2, 11 and 12)										Total					
	Capital Stock	Capital in Excess of Par Subscription	Deposit for Future Stock	Preferred shares of Subsidiaries Issued to Parent Company	Other Equity Reserves	Accumulated Translation Adjustment	Net Changes in AFS Financial Assets (Note 7)	Re-measurement Gains (Losses) on Defined Benefit Plans (Note 24)	Revaluation Increment on Property, Plant and Equipment (Note 12)	Re-measurement Gains on Defined Benefit Plans of an Associate (Note 11)	Total Other Comprehensive Income (Loss), Net of Deferred Income Tax Effect (Note 11)	Shares of the Company Held by Subsidiaries	Retained Earnings	Total	Non-controlling Interests (Notes 1 and 30)	
Total comprehensive income (loss) for the year, as restated (Brought Forward)	P - 5,398,139	P - 1,241,262	P - (1,639,401)	P - -	P - -	P - (456,300)	P 418,825	P 259,446	P 67,930	P -	P - (547,749)	P 12,757,189	P - 5,000,000	P 12,209,440	P 2,214,911	P 14,424,351
Issuance of capital stock	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- 5,000,000
Stock issue costs	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (67,490)
Acquisition of shares of subsidiaries from the Controlling Shareholders	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sale of shares of the Company held by a subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (390,906)
Acquisition of non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- 344,101
Business combination adjustments	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- 22,528
Dividends declared by subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- 151,382
Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal, as restated	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- 161,840
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	- (32,445)
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See accompanying Notes to Consolidated Financial Statements.



**LT GROUP, INC.**

(a Subsidiary of Tangent Holdings Corporation)

**AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in Thousands)

	<b>Years Ended December 31</b>		
	<b>2013</b>	<b>2012</b> (As Restated, Note 36)	<b>2011</b> (As Restated, Note 36)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Income before income tax	<b>P 13,583,894</b>	P 18,237,475	P 15,108,193
Adjustments for:			
Depreciation and amortization (Notes 12 and 13)	<b>4,034,210</b>	3,677,908	3,581,501
Provision for losses (Notes 8 and 9)	<b>979,839</b>	2,738,189	1,570,070
Gain on disposal of:			
AFS (Notes 7 and 28)	<b>(290,505)</b>	78	—
Other assets (Notes 12, 13 and 28)	<b>(528,632)</b>	(620,547)	(1,499,121)
Equity in net earnings of an associate (Note 11)	<b>(3,704,117)</b>	(6,498,972)	(4,117,904)
Share in losses of joint venture (Note 11)	<b>20,091</b>	—	—
Finance costs (Note 22)	<b>480,892</b>	548,187	543,804
Finance income (Note 22)	<b>(139,093)</b>	(158,244)	(104,524)
Movement in accrued retirement benefits (Note 24)	<b>(451,688)</b>	(399,190)	328,280
Dividend income (Note 28)	<b>(19,123)</b>	(31,072)	(30,860)
Operating income before changes in working capital	<b>13,965,768</b>	17,493,812	15,379,439
Decrease (increase) in:			
Financial assets at fair value through profit or loss	<b>2,584,199</b>	(6,201,903)	10,549,210
Receivables - net	<b>(33,367,165)</b>	(18,075,815)	(33,373,308)
Inventories	<b>(41,504)</b>	(1,307,296)	(302,357)
Other assets	<b>(1,323,412)</b>	(6,122,137)	(2,472,828)
Increase (decrease) in:			
Deposit liabilities	<b>47,394,292</b>	(4,219,593)	16,713,488
Accounts payable and accrued expenses	<b>1,525,867</b>	253,285	(102,142)
Customers' deposits	<b>222,759</b>	881,608	(87,109)
Financial liabilities at fair value through profit or loss	<b>(2,250,568)</b>	2,218,872	1,531,995
Other liabilities	<b>7,953,877</b>	2,781,700	9,462,976
Cash generated from (used in) operations	<b>36,664,113</b>	(12,297,467)	17,299,364
Dividends received	<b>3,980,680</b>	4,208,048	3,522,465
Interest received	<b>114,551</b>	158,244	104,524
Income taxes paid, including creditable withholding and final taxes	<b>(3,013,291)</b>	(2,560,494)	(2,271,062)
<b>Net cash from (used in) operating activities</b>	<b>37,746,053</b>	(10,491,669)	18,655,291
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisition of:			
AFS financial assets (Note 7)	<b>(P122,879,759)</b>	(P274,740,921)	(P170,706,573)
Investment in a joint venture (Note 11)	<b>—</b>	(20,091)	—
Property, plant and equipment (Note 12)	<b>(3,081,169)</b>	(4,182,600)	(4,767,286)
Investment properties (Note 13)	<b>(3,706,501)</b>	(1,906,922)	(1,525,200)
Software (Note 8)	<b>—</b>	(131,392)	(85,293)
Proceeds from sale of:			
AFS (Note 7)	<b>135,126,488</b>	269,986,164	194,899,945
Other assets (Notes 12 and 13)	<b>3,717,822</b>	5,956,061	417,509
Advances granted to affiliates (Note 23)	<b>(1,755,327)</b>	(3,176,552)	(2,708,093)
<b>Net cash from (used in) investing activities</b>	<b>7,421,554</b>	(8,216,253)	15,525,009
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Availments (payments) of short-term debts (Note 19)	<b>(1,320,000)</b>	400,000	820,000
Proceeds from (payments of) bill and acceptance payable	<b>(5,270,255)</b>	4,731,528	(1,537,856)
Deposit for future stock subscription (Note 30)	<b>—</b>	—	1,680,146
Availments (payments) of long-term debts (Note 19)	<b>(2,703,780)</b>	3,658,466	947,754
Proceeds from issuance of shares (Note 30)	<b>37,720,000</b>	5,000,000	—
Sale of Company shares held by subsidiary	<b>—</b>	344,101	—
Payment of stock issue costs (Note 30)	<b>(1,147,541)</b>	(68,740)	(40,745)
Dividends paid (Note 30)	<b>(1,685,349)</b>	(32,445)	(3,265)
Acquisition of non-controlling interest	<b>—</b>	(22,528)	—
Advances from affiliates (Note 23)	<b>733,138</b>	1,566,201	71,039
Payment of advances from affiliates (Note 23)	<b>(9,223,000)</b>	(2,030,960)	—
Payment of finance cost	<b>(572,048)</b>	(621,909)	(544,480)
<b>Net cash from financing activities</b>	<b>16,531,165</b>	12,923,714	1,392,593
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>61,698,772</b>	(5,784,208)	35,572,893
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>126,620,890</b>	132,405,098	96,832,205
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 5)</b>	<b>P 188,319,662</b>	P 126,620,890	P 132,405,098

See accompanying Notes to Consolidated Financial Statements.



## **LT GROUP, INC.**

(a Subsidiary of Tangent Holdings Corporation)

### **AND SUBSIDIARIES**

#### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Amounts in Thousands, Except for Par Value Per Share and Basic/Diluted Earnings per Share)

#### **1. Corporate Information, Corporate Restructuring, and Authorization for Issue of the Consolidated Financial Statements**

##### **Corporate Information**

LT Group, Inc. ("LTG" or the "Company") was incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on May 25, 1937 under the name "The Manila Wine Merchants, Inc." to engage in the trading business. On November 17, 1947, the Company's shares of stock were listed in the Philippine Stock Exchange (PSE). The Company's corporate life is 50 years from the date of incorporation and was extended for another 50 years from and after May 27, 1987. On September 22, 1995, the Philippine SEC approved the change in Company's name to "Asian Pacific Equity Corporation" and the change in its primary purpose to that of a holding company. On July 30, 1999, the Company acquired Twin Ace Holdings Corp., now known as Tanduay Distillers, Inc. (TDI), a producer of distilled spirits, through a share swap with Tangent Holdings Corporation ("Tangent" or the "Parent Company"). The share swap resulted in LTG wholly owning TDI and Tangent increasing its ownership in LTG to 97.0%. On November 10, 1999, the Philippine SEC approved the change in the Company's corporate name from "Asian Pacific Equity Corporation" to "Tanduay Holdings, Inc.". On September 24, 2012, LTG's stockholders approved the amendment in its Articles of Incorporation and By-Laws to reflect the change in its corporate name from "Tanduay Holdings, Inc." to "LT Group, Inc." which was approved by the Philippine SEC on September 28, 2012. The Company's primary purpose is to engage in the acquisition by purchase, exchange, assignment, gift or otherwise; and to hold, own and use for investment or otherwise; and to sell, assign, transfer, exchange, lease, let, develop, mortgage, enjoy and dispose of, any and all properties of every kind and description and wherever situated, as to and to the extent permitted by law.

After a series of restructuring activities in 2012 and 2013, LTG has expanded and diversified its investments to include the beverages, tobacco, property development and banking businesses, all belonging to Mr. Lucio C. Tan and his family and assignees (collectively referred to as the "Controlling Shareholders"). These business segments in which LTG and subsidiaries (collectively referred to as "the Group") operate are described in Note 4 to the consolidated financial statements.

As of December 31, 2013 and 2012, LTG is 74.36% and 89.59%-owned, respectively, by its ultimate parent company, Tangent, which is also incorporated in the Philippines.

The official business address of the head office is 11<sup>th</sup> Floor, Unit 3 Bench Tower, 30<sup>th</sup> St. Corner Rizal Drive Crescent Park West 5 Bonifacio Global City, Taguig City.

##### **Capital Raising of LTG**

On October 26, 2011, LTG's Board of Directors (BOD) approved a capital raising exercise via the 2-tranche Placing and Subscription Transaction involving (i) the sale by Tangent of 398,138,889 shares in LTG to the public at an offer price of P4.22 each (the "Placing Tranche") and (ii) the subscription at a price equivalent to the offer price offered to the public at the Placing Tranche, as maybe adjusted to account for the expenses of the Placing Tranche (the "Subscription Tranche").

The capital raising exercise is intended to fund LTG's expansion of its distilled spirits segment's plant capacity, increase in operational efficiency and rationalization of operations, and at the same time offer the investing public the opportunity to participate in LTG's growth. In December 2011, Tangent sold the said shares, thereby reducing its ownership interest in LTG from 97% to 86%. In accordance with the Subscription Tranche, Tangent agreed to subscribe to 398,138,889 new common shares from LTG's unissued capital stock for a total consideration of P1,639.4 million. On May 2, 2012, LTG's BOD and stockholders approved the conversion of the deposit for future stock subscription into issued common shares of LTG, which resulted to an

increased ownership of Tangent in LTG, from 86% to 87% as of that date.

On July 27, 2012, LTG's BOD and stockholders approved the amendments in the Articles of Incorporation to reflect the increase in LTG's authorized capital stock from P5.0 billion divided into 5,000,000,000 shares with a par value of P1.00 per share to P25.0 billion divided into 25,000,000,000 shares with a par value of P1.00 per share. On the same date, LTG's BOD and stockholders also approved the issuance of 5,000,000,000 shares to Tangent in support of the increase in authorized capital stock and the waiver of rights/public offering in relation to the said shares to be issued to Tangent. On September 28, 2012, upon approval by the SEC of the increase in authorized capital stock, Tangent increased its ownership interest to 95.25%.

In December 2012, Tangent sold 508,544,100 shares to the public, thus, decreasing its ownership interest to 89.59% as of December 31, 2012.

On September 24, 2012, LTG's stockholders approved the 2-tranche Placing and Subscription Transaction involving the sale by Tangent of up to, but not exceeding 3,000,000,000 common shares of LTG registered in its name to investors by way of a follow-on offering at a placing price to be determined through a book building exercise to be hereafter conducted (the "Placing Tranche") and the subsequent subscription by Tangent using the proceeds of the Placing Tranche (net of expenses incurred in the Placing Tranche) to new shares of LTG in an amount equivalent to the number of shares sold during the Placing Tranche at an issue price equivalent to the placing price (the "Subscription Tranche"). The total number of the shares subject of the Placing Tranche shall be determined based on investor demand as determined through a book building exercise, provided the same shall not exceed 3,000,000,000 shares and the total number of subscription shares shall not exceed the shares sold in the Placing Tranche. The BOD was granted authority to determine such other terms and conditions of the transaction as may be most beneficial to LTG, including (but not limited to) the timing of the same and total funds to be raised therefrom. Further, the subscription shares shall be listed with the PSE.

In April 2013, Tangent sold 1.84 million shares to the public and agreed to subscribe to the same number of shares newly issued by LTG. The entire proceeds from the sale of LTG's shares was used by Tangent as payment for the subscription to new shares amounting to P36.6 billion, net of stock issuance costs (see Note 30). As a result of the placing and subscription transaction, Tangent's ownership in LTG decreased to 74.36% as of December 31, 2013.

##### **Corporate Restructuring**

###### **Consolidation of Businesses under LTG**

In preparation for, and prior to the completion of the capital raising exercise approved by the stockholders on September 24, 2012 as discussed above, the Group has undergone certain transactions to transfer certain businesses of the Controlling Shareholders to LTG. This restructuring exercise was approved by LTG's BOD on July 31, 2012. In support of LTG's restructuring activities, Tangent subscribed in cash to 5,000,000,000 common shares on the increase in LTG's authorized capital (see Note 30).

- a. Consolidation of the beverage business and acquisition of Asia Brewery, Incorporated (ABI)

On May 24, 2012, ABI's BOD approved the subscription to 400,000,000 shares of Interbev Philippines, Inc. (Interbev) at P1.00 par value per share by way of conversion of ABI advances to equity investment in Interbev. On the same date, ABI's BOD approved the acquisition of 125,000,000 shares of Packageworld, Inc. (Packageworld) at P1.00 par value per share through cash infusion. Effective June 29, 2012, upon approval by the Philippine SEC of Interbev's and Packageworld's application for the increase in capital stock, ABI became a stockholder of Interbev and Packageworld with 80.0% and 33.3% ownership interests, respectively. On June 24, 2012 and July 19, 2012, ABI's BOD approved the resolutions to buy out 100.0% of the outstanding shares of Waterich Resources Corporation (Waterich) and the remaining ownership interests in Interbev and Packageworld owned by the Controlling Shareholders, respectively. To effect the buyout transactions, ABI and the Controlling Shareholders executed the deeds of sale of shares of Waterich on June 24, 2012 and the

deeds of assignment of ABI's advances to Packageworld and Interbev on July 25, 2012. Thus, Waterich, Interbev and Packageworld became wholly-owned subsidiaries of ABI.

On July 19, 2012, ABI's BOD authorized ABI to issue 800,000,000 shares to LTG from its authorized but unissued capital stock and 1,000,000,000 shares from the proposed increase in its authorized capital stock with par value of P1.00 per share. In August 2012, ABI issued the remaining authorized but unissued capital stock to LTG, thus, making ABI an 80.0%-owned subsidiary. On October 10, 2012, SEC approved ABI's application to increase its authorized capital stock, thus, increasing LTG's ownership interest in ABI to 90.0%. In December 2012, LTG acquired the shares of ABI which are owned by Shareholdings, Inc. (Shareholdings), a company belonging to the Controlling Shareholders, and certain stockholders, thus, increasing LTG's ownership interest in ABI to 99.99%.

**b. Acquisition of Fortune Tobacco Corporation (FTC)**

On July 31, 2012, LTG's BOD approved the acquisition of at least 83.0% of FTC through a cash subscription to 1,646,489,828 shares at its par value of P1.00 per share. FTC has 49.6% ownership in PMFTC, Inc. (PMFTC), a company incorporated and domiciled in the Philippines which operates the combined businesses contributed by FTC and Philip Morris Philippines Manufacturing, Inc. (PMPMI) (see Note 11).

On September 26, 2012, LTG subscribed to 346,489,828 new shares of FTC with a par value of P1.00 per share, which was paid in cash by LTG in the amount of P346.5 million resulting in 49.5% interest of LTG in FTC.

On September 28, 2012, LTG subscribed in cash an additional 1,300,000,000 common shares of FTC with a par value of P1.00 per share, which was issued to LTG on October 10, 2012 upon approval of the Philippine SEC of FTC's application to increase its authorized capital stock. Thus, LTG increased its direct ownership interest in FTC to 82.32% while diluting ownership interest of Shareholdings in FTC from 98.0% to 17.33%.

On October 30, 2012, LTG's BOD approved the acquisition of up to 100% of equity interests in FTC.

As of December 31, 2012, LTG has direct ownership interest in FTC of 82.32%, while the balance of 17.33% and 0.35% is owned by Shareholdings and the Controlling Shareholders, respectively, and was previously presented as non-controlling interest in the 2012 consolidated financial statements.

In February 2013, LTG increased its effective ownership interest in FTC to 99.58% through the following:

- Acquired subscription rights to 453,500,000 shares of Shareholdings, which represents 90.70% ownership interest in Shareholdings or equivalent to 15.71% indirect ownership interest in FTC;
- Assumed certain liabilities of Shareholdings from Controlling Shareholders amounting to P1.5 billion, which was used as payment for the subscription of 1,500,000,000 out of the unissued capital stock of Shareholdings thereby increasing the ownership interest in Shareholdings to 97.68% (equivalent to 1.21% indirect ownership in FTC);
- Acquired additional 0.34% direct ownership interest in FTC through purchase of FTC's 104,330,633 outstanding shares held by the Controlling Shareholders.

**c. Acquisition of Eton Properties Philippines, Inc. (Eton)**

Prior to restructuring in 2012, Paramount Landequities, Inc. (Paramount) and Saturn Holdings, Inc. (Saturn) have ownership interest of 55.07% and 42.39%, respectively, in Eton, a listed company incorporated and registered with the Philippine SEC and is primarily engaged in real estate development.

On September 17, 2012, LTG's BOD approved the assumption by LTG of certain liabilities of Paramount from Step Dragon Co. Ltd. and Billinge Investments Ltd., BVI-based companies, and Saturn from Penick Group Ltd., also a BVI-based company, amounting to P1,350.8 million and P521.3 million, respectively.

On September 25 and September 26, 2012, LTG subscribed to 1,350,819,487 common shares of Paramount and 490,000,000 common shares of Saturn, respectively, with a par value of P1.00 per share and will be issued to LTG out of an increase in Paramount's and Saturn's authorized capital stock. LTG paid the subscription in full by way of conversion into equity of LTG's advances to Paramount and Saturn amounting to P1,350.8 million and P490.0 million, respectively. On the same dates, Paramount and Saturn filed its application for increase in authorized capital with the Philippine SEC in order to accommodate LTG's investment.

Upon SEC's approval on October 10, 2012, Paramount and Saturn became subsidiaries of LTG with 98.18% and 98.99% ownership interests, respectively, thus, giving LTG a 98.0% effective ownership in Eton.

On October 30, 2012, LTG entered into deeds of sale of shares with the Controlling Shareholders of Paramount and Saturn for the remaining issued and outstanding shares of the said companies. Thus, Paramount and Saturn became wholly owned subsidiaries of LTG.

On December 8, 2012, Paramount made a tender offer to buy back shares of Eton traded in the PSE resulting in the increase in its ownership interest from 55.07% to 56.86%, thus, increasing LTG's effective ownership interest in Eton to 99.3%.

**d. Merger of Philippine National Bank (PNB) and Allied Banking Corporation (ABC) and acquisition of Bank Holding Companies.**

On March 6, 2012, PNB held a Special Stockholders' Meeting approving the amended terms of the Plan of Merger of PNB with ABC. Under the approved amended terms, merger will be effected via a share-for-share exchange with PNB as the surviving entity. PNB will issue to ABC shareholders 130 Parent Company common shares for every ABC common share and 22.763 PNB common shares for every ABC preferred share. As of January 17, 2013, PNB has received all the necessary approvals from SEC and foreign regulatory agencies to effectuate the merger. On February 9, 2013, PNB completed its planned merger with ABC (the merger of PNB and ABC will be referred to herein as "Merged PNB") as approved and confirmed by the BOD of PNB and ABC on January 22 and January 23, 2013, respectively.

The merger of PNB and ABC was accounted for using the pooling of interests method by the Company since both entities are under the common control of Mr. Tan (see Note 30).

On February 11, 2013, LTG's BOD approved the acquisition of indirect ownership interest in the Merged PNB through the investment in the 27 holding companies which have collective ownership interest in the Merged PNB of 59.83% (collectively referred to as "Bank Holding Companies"). LTG's acquisition of the Bank Holding Companies will be effected by way of subscription to the increase in authorized shares of the Bank Holding Companies and acquisition of the Bank Holding Companies' shares owned by the Controlling Shareholders. On November 8, 2013, LTG has obtained the requisite regulatory approval from the Hongkong Monetary Authority (HKMA) to become a majority shareholder controller of ABC (Hongkong) Limited (ABCHK) and the HKMA took note of the plan of LTG to acquire or increase its shareholdings in PNB up to 59.83%.

In various dates in February, March and December 2013, upon approval of the SEC for the increase in authorized capital stock of certain Bank Holding Companies, LTG has acquired between 80% to 100% ownership of these Bank Holding Companies. The transactions were consummated through conversion of LTG's advances from the Bank Holding Companies in exchange for the



shares acquired. As of December 31, 2013, LTG indirectly owns 56.47% of PNB through the 59.83% collective ownership of the Bank Holding Companies.

These business combinations were accounted for using pooling of interests method. Accordingly, LTG recognized the net assets of the acquired subsidiaries equivalent to their carrying values. The December 31, 2012 and January 1, 2012 comparative financial information were restated at the beginning of the earliest period presented (see Note 30).

#### Authorization for Issue of the Consolidated Financial Statements

The consolidated financial statements as at December 31, 2013 and 2012 and January 1, 2012 and for the three years in the period ended December 31, 2013, were authorized for issue by the BOD on March 18, 2014.

## 2. Summary of Significant Accounting and Financial Reporting Policies

#### Basis of Preparation and Statement of Compliance

The consolidated financial statements have been prepared under the historical cost basis, except for financial assets and liabilities at fair value through profit or loss (FVPL), AFS financial assets, land and

land improvements, plant buildings and building improvements, and machineries and equipment that have been measured at fair value. The consolidated financial statements are presented in Philippine peso (Peso), the functional currency of LTG. All values are rounded to the nearest Peso, except when otherwise indicated.

The consolidated financial statements provide comparative information in respect of the previous period. In addition, the Group presents an additional statement of financial position at the beginning of the earliest period presented when there is a retrospective application of an accounting policy, a retrospective restatement, or a reclassification of items in financial statements. An additional consolidated statement of financial position as at January 1, 2012 is presented in these consolidated financial statements due to accounting for business combination under common control and retrospective application of certain accounting policies (see Changes in Accounting Policies and Disclosures).

The consolidated financial statements of LTG have been prepared in accordance with Philippine Financial Reporting Standards (PFRS).

#### Basis of Consolidation

The consolidated financial statements include the financial statements of LTG and the following subsidiaries:

	Percentage of Ownership						Country of Incorporation
	December 31				January 1,		
	2013		2012 <sup>(1)</sup>		2012 <sup>(1)</sup>		
	Direct	Indirect	Direct	Indirect	Direct	Indirect	
<b>Distilled Spirits</b>							
TDI and subsidiaries	100.0	—	100.0	—	100.0	—	Philippines
Absolut Distillers, Inc. (ADI)	—	95.0	—	95.0	—	95.0	Philippines
Asian Alcohol Corporation (AAC)	—	96.0	—	96.0	—	96.0	Philippines
Tanduay Brands International, Inc. (TBI) <sup>(2)</sup>	100.0	—	100.0	—	100.0	—	Philippines
<b>Beverages</b>							Philippines
ABI and subsidiaries	99.9	—	99.9	—	99.9	—	Philippines
Agua Vida Systems, Inc.	—	99.9	—	99.9	—	99.9	Philippines
Interbev	—	99.9	—	99.9	—	99.9	Philippines
Waterich	—	99.9	—	99.9	—	99.9	Philippines
Packageworld	—	99.9	—	99.9	—	99.9	Philippines
<b>Tobacco</b>							
Shareholdings, Inc.	97.7	—	97.7	—	97.7	—	Philippines
FTC	82.7	16.9	82.7	16.9	82.7	16.9	Philippines
<b>Property Development</b>							
Saturn <sup>(3)</sup>	100.0	—	100.0	—	100.0	—	Philippines
Paramount and subsidiaries <sup>(3)</sup>	100.0	—	100.0	—	100.0	—	Philippines
Eton	—	99.3	—	99.3	—	99.3	Philippines
Belton Communities, Inc. (BCI)	—	99.3	—	99.3	—	99.3	Philippines
Eton City, Inc. (ECI)	—	99.3	—	99.3	—	99.3	Philippines
FirstHomes, Inc. (FHI)	—	99.3	—	99.3	—	99.3	Philippines
Eton Properties Management Corporation (EPMC)	—	99.3	—	99.3	—	99.3	Philippines
<b>Banking</b>							
Bank Holding Companies (Note 23) <sup>(4)</sup>	80-100	—	80-100	—	80-100	—	Various
PNB and Subsidiaries <sup>(5)</sup>	—	56.5	—	56.5	—	56.5	Philippines
PNB Capital and Investment Corporation (PNB Capital)	—	56.5	—	56.5	—	56.5	Philippines
PNB Securities, Inc. (PNB Securities)	—	56.5	—	56.5	—	56.5	Philippines

(Forward)



	Percentage of Ownership						Country of Incorporation
	December 31				January 1,		
	2013		2012 <sup>(1)</sup>		2012 <sup>(1)</sup>		
	Direct	Indirect	Direct	Indirect	Direct	Indirect	
<b>Banking (continued)</b>							
PNB Forex, Inc.	—	56.5	—	56.5	—	56.5	Philippines
PNB Holdings Corporation (PNB Holdings)	—	56.5	—	56.5	—	56.5	Philippines
PNB General Insurers, Inc. (PNB Gen)	—	56.5	—	56.5	—	56.5	Philippines
PNB Corporation - Guam	—	56.5	—	56.5	—	56.5	United States of America (USA)
PNB International Investments Corporation (PNB IIC)	—	56.5	—	56.5	—	56.5	USA
PNB Remittance Centers, Inc. (PNBRCC)	—	56.5	—	56.5	—	56.5	USA
PNB RCI Holding Co. Ltd.	—	56.5	—	56.5	—	56.5	USA
PNB Remittance Co. (Canada)	—	56.5	—	56.5	—	56.5	Canada
PNB Europe PLC	—	56.5	—	56.5	—	56.5	United Kingdom
PNB Global Remittance & Financial Co. (HK) Ltd. (PNB GRF)	—	56.5	—	56.5	—	56.5	Hong Kong
PNB Italy SpA	—	56.5	—	56.5	—	56.5	Italy
Japan - PNB Leasing and Finance Corporation (Japan-PNB Leasing)	—	50.8	—	50.8	—	50.8	Philippines
Japan - PNB Equipment Rentals Corporation	—	50.8	—	50.8	—	50.8	Philippines
Allied Savings Bank (ASB)	—	56.5	—	56.5	—	56.5	Philippines
Allied Bank Philippines (UK) Plc (ABUK)	—	56.5	—	56.5	—	56.5	United Kingdom
Allied Commercial Bank (ACB)	—	50.8	—	50.8	—	50.8	People's Republic of China
Allied Banking Corporation (Hongkong) Limited (ABCHKL)	—	28.8	—	28.8	—	28.8	Hong Kong
ACR Nominees Limited	—	28.8	—	28.8	—	28.8	Hong Kong
PNB Life Insurance, Inc. (PLII)	—	45.2	—	45.2	—	45.2	Philippines
Allied Leasing and Finance Corporation (ALFC)	—	32.3	—	32.3	—	32.3	Philippines
Oceanic Holdings (BVI) Ltd. (OHBVI)	—	15.7	—	15.7	—	15.7	USA

<sup>(1)</sup> Effective percentage of ownership as of December 31, 2012 and January 1, 2012 was restated to reflect pooling of interest as if the newly acquired subsidiaries have always been combined.

<sup>(2)</sup> Incorporated on May 6, 2003 to handle the marketing of TDI's products in the export market, TBI has not yet started commercial operations.

<sup>(3)</sup> In July 2011, upon approval by the Philippine SEC of the asset-for-share swap which was filed in 2009, Paramount acquired 1.6 billion unissued shares of Eton, which is equivalent to 55.07% ownership interest in Eton. The acquisition resulted to dilution of Saturn and the non-controlling ownership interest in Eton from 94.4% and 5.6% as of December 31, 2010 to 42.39% and 2.54% as of December 31, 2011, respectively.

<sup>(4)</sup> As of December 31, 2013, the Bank Holding Companies consist of 27 entities with aggregate direct ownership interest of 59.83% in PNB, of which 20 companies are incorporated in the Philippines and seven (7) companies are incorporated in the British Virgin Islands (see Note 23).

<sup>(5)</sup> Represents the effective ownership interest of LTG through the collective ownership of the Bank Holding Companies in the merged PNB. Subsidiaries of Merged PNB pertain to the 18 subsidiaries of PNB and Allied Bank, respectively, prior to the merger.

Subsidiaries are entities over which the Company has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect that return through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

- Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee)
- Exposure, or rights, to variable returns from its involvement with the investee, and
- The ability to use its power over the investee to affect its returns

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangement with the other vote holders of the investee
- Rights arising from other contractual arrangements
- The Group's voting rights and potential voting rights

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included or excluded in the consolidated financial statements from the date the Group gains control or until the date the Group ceases to control the subsidiary.

Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. Adjustments, where necessary, are made to ensure consistency with the policies adopted by the Group.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but are considered as an impairment indicator of the assets transferred.

#### **Non-controlling interest**

Non-controlling interest represents equity in a subsidiary not attributable, directly or indirectly, to the equity holders of LTG and subsidiaries. Non-controlling interest represents the portion of profit or loss and the net assets not held by the Group. Transactions with non-controlling interest are accounted for as equity transactions.

Non-controlling interest shares in losses even if the losses exceed the non-controlling equity interest in the subsidiary.



A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it derecognizes assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interest and the cumulative translation differences recorded in equity; recognizes the fair value of the consideration received, any investment retained, and any surplus or deficit in profit or loss; and reclassifies the parent's share of components previously recognized in other comprehensive income to profit or loss or retained earnings, as appropriate.

#### **Business Combinations and Goodwill**

Business combinations are accounted for using the acquisition method. As of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value, and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer has the option to measure the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

When a business is acquired, the financial assets and financial liabilities assumed are assessed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group as an acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the Group as an acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the Group as an acquirer shall also recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the Group as an acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value as at the acquisition date through profit or loss. Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability will be recognized in accordance with PAS 39 either in profit or loss or as a charge to other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity. Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interest over the fair values of net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units (CGU) that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a CGU 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 this

circumstance is measured based on the relative values of the operation disposed of and the portion of the CGU retained.

A CGU to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the unit may be impaired, by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit shall be regarded as not impaired. If the carrying amount of the unit exceeds the recoverable amount of the unit, the Group shall recognize the impairment loss. Impairment losses relating to goodwill cannot be reversed in subsequent periods.

The Group performs its impairment test of goodwill on an annual basis every December 31 or earlier whenever events or changes in circumstances indicate that goodwill may be impaired.

#### **Common control business combinations**

Where there are business combinations involving entities that are ultimately controlled by the same ultimate parent (i.e., Controlling Shareholders) before and after the business combination and that the control is not transitory ("business combinations under common control"), the Group accounts such business combinations in accordance with the guidance provided by the Philippine Interpretations Committee Q&A No. 2011-02, PFRS 3.2 *Common Control Business Combinations*. The purchase method of accounting is used, if the transaction was deemed to have substance from the perspective of the reporting entity. In determining whether the business combination has substance, factors such as the underlying purpose of the business combination and the involvement of parties other than the combining entities such as the non-controlling interest, shall be considered. In cases where the transaction has no commercial substance, the business combination is accounted for using pooling of interest method.

In applying the pooling of interest method, the Group follows the Philippine Interpretations Committee Q&A No. 2012-01, PFRS 3.2 – *Application of the Pooling of Interest Method for Business Combinations of Entities under Common Control in Consolidated Financial Statements*, which provides the following guidance:

- The assets and liabilities of the combining entities are reflected in the consolidated financial statements at their carrying amounts. No adjustments are made to reflect fair values, or recognize any new assets or liabilities, at the date of the combination. The only adjustments that are made are those adjustments to harmonize accounting policies.
- No new goodwill is recognized as a result of the combination. The only goodwill that is recognized is any existing goodwill relating to either of the combining entities. Any difference between the consideration paid or transferred and the equity acquired is reflected within equity as other equity reserve, i.e., either contribution or distribution of equity.
- The consolidated statement of income reflects the results of the combining entities for the full year, irrespective of when the combination took place.
- As a policy, comparatives are presented as if the entities had always been combined.

#### **Changes in Accounting Policies and Disclosures**

The accounting policies adopted in the preparation of the Group's consolidated financial statements are consistent with those of the previous financial year except for the following amended PFRSs which were adopted effective beginning January 1, 2013.

The Group applies, for the first time, certain standards and amendments that require restatement of previous financial statements. These include PFRS 10, *Consolidated Financial Statements*, PFRS 11, *Joint Arrangements*, PAS 19 (Revised 2011), *Employee Benefits*, PFRS 13, *Fair Value Measurement* and amendments to PAS 1, *Presentation of Financial Statements* (see Note 36). In addition, the application of PFRS 7, *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments)* and PFRS 12, *Disclosure of Interest in Other Entities would result in additional disclosures in the consolidated financial statements* (see Notes 11 and 37).

The nature and the impact of each new standard/amendments are described below:

- PFRS 7, *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments)*, requires an entity to disclose information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32. The amendments require entities to disclose, in a tabular format, unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

- a) The gross amounts of those recognized financial assets and recognized financial liabilities;
- b) The amounts that are set off in accordance with the criteria in PAS 32 when determining the net amounts presented in the balance sheet;
- c) The net amounts presented in the balance sheet;
- d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
  - i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32; and
  - ii. Amounts related to financial collateral (including cash collateral); and
- e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

Refer to Note 37 for the details and the tabular format of the required offsetting disclosures with the Group retrospectively applied.

- PFRS 10, *Consolidated Financial Statements*, replaced the portion of PAS 27, *Consolidated and Separate Financial Statements*, that addressed the accounting for consolidated financial statements. It also included the issues raised in SIC 12, *Consolidation - Special Purpose Entities*. PFRS 10 established a single control model that applied to all entities including special purpose entities. The changes introduced by PFRS 10 require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in PAS 27.

#### *Deconsolidation of Instrument in SPV-Opal Portfolio Investments (SPV-AMC), Inc. (OPII)*

Before the effectivity of PFRS 10, Opal Portfolio Investment (SPV-AMC) (OPII) is consolidated by PNB based on the provisions of SIC 12. Under SIC 12, control over an SPE may exist even in cases where an entity owns little or none of the SPE's equity, such as when an entity retains majority of the residual risks related to the SPE in order to obtain benefits from its activities. Beginning January 1, 2013, the Group adopted PFRS 10 which supersedes SIC 12. PFRS 10 establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. Based on management's assessment, PNB should no longer consolidate OPII since it failed to demonstrate control over OPII. Thus, the consolidated financial statements of PNB as of December 31, 2012 and January 1, 2012 were restated to retroactively effect the deconsolidation of Opal in accordance with the transition provision of PFRS 10.

- Amendments to PAS 27, *Separate Financial Statements*. As a consequence of the issuance of the new PFRS 10 and PFRS 12, what remains of PAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in the separate financial statements. The adoption of the amended PAS 27 did not have a significant impact on the separate financial statements of the entities in the Group.

- PFRS 11, *Joint Arrangements*, replaced PAS 31, *Interests in Joint Ventures*, and SIC 13, *Jointly Controlled Entities - Non-Monetary Contributions by Venturers*. PFRS 11 removed the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled entities that meet the definition of a joint venture must be accounted for using the equity method. The application of this new standard does not have an impact on the financial position of the Group since its investments in associates and joint venture are currently accounted for under the equity method.

- PFRS 12, *Disclosure of Interests in Other Entities*, sets out the requirements for disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. The requirements in PFRS 12 are more comprehensive than the previously existing disclosure requirements for subsidiaries (for example, where a subsidiary is controlled with less than a majority of voting rights). While the Group has subsidiaries with material noncontrolling interests, there are no unconsolidated structured entities. PFRS 12 disclosures are provided in Note 11.

- Amendments to PAS 28, *Investments in Associates and Joint Ventures*. As a consequence of the issuance of the new PFRS 11 and PFRS 12, PAS 28 has been renamed PAS 28, *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The application of this new standard did not have an impact on the financial position of the Group since its investments in associates and joint venture are currently accounted for under the equity method.

- PFRS 13, *Fair Value Measurement*, establishes a single source of guidance under PFRSs for all fair value measurements. PFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS. PFRS 13 defines fair value as an exit price. PFRS 13 also requires additional disclosures.

As a result of the guidance in PFRS 13, the Group re-assessed its policies for measuring fair values, in particular, its valuation inputs such as non-performance risk for fair value measurement of liabilities. The Group has assessed that the application of PFRS 13 has not materially impacted the fair value measurements of the Group. Additional disclosures, where required, are provided in the individual notes relating to the assets and liabilities whose fair values were determined. Fair value hierarchy is provided in Note 33.

- Amendments to PAS 1, *Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income or OCI*, introduced a grouping of items presented in OCI. Items that will be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) will be presented separately from items that will never be recycled. The amendments affected presentation only and did not have an impact on the Group's financial position or performance.

- Amendments to PAS 19, *Employee Benefits* (Revised PAS 19), require all actuarial gains and losses to be recognized in other comprehensive income and unvested past service costs previously recognized over the average vesting period to be recognized immediately in profit or loss when incurred.

Prior to adoption of the Revised PAS 19, the Group recognized actuarial gains and losses as income or expense when the net cumulative unrecognized gains and losses for each individual plan at the end of the previous period exceeded 10% of the higher of the defined benefit obligation and the fair value of the plan assets and recognized unvested past service costs as an expense on a straight-line basis over the average vesting period until the benefits become vested. Upon adoption of the Revised PAS 19, the Group changed its accounting policy to recognize all actuarial gains and losses in other comprehensive income and all past service costs in profit or loss in the period they occur.

The Revised PAS 19 replaced the interest cost and expected return on plan

assets with the concept of net interest on defined benefit liability or asset which is calculated by multiplying the net balance sheet defined benefit liability or asset by the discount rate used to measure the employee benefit obligation, each as at the beginning of the annual period.

The Revised PAS 19 also amended the definition of short-term employee benefits and requires employee benefits to be classified as short-term based on expected timing of settlement rather than the employee's entitlement to the benefits. In addition, the Revised PAS 19 modifies the timing of recognition for termination benefits. The modification requires the termination benefits to be recognized at the earlier of when the offer cannot be withdrawn or when the related restructuring costs are recognized.

Changes to definition of short-term employee benefits and timing of recognition for termination benefits do not have any impact to the Group's financial position and financial performance.

The changes in accounting policies have been applied retrospectively. The effects of adoption on the consolidated financial statements, except for the impact of the PAS 19R on the banking segment which were already considered in the accounting for business combination under common control using the pooling of interest method (see Note 36), follow:

### Consolidated Balance Sheets

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Increase (decrease) in:			
Net retirement plan assets	(P 96,362)	(P 42,530)	(P 22,664)
Accrued retirement benefits	338,173	321,773	185,223
Deferred income tax assets	14,643	19,396	9,894
Deferred income tax liabilities	(101,329)	(85,918)	(50,831)
Other comprehensive income	(258,927)	(201,893)	(85,967)
Retained earnings	(60,198)	(57,839)	(62,415)
Non-controlling interests	562	743	1,220

### Consolidated Statements of Income

	Years Ended December 31		
	2013	2012	2011
	(In Thousands, except earnings per share)		
Impact on profit or loss:			
Cost of sales	(P 8,734)	(P 4,299)	(P 1,345)
Gross profit	8,734	4,299	1,345
Selling expenses	(984)	(1,086)	(1,252)
General and administrative expenses	(1,522)	(810)	(953)
Other income	(14,696)	—	—
Income before income tax	(3,456)	6,195	3,550
Provision for income tax	(1,037)	1,681	1,052
Increase (decrease) in net income	(P 2,419)	P 4,514	P 2,497
Attributable to:			
Equity holders of the parent	(P 2,360)	P 4,577	P 2,567
Non-controlling interests	(59)	(63)	(70)
Basic/diluted earnings per share	—	—	—

### Consolidated Statements of Comprehensive Income

	Years Ended December 31		
	2013	2012	2011
	(In Thousands)		
Increase (decrease) in net income	(P 2,419)	P 4,514	P 2,498
Impact on other comprehensive income:			
Re-measurement gain (loss) of defined benefit obligation	(81,473)	(162,795)	(116,477)
Income tax effect	24,318	46,455	34,566
Other comprehensive income (loss) for the year, net of tax	(57,155)	(116,340)	(81,911)
Increase (decrease) in total comprehensive income for the year	(P 59,574)	(P 111,826)	(P 79,414)
Attributable to:			
Equity holders of the parent	(P 59,394)	(P 111,349)	(P 79,242)
Non-controlling interests	(180)	(477)	(172)

The adoption of the Revised PAS 19 did not have a significant impact on the consolidated statements of cash flows for the years ended December 31, 2012 and 2011.

Re-measurement losses on accrued retirement benefits were closed to retained earnings at transition date. Subsequent to January 1,

2011, re-measurement losses on accrued retirement benefits is presented separately under other comprehensive income. The Revised PAS 19 also requires more extensive disclosures which are presented in Note 24 to the financial statements.

- Philippine Interpretation IFRIC 20, *Stripping Costs in the Production Phase of a Surface Mine*, applies to waste removal (stripping) costs incurred in surface mining activity, during the production phase of the mine. The interpretation addresses the accounting for the benefit from the stripping activity. This new interpretation is not relevant to the Group as the Group is not involved in any mining activities.
- Amendment to PFRS 1, *First-time Adoption of International Financial Reporting Standards - Government Loans*, requires first-time adopters to apply the requirements of PAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, prospectively to government loans existing at the date of transition to PFRS. However, entities may choose to apply the requirements of PAS 39, *Financial Instruments: Recognition and Measurement*, and PAS 20 to government loans retrospectively if the information needed to do so had been obtained at the time of initially accounting for those loans. These amendments are not relevant to the Group as the Group is not a first time adopter of PFRS.

### Annual Improvements to PFRSs (2009-2011 cycle)

The Annual Improvements to PFRSs (2009-2011 cycle) contain non-urgent but necessary amendments to PFRSs. The Group adopted these amendments for the current year.

- PFRS 1, *First-time Adoption of PFRS - Borrowing Costs*, clarifies that, upon adoption of PFRS, an entity that capitalized borrowing costs in accordance with its previous generally accepted accounting principles, may carry forward, without any adjustment, the amount previously capitalized in its opening statement of financial position at the date of transition. Subsequent to the adoption of PFRS, borrowing costs are recognized in accordance with PAS 23, *Borrowing Costs*. The amendment does not apply to the Group as it is not a first-time adopter of PFRS.
- PAS 1, *Presentation of Financial Statements - Clarification of the requirements for comparative information*, clarifies the requirements for comparative information that are disclosed voluntarily and those that are mandatory due to retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The additional comparative period does not need to contain a complete set of financial statements. On the other hand, supporting notes for the third balance sheet (mandatory when there is a retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements) are not required. As a result of accounting for business combination under common control and adoption of Revised PAS 19, the Group has included comparative information in respect of the opening balance sheet as at January 1, 2012 and supporting notes for the balance sheet accounts affected. The amendments affected disclosures only and did not have an impact on the Group's financial position or performance.
- PAS 16, *Property, Plant and Equipment - Classification of Servicing Equipment*, clarifies that spare parts, stand-by equipment and servicing equipment should be recognized as property, plant and equipment when they meet the definition of property, plant and equipment and should be recognized as inventory if otherwise. The amendment did not have any significant impact on the Group's financial position or performance.
- PAS 32, *Financial Instruments: Presentation - Tax Effect of Distribution to Holders of Equity Instruments*, clarifies that income taxes relating to distributions to equity holders and to transaction costs of an equity transaction are accounted for in accordance with PAS 12, *Income Taxes*. The amendment did not have an impact on the consolidated



financial statements for the Group, as there is no tax consequences attached to cash or non-cash distribution.

- PAS 34, *Interim Financial Reporting - Interim Financial Reporting and Segment Information for Total Assets and Liabilities*, clarifies that the total assets and liabilities for a particular reportable segment need to be disclosed only when the amounts are regularly provided to the chief operating decision maker (CODM) and there has been a material change from the amount disclosed in the entity's previous annual financial statements for that reportable segment. The amendment affected disclosures only and did not have an impact on the Group's financial position or performance.

#### **New Accounting Standards, Interpretations and Amendments to Existing Standards Effective Subsequent to December 31, 2013**

The Group will adopt the standards, amendments and interpretations enumerated below when these become effective. Except as otherwise indicated, the Group does not expect the adoption of these new changes in PFRS to have a significant impact on the consolidated financial statements. The relevant disclosures will be included in the notes to the consolidated financial statements when these become effective.

##### **Effective in 2014**

- Amendments to PFRS 10, PFRS 12 and PAS 27, *Investment Entities*, provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under PFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. It is not expected that this amendment would be relevant to the Group since none of the entities in the Group would qualify to be an investment entity under PFRS 10.
- Amendments to PAS 32, *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities*, clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments affect presentation only and will have no impact on the Group's financial position and performance.
- Amendments to PAS 36, *Impairment of Assets - Recoverable Amount Disclosures for Non-Financial Assets*, remove the unintended consequences of PFRS 13 on the disclosures required under PAS 36. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which impairment loss has been recognized or reversed during the period. The amendments affect disclosures only and have no impact on the Group's financial position or performance.
- Amendments to PAS 39, *Financial Instruments: Recognition and Measurement - Novation of Derivatives and Continuation of Hedge Accounting*, provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. The amendment is not relevant to the Group as it has no derivatives designated as a hedging instrument.
- Philippine Interpretation IFRIC 21, *Levies* (IFRIC 21), clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. The Group does not expect that IFRIC 21 will have material financial impact in future financial statements.

##### **Effective in 2015**

- PAS 19, *Employee Benefits - Defined Benefit Plans: Employee Contributions* (Amendments), apply to contributions from employees or third parties to defined benefit plans. Contributions that are set out in the formal terms of the plan shall be accounted for as reductions

to current service costs if they are linked to service or as part of the remeasurements of the net defined benefit asset or liability if they are not linked to service. Contributions that are discretionary shall be accounted for as reductions of current service cost upon payment of these contributions to the plans. The amendments will have no impact on the Group's financial position and performance since the Group has no contributory defined benefit plans.

##### **Annual Improvements to PFRSs (2010-2012 cycle)**

The *Annual Improvements to PFRSs* (2010-2012 cycle) contain non-urgent but necessary amendments to the following standards:

- PFRS 2, *Share-based Payment - Definition of Vesting Condition*, revised the definitions of vesting condition and market condition and added the definitions of performance condition and service condition to clarify various issues. This amendment does not apply to the Group as it has no share-based payments.
- PFRS 3, *Business Combinations - Accounting for Contingent Consideration in a Business Combination*, clarifies that a contingent consideration that meets the definition of a financial instrument should be classified as a financial liability or as equity in accordance with PAS 32. Contingent consideration that is not classified as equity is subsequently measured at fair value through profit or loss whether or not it falls within the scope of PFRS 9 (or PAS 39, if PFRS 9 is not yet adopted). The Group shall consider this amendment for future business combinations.
- PFRS 8, *Operating Segments - Aggregation of Operating Segments and Reconciliation of the Total of the Reportable Segments' Assets to the Entity's Assets*, require entities to disclose the judgment made by management in aggregating two or more operating segments. This disclosure should include a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics. The amendments also clarify that an entity shall provide reconciliations of the total of the reportable segments' assets to the entity's assets if such amounts are regularly provided to the chief operating decision maker. The amendments affect disclosures only and have no impact on the Group's financial position or performance.
- PFRS 13, *Fair Value Measurement - Short-term Receivables and Payables*, clarifies that short-term receivables and payables with no stated interest rates can be held at invoice amounts when the effect of discounting is immaterial.
- PAS 16, *Property, Plant and Equipment - Revaluation Method - Proportionate Restatement of Accumulated Depreciation*, clarifies that, upon revaluation of an item of property, plant and equipment, the carrying amount of the asset shall be adjusted to the revalued amount, and the asset shall be treated in one of the following ways:
  - a. The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated depreciation at the date of revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account any accumulated impairment losses.
  - b. The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amendment shall apply to all revaluations recognized in annual periods beginning on or after the date of initial application of this amendment and in the immediately preceding annual period. The Group shall continue to adopt option (a) for future revaluations.
- PAS 24, *Related Party Disclosures - Key Management Personnel*, clarifies that an entity is a related party of the reporting entity if the said entity, or any member of a group for which it is a part of,



provides key management personnel services to the reporting entity or to the parent company of the reporting entity. The amendments also clarify that a reporting entity that obtains management personnel services from another entity (also referred to as management entity) is not required to disclose the compensation paid or payable by the management entity to its employees or directors. The reporting entity is required to disclose the amounts incurred for the key management personnel services provided by a separate management entity. The amendments affect disclosures only and have no impact on the Group's financial position or performance.

- **PAS 38, *Intangible Assets - Revaluation Method - Proportionate Restatement of Accumulated Amortization***, clarifies that, upon revaluation of an intangible asset, the carrying amount of the asset shall be adjusted to the revalued amount, and the asset shall be treated in one of the following ways:

a. The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. The accumulated amortization at the date of revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account any accumulated impairment losses.

b. The accumulated amortization is eliminated against the gross carrying amount of the asset.

The amendments also clarify that the amount of the adjustment of the accumulated amortization should form part of the increase or decrease in the carrying amount accounted for in accordance with the standard.

The amendments will have no impact on the Group's financial position and performance.

#### *Annual Improvements to PFRSs (2011-2013 cycle)*

The *Annual Improvements to PFRSs (2011-2013 cycle)* contain non-urgent but necessary amendments to the following standards:

- **PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards - Meaning of 'Effective PFRSs'***, clarifies that an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but that permits early application, provided either standard is applied consistently throughout the periods presented in the entity's first PFRS financial statements. This amendment is not applicable to the Group as it is not a first-time adopter of PFRS.
- **PFRS 3, *Business Combinations - Scope Exceptions for Joint Arrangements***, clarifies that PFRS 3 does not apply to the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself. The amendments will have no impact on the Group's financial position and performance.
- **PFRS 13, *Fair Value Measurement - Portfolio Exception***, clarifies that the portfolio exception in PFRS 13 can be applied to financial assets, financial liabilities and other contracts. The amendment has no significant impact on the Group's financial position or performance.
- **PAS 40, *Investment Property***, clarifies the interrelationship between PFRS 3 and PAS 40 when classifying property as investment property or owner-occupied property. The amendment stated that judgment is needed when determining whether the acquisition of investment property is the acquisition of an asset or a group of assets or a business combination within the scope of PFRS 3. This judgment is based on the guidance of PFRS 3. The amendment has no significant impact on the Group's financial position or performance.

#### *Standard with no mandatory effective date*

- **PFRS 9, *Financial Instruments***, reflects the first and third phases of the project to replace PAS 39 and applies to the classification and measurement of financial assets and liabilities and hedge accounting, respectively. Work on the second phase, which relate to impairment of financial instruments, and the limited amendments to the classification

and measurement model is still ongoing, with a view to replace PAS 39 in its entirety. PFRS 9 requires all financial assets to be measured at fair value at initial recognition. A debt financial asset may, if the fair value option (FVO) is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms 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 through profit or loss. All equity financial assets are measured at fair value either through other comprehensive income (OCI) or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For liabilities designated as at FVPL using the fair value option, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in OCI. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change relating to the entity's own credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. All other PAS 39 classification and measurement requirements for financial liabilities have been carried forward to PFRS 9, including the embedded derivative bifurcation rules and the criteria for using the FVO. The adoption of the first phase of PFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will potentially have no impact on the classification and measurement of financial liabilities.

On hedge accounting, PFRS 9 replaces the rules-based hedge accounting model of PAS 39 with a more principles-based approach. Changes include replacing the rules-based hedge effectiveness test with an objectives-based test that focuses on the economic relationship between the hedged item and the hedging instrument, and the effect of credit risk on that economic relationship; allowing risk components to be designated as the hedged item, not only for financial items, but also for non-financial items, provided that the risk component is separately identifiable and reliably measurable; and allowing the time value of an option, the forward element of a forward contract and any foreign currency basis spread to be excluded from the designation of a financial instrument as the hedging instrument and accounted for as costs of hedging. PFRS 9 also requires more extensive disclosures for hedge accounting.

PFRS 9 currently has no mandatory effective date. PFRS 9 may be applied before the completion of the limited amendments to the classification and measurement model and impairment methodology. An evaluation of the requirements was conducted to determine the impact of early adoption of PFRS 9 and the accounts affected are "Available for sale investments" and "Loans and receivables". As at December 31, 2013, the Group opted not to early adopt the standard before the completion of the limited amendments and the second phase of the project.

#### *Effectivity date to be determined*

- **Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate***, covers 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 construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11 or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the 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. The SEC and the Financial Reporting Standards Council (FRSC) have deferred the effectivity of this interpretation until the final Revenue standard is issued by the International Accounting Standards Board (IASB) and an evaluation of the requirements of the final Revenue standard against the practices of the Philippine real estate industry is completed. The adoption of this Philippine Interpretation may significantly affect the determination of the revenue from real estate sales and the corresponding costs, and the related contracts receivables, deferred income tax assets and retained earnings accounts. The adoption of this Philippine Interpretation will be accounted for retrospectively, and will result to restatement of prior period financial statements. The Group is currently assessing the impact of this amendment on its financial position or performance.

## Significant Accounting Policies

### Investments in an Associate and a Joint Venture

Investment in associate pertains to an entity over which the Group has significant influence but not control. Investment in joint venture pertains to the Group's interest in a joint venture, which is a jointly controlled entity, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The joint venture arrangement requires unanimous agreement for financial and operating decisions among the venturers. The Group recognizes its investments in associate and joint venture using equity method.

Under the equity method, the investments in associate and joint venture are carried in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the associate and joint venture. The Group's share in the associate's and joint venture's post-acquisition profits or losses is recognized in the consolidated statement of income, and its share of post-acquisition movements in the associate's and joint venture's equity reserves is recognized directly in other comprehensive income. When the Group's share of losses in the associate and joint venture equals or exceeds its interest in the associate and joint venture, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate and joint venture. Profits and losses resulting from transactions between the Group and the associate and joint venture are eliminated to the extent of the interest in the associate and joint venture.

Where necessary, adjustments are made to the financial statements of the associate and joint venture to bring the accounting policies used in line with those used by the Group.

For additional acquisitions resulting to a significant influence over an associate whose original investments were previously held at fair value through other comprehensive income, the changes in fair value previously recognized are reversed through equity reserves to bring the asset back to its original cost. The difference between the sum of consideration and the share of fair value of net assets at date the investment becomes an associate is recognized as gain or loss in the consolidated statements of income.

Upon loss of significant influence over the associate or upon loss of joint control on the jointly controlled entity, the Group measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate and joint venture upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognized either in profit or loss or other comprehensive income in the consolidated statement of comprehensive income.

### Fair Value Measurement

The Group measures certain financial instruments and nonfinancial assets at fair value at each balance sheet date. Also, fair values of financial instruments measured at amortized cost and investment properties carried at cost are disclosed in Note 33.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account

a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 - Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

External valuers are involved for valuation of significant assets, such as properties and AFS financial assets. Involvement of external valuers is decided upon annually by the respective segment management after discussion with and approval by the audit committee. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Management decides, after discussions with the Group's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents.

### Cash and Cash Equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from dates of acquisition, and that are subject to an insignificant risk of change in value.

For purposes of reporting cash flows, cash and cash equivalents include cash and other cash items (COCI), amounts due from BSP and other banks, interbank loans receivable and securities held under agreements to resell that are convertible to known amounts of cash, with original maturities of three months or less from dates of placements and that are subject to an insignificant risk of changes in fair value.

### Financial Instruments

#### Date of recognition

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on settlement date. Derivatives are recognized on trade date basis (i.e., the date that the Group commits to purchase or sell). Deposits, amounts due to banks and customers and loans are recognized when cash is received by the Group or advanced to the borrowers.

#### Initial recognition of financial instruments

All financial instruments are initially recognized at fair value. Except for financial instruments at FVPL, the initial measurement of financial instruments includes transaction costs. The Group classifies its



financial assets in the following categories: financial assets at FVPL, HTM investments, AFS investments, and loans and receivables. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date. Financial liabilities are classified into financial liabilities at FVPL and other financial liabilities at amortized cost.

As of December 31, 2013 and 2012, the Group has no HTM investments.

#### *Reclassification of financial assets*

The Group may choose to reclassify a non-derivative trading financial asset out of the held-for-trading (HFT) category if the financial asset is no longer held for purposes of selling it in the near term and only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, the Group may choose to reclassify financial assets that would meet the definition of loans and receivables out of the HFT or AFS investments categories if the Group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

The Group may also reclassify certain AFS investments to HTM investments when there is a change of intention and the Group has the ability to hold the financial instruments to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortized cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates (EIR) for financial assets reclassified to loans and receivables and HTM categories are determined at the reclassification date. Further increases in estimates of cash flows adjust the EIR prospectively.

#### *'Day 1' difference*

Where the transaction price in a non-active market is different from the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a 'Day 1' difference) in the consolidated statement of income in 'Trading and investment securities gains - net' unless it qualifies for recognition as some other type of asset. In cases where data 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 Group determines the appropriate method of recognizing the 'Day 1' difference amount.

#### *Derivatives recorded at FVPL*

The Group has subsidiaries in the banking segment that are counterparties to derivative contracts, such as currency forwards, currency swaps, interest rate swaps and warrants. These derivatives are entered into as a service to customers and as a means of reducing or managing their respective foreign exchange and interest rate exposures, as well as for trading purposes. Such derivative financial instruments are initially recorded at fair value on the date at which the derivative contract is entered into and are subsequently remeasured at fair value. Any gains or losses arising from changes in fair values of derivatives are taken directly to the consolidated statement of income and are included in 'Trading and investment securities gains - net'. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

#### *Embedded derivatives*

The Group's banking segment has certain derivatives that are embedded in host financial (such as structured notes, debt investments, and loans receivables) and non-financial (such as purchase orders and service agreements) contracts. These embedded derivatives include credit default swaps (which are linked either to a single reference entity or a basket of reference entities); conversion options in loans receivables; call options in certain long-term debt, and foreign-currency derivatives in debt instruments, purchase orders and service agreements. Embedded derivatives are bifurcated from their host contracts and

carried at fair value with fair value changes being reported through profit or loss, when the entire hybrid contracts (composed of both the host contract and the embedded derivative) are not accounted for as financial assets at FVPL, when their economic risks and characteristics are not closely related to those of their respective host contracts, and when a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative. The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group first becomes a party to the contract. Reassessment of embedded derivatives is only done when there are changes in the contract that significantly modifies the contractual cash flows.

#### *Other financial assets or financial liabilities held-for-trading*

Other financial assets or financial liabilities held for trading (classified as 'Financial assets at FVPL' or 'Financial liabilities at FVPL') are recorded in the consolidated balance sheet at fair value. Changes in fair value relating to the held-for-trading positions are recognized in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in 'Interest income' or 'Interest expense', respectively, while dividend income is recorded in 'Miscellaneous income' when the right to receive payment has been established.

Included in this classification are debt and equity securities which have been acquired principally for the purpose of selling or repurchasing in the near term.

#### *Designated financial assets or financial liabilities at FVPL*

Financial assets or financial liabilities classified in this category are designated by management on initial recognition when any of the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis; or
- The assets and 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 or investment strategy; or
- 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.

Designated financial assets and financial liabilities at FVPL are recorded in the consolidated balance sheet at fair value. Changes in fair value are recorded in 'Trading and investment securities gains - net'. Interest earned or incurred is recorded in 'Interest income' or 'Interest expense', respectively, while dividend income is recorded in 'Miscellaneous income' according to the terms of the contract, or when the right of payment has been established.

#### *Loans and receivables*

Significant accounts falling under this category are loans and receivables, amounts due from BSP and other banks, interbank loans receivable, securities held under agreements to resell, and receivable from SPV (included under 'Other noncurrent assets').

These are financial assets with fixed or determinable payments and fixed maturities and are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as financial assets at FVPL or designated as AFS investments. Loans and receivables also include receivables arising from transactions on credit cards issued directly by PNB. Furthermore, 'Loans and receivables' include the aggregate rental on finance lease transactions and notes receivables financed by Japan - PNB Leasing. Unearned income on finance lease transactions is shown as a deduction from 'Loans and receivables' (included in 'Unearned interest and other deferred income').

After initial measurement, the 'Loans and receivables', 'Due from BSP', 'Due from other banks', 'Interbank loans receivable', 'Securities held



under agreements to resell' and 'Receivable from SPV' are subsequently measured at amortized cost using the effective interest method, less allowance for credit losses. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortization is included in 'Interest income' in the consolidated statement of income. The losses arising from impairment are recognized in 'Provision for impairment and credit losses' in the consolidated statement of income.

#### *AFS investments*

AFS investments are those which are designated as such or do not qualify to be classified as "Financial assets at FVPL", "HTM investments" or "Loans and receivables". They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. They include debt and equity instruments.

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, is reported in the consolidated statement of income. The unrealized gains and losses arising from the fair valuation of AFS investments are excluded, net of tax, from reported income and are reported as 'Net unrealized gain (loss) on AFS investments' in the consolidated statement of comprehensive income.

The losses arising from impairment of AFS investments are recognized as "Provision for impairment and credit losses" in the consolidated statement of income. The impairment assessment would include an analysis of the significant or prolonged decline in fair value of the investments below its cost. The Group treats "significant" generally as 20% or more and "prolonged" as greater than 12 months for quoted equity securities.

When the security is disposed of, the cumulative gain or loss previously recognized in other comprehensive income is recognized as 'Trading and investment securities gains - net' in the consolidated statement of income. Interest earned on holding AFS debt investments are reported as 'Interest income' using the EIR. Dividends earned on holding AFS equity investments are recognized in the consolidated statement of income as 'Miscellaneous income' when the right of the payment has been established.

#### *HTM investments*

HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and would have to be reclassified as AFS investments. After initial measurement, these HTM investments are subsequently measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortization is included in "Interest income" in the consolidated statement of income. The losses arising from impairment of such investments are recognized in the consolidated statement of income under "Provision for impairment, credit and other losses".

#### *Other financial liabilities*

Issued financial instruments or their components, which are not designated at FVPL, are classified as deposit liabilities, bills and acceptances payable, accounts payable and accrued expenses, short-term and long-term debts and other appropriate financial liability accounts, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy 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. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

After initial measurement, other financial liabilities not qualified as and not designated at FVPL are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on the issue and fees that are an integral part of the EIR.

#### Derecognition of Financial Assets and Liabilities

##### *Financial asset*

A financial asset (or, where applicable a part of a financial asset or part of a group of financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risk and rewards of the asset but has transferred control over the asset.

Where the Group 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 over the asset, the asset is recognized to the extent of the Group'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 Group could be required to repay.

##### *Financial liability*

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired. Where 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.

#### Offsetting Financial Instruments

Financial instruments are offset and the net amount reported in the consolidated balance sheet 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 gross in the consolidated balance sheet.

#### Product Classification

Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party (the policyholders) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Group determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can, however, be reclassified as insurance contracts after inception if insurance risk becomes significant.

Insurance and investment contracts are further classified as being with or without discretionary participation features (DPF).

DPF is a contractual right to receive, as a supplement to guaranteed contracts, additional benefits that are likely to be a significant portion of the total contractual benefits, whose amount or timing



is contractually at the discretion of the issuer, and that are contractually based on the performance of a specified pool of contracts or a specified type of contract, realized and or unrealized investment returns on a specified pool of assets held by the issuer, or the profit or loss of the company, fund or other entity that issues the contract.

Investment contracts are those contracts that transfer significant financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign currency exchange rate, index of price or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

#### Repurchase and Reverse Repurchase Agreements

Securities sold under agreements to repurchase at a specified future date ('repos') are not derecognized from the consolidated balance sheet. The corresponding cash received, including accrued interest, is recognized in the consolidated balance sheet as a loan to the Group, reflecting the economic substance of such transaction.

Conversely, securities purchased under agreements to resell at a specified future date ('reverse repos') are not recognized in the consolidated balance sheet. The Group is not permitted to sell or repledge the securities in the absence of default by the owner of the collateral. The corresponding cash paid, including accrued interest, is recognized on the consolidated balance sheet as "Securities held under agreements to resell", and is considered a loan to the counterparty. The difference between the purchase price and resale price is treated as interest income and is accrued over the life of the agreement using the effective interest method.

#### Financial Guarantees

In the ordinary course of business, the Group gives financial guarantees consisting of letters of credit, letters of guarantees, and acceptances. Financial guarantees are initially recognized in the financial statements at fair value under 'Other liabilities'. Subsequent to initial recognition, the Group's liabilities under such guarantees are each measured at the higher of the initial fair value less, when appropriate, cumulative amortization calculated to recognize the fee in the consolidated statement of income in "Service fees and commission income", over the term of the guarantee, and the best estimate of the expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of income in "Provision for impairment and credit losses". Any financial guarantee liability remaining is recognized in the consolidated statement of income in 'Service fees and commission income', when the guarantee is discharged, cancelled or has expired.

Management, in conjunction with the Group's external valuers, also compares each change in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable.

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

#### Inventories

Inventories are valued at the lower of cost and net realizable value (NRV). Costs incurred in bringing the inventory to its present location and condition are accounted for as follows:

##### *Consumer goods inventories*

Finished goods and work in process include direct materials, direct labor, and manufacturing overhead costs. Raw materials include purchase cost. The cost of these inventories is determined using the following:

	Distilled Spirits	Beverage	Tobacco
Consumer goods:			
Finished goods	Moving-average	Weighted-average	Moving-average
Work in process	Moving-average	Weighted-average	First-in first-out
Raw materials	Moving-average	Moving-average	First-in first-out

NRV of finished goods is the estimated selling price less the estimated costs of marketing and distribution. NRV of work in process is the estimated selling price less estimated costs of completion and the estimated costs necessary to make the sale. For raw materials, NRV is current replacement cost.

##### *Materials and supplies*

Materials and supplies include purchase cost. The cost of these inventories is determined using moving-average method. NRV of materials and supplies is the estimated realizable value of the materials and supplies when disposed of at their condition at the end of the reporting period.

##### *Real estate inventories*

Property acquired or being constructed for sale in the ordinary course of business, rather than to be held for rental or capital appreciation, is held as inventory and is measured at the lower of cost and net realizable value (NRV). Cost includes: (a) land cost; (b) amounts paid to contractors for construction; (c) borrowing costs, planning and design costs, costs of site preparation, professional fees, property transfer taxes, construction overheads and other related costs.

NRV is the estimated selling price in the ordinary course of the business, based on market prices at the reporting date, less estimated costs of completion and the estimated costs of sale.

#### Other Current Assets

Prepayments are expenses paid in advance and recorded as asset before they are utilized. This account comprises mainly of prepaid importation charges and excise tax, prepaid rentals and insurance premiums and other prepaid items, and creditable withholding tax. Prepaid rentals and insurance premiums and other prepaid items are apportioned over the period covered by the payment and charged to the appropriate accounts in the consolidated statement of income when incurred.

Prepaid importation charges are applied to respective asset accounts, i.e., inventories and equipment, as part of their direct cost once importation is complete. Prepaid excise taxes are applied to inventory as part of its cost once related raw material item is consumed in the production. Creditable withholding tax is deducted from income tax payable on the same year the revenue was recognized. Prepayments that are expected to be realized for no more than 12 months after the reporting period are classified as current assets, otherwise, these are classified as other noncurrent assets.

#### Property, Plant and Equipment

Property, plant and equipment, other than land and land improvements, plant buildings and building improvements, and machineries and equipment, are stated at cost less accumulated depreciation and amortization and any impairment in value.

The initial cost of property, plant and equipment consists of its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use and any estimated cost of dismantling and removing the property, plant and equipment item and restoring the site on which it is located to the extent that the Group had recognized the obligation of that cost. Such cost includes the cost of replacing part of the property, plant and equipment if the recognition criteria are met. When significant parts of property, plant and equipment are required to be replaced in intervals, the Group recognizes such parts as individual assets with specific useful lives and depreciation, respectively. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of property, plant and equipment as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are expensed in the consolidated statement of income as incurred. Borrowing costs incurred during the construction of a qualifying asset is likewise included in the initial cost of property, plant and equipment.

Land and land improvements, plant buildings and building improvements, and machineries and equipment are stated at revalued amounts based on a valuation performed by professionally qualified, independent appraisers. Revaluation is made every three to five years such that the carrying amount does not differ materially from that which would be determined using fair value at the end of reporting period. For subsequent revaluations, the accumulated depreciation at the date of revaluation is restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals the revalued amount. Any resulting increase in the asset's carrying amount as a result of the revaluation is credited directly to "Revaluation increment on property, plant and equipment, net of related deferred income tax effect" (presented as part of "Other comprehensive income" in the equity section of the consolidated balance sheet). Any resulting decrease is directly charged against any related revaluation increment to the extent that the decrease does not exceed the amount of the revaluation increment in respect of the same asset. Further, the revaluation increment of depreciable property, plant and equipment is transferred to retained earnings as the asset is used by the Group. The amount of the revaluation increment transferred would be the difference between the depreciation and amortization based on the revalued carrying amount of the asset and depreciation and amortization based on the asset's original cost. In case the asset is retired or disposed of, the related remaining revaluation increment is transferred directly to retained earnings. Transfers from revaluation increment to retained earnings are not made through profit or loss.

As discussed in Note 1, certain assets and liabilities of FTC were transferred by the Group as capital contribution to PMFTC. Such properties transferred include revaluation increment on depreciable property, plant and equipment amounting to P4.6 billion. Thus, the carrying value of the net assets transferred to PMFTC, including the revaluation increment, plus the fair value adjustment at the date of transfer, was deemed as the historical cost of such assets for PMFTC.

Upon transfer in 2010, the Group realized through retained earnings portion of its share in the net appraisal increase from the previous revaluation of FTC's property, plant and equipment amounting to P1.9 billion and transferred the unrealized portion amounting to P1.9 billion to "Revaluation increment on property, plant and equipment transferred to an associate", net of related deferred income tax effect, in the consolidated balance sheet and consolidated statement of changes in equity. An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets' original cost.

Construction in progress consists of properties in the course of construction for production or administrative purposes, which are carried at cost less any recognized impairment loss. This includes cost of construction and equipment, and other direct costs. Construction in progress is not depreciated until such time that the relevant assets are completed and put into operational use.

Containers (i.e., returnable bottles and crates) are stated at cost less accumulated depreciation and any impairment in value. Cost of manufactured containers comprises materials used and applicable allocation of fixed and variable labor and overhead cost. Amortization of returnable containers is included under "Selling expenses" account in the consolidated statement of income.

Deposit value for the containers loaned to customer is included as part of "Trade accounts payable" under "Accounts payable and accrued expenses" account in the consolidated balance sheet.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

Depreciation and amortization are computed using the straight-line

method over the following estimated useful lives of the assets:

	Number of Years
At Appraisal Values:	
Land improvements	5 - 15
Plant buildings and building improvements	8 - 50
Machineries and equipment	5 - 30
At Cost:	
Office and administration buildings	20 - 40
Leasehold improvements	3 - 30
Transportation equipment	2 - 5
Returnable containers	5 - 7
Furniture, fixtures and other equipment	3 - 20

Leasehold improvements are amortized on a straight-line basis over the terms of the leases or the estimated useful lives, whichever is shorter.

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

Depreciation or amortization of an item of property, plant and equipment begins when it becomes available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation or amortization ceases at the earlier of the date that the item is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operation*, and the date the item is derecognized.

When assets are sold or retired, their cost and accumulated depreciation and amortization and any impairment in value are removed from the accounts, and any gain or loss resulting from their disposal is recognized in the consolidated statement of income.

Fully depreciated property and equipment are retained in the accounts until they are no longer in use and no further depreciation and amortization is charged to current operations.

#### Investment Properties

Investment properties are initially measured at cost, including certain transaction costs. Investment properties acquired through a nonmonetary asset exchange is measured initially at fair value unless the exchange lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. Any gain or loss on the exchange is recognized in 'Gain on acquisition of investment properties' and presented in the consolidated statement of income. Foreclosed properties are classified under 'Investment properties' upon:

- entry of judgment in case of judicial foreclosure;
- execution of the Sheriff's Certificate of Sale in case of extra-judicial foreclosure; or
- notarization of the Deed of Dacion in case of payment in kind (dacion en pago).

Expenditures incurred after the investment properties have been put into operations, such as repairs and maintenance costs, are normally charged against current operations in the period in which the costs are incurred.

Subsequent to initial recognition, depreciable investment properties are stated at cost less accumulated depreciation and any accumulated impairment in value.

Depreciation is calculated on a straight-line basis using the estimated useful life from the time of acquisition of the investment properties.

The estimated useful life of the depreciable investment properties which generally include building and improvements ranges from 5 to 50 years.



Investment properties are derecognized when they have either been disposed of or when the investment properties are permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognized in the consolidated statement of income in "Others - net" in the year of retirement or disposal.

Transfers are made to investment property only when there is a change in use evidenced by cessation of owner-occupation or of construction or development, or commencement of an operating lease to another party. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale.

#### Other Properties Acquired

Other properties acquired include chattel mortgage properties acquired in settlement of loan receivables. These are carried at cost, which is the fair value at recognition date, less accumulated depreciation and any impairment in value.

The Group applies the cost model in accounting for other properties acquired. Depreciation is computed on a straight-line basis over the estimated useful life of five years. The estimated useful life and the depreciation method are reviewed periodically to ensure that the period and the method of depreciation are consistent with the expected pattern of economic benefits from items of other properties acquired.

The carrying values of other properties acquired are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amounts.

#### Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its 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 losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is reflected in the consolidated statement of income in the year in which the expenditure is incurred.

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 assets may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at the end of the reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statement of income in the expense category consistent with the function of the intangible asset.

#### Software costs

Software costs, included in "Other noncurrent assets", are capitalized on the basis of the cost incurred to acquire and bring to use the specific software. These costs are amortized over five years on a straight-line basis.

Costs associated with maintaining the computer software programs are recognized as expense when incurred.

#### Impairment of Noncurrent Nonfinancial Assets

*Property, plant and equipment, investment properties, investments in an associate and a joint venture, and software costs*

At each reporting date, the Group assesses whether there is any indication that its nonfinancial assets may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the Group makes a formal estimate of recoverable

amount. Recoverable amount is the higher of an asset's (or cash-generating units') 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, in which case the recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount. 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 (or cash-generating unit).

An impairment loss is charged to operations or to the revaluation increment for assets carried at revalued amount, in the year in which it arises.

An assessment is 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 recoverable amount is estimated. 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 accumulated depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation or amortization expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

#### Goodwill

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (or group of cash-generating units) to which goodwill has been allocated (or to the aggregate carrying amount of a group of cash-generating units to which the goodwill relates but cannot be allocated), an impairment loss is recognized immediately in the consolidated statement of income. Impairment losses relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods. The Group performs its annual impairment test of goodwill at the end of the reporting period.

#### Customers' Deposits including Excess of Collections over Recognized Receivables

Customers' deposits represent payments from buyers of property development segment which will be applied against the related contracts receivables. This account also includes the excess of collections over the recognized contracts receivables, which is based on the revenue recognition policy of the Group.

#### Security Deposits

Security deposits, included in the "Other current liabilities" and "Other noncurrent liabilities" accounts in the liabilities section of the consolidated balance sheet, are measured initially at fair value and are subsequently measured at amortized cost using the effective interest method.

The difference between the cash received and its fair value is deferred, included in the "Other noncurrent liabilities" account in the consolidated balance sheet, and amortized using the straight-line method under the "Rental income" account in the consolidated statement of income.



### Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The Group assesses its revenue arrangement against specific criteria in order to determine if it is acting as principal or agent. The Group has concluded that it is acting as principal in all its revenue arrangements except for their brokerage transactions. The following specific recognition criteria must also be met before revenue is recognized:

#### *Sale of goods*

Revenue from the sale of goods is recognized when goods are delivered to and accepted by customers. Revenue is measured at fair value of the consideration received or receivable, excluding discounts, returns and value-added tax (VAT).

#### *Real estate sales*

The percentage-of-completion method is used to recognize income from sales of projects where the Group has material obligations under the sales contract to complete the project after the property is sold, the equitable interest has been transferred to the buyer, construction is beyond preliminary stage (i.e., engineering, design work, construction contracts execution, site clearance and preparation, excavation and the building foundation are finished), and the costs incurred or to be incurred can be measured reliably. Under this method, revenue is recognized as the related obligations are fulfilled, measured principally on the basis of the estimated completion of a physical proportion of the contract work.

When a sale of real estate does not meet the requirements for income recognition, the sale is accounted for under the deposit method. Under this method, revenue is not recognized and the receivable from the buyer is not recorded. The real estate inventory continues to be reported in the Group's consolidated balance sheet as part of real estate inventories and the deposit as part of liabilities as "Customers' deposits".

#### *Rental income*

Rental income under noncancellable and cancellable leases on investment properties is recognized in the consolidated statement of income on a straight-line basis over the lease term, or based on a certain percentage of the gross revenue of the tenants, as provided under the terms of the lease contract.

#### *Charges and expenses recoverable from tenants*

Income arising from expenses recharged to tenants in Other income account is recognized in the period in which the compensation becomes receivable.

#### *Interest income*

For all financial instruments measured at amortized cost and interest-bearing financial instruments classified as HFT and AFS investments, interest income is recorded at the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options), includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. The adjusted carrying amount is calculated based on the original EIR. The change in carrying amount is recorded as interest income. Once the recorded value of a financial asset or group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original EIR applied to the new carrying amount.

#### *Service fees and commission income*

The Group earns fee and commission income from diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- *Fee income earned from services that are provided over a certain period of time*  
Fees earned for the provision of services over a period of time are

accrued over that period. These fees include investment fund fees, custodian fees, fiduciary fees, commission income, credit-related fees, trust fees, portfolio and other management fees, and advisory fees. However, loan commitment fees for loans that are likely to be drawn down are deferred (together with any incremental costs) and recognized as an adjustment to the EIR of the loan.

- *Fee income from providing transaction services*

Fees arising from negotiating or participating in the negotiation of a transaction for a third party - such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses - are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria. These fees include underwriting fees, corporate finance fees, remittance fees, brokerage fees, deposit-related and other credit-related fees. Loan syndication fees are recognized in the statement of income when the syndication has been completed and the Group retains no part of the loans for itself or retains part at the same EIR as for the other participants.

#### *Interchange fee and awards revenue on credit cards*

Discounts lodged under 'interchange fees' are taken up as income upon receipt from member establishments of charges arising from credit availments by the Group's cardholders. These discounts are computed based on certain agreed rates and are deducted from amounts remitted to the member establishments.

The Group operates a loyalty points program which allows customers to accumulate points when they purchase from member establishments using the issued card of the Group. The points can then be redeemed for free products subject to a minimum number of points being obtained. Consideration received is allocated between the discounts earned, interchange fee and the points earned, with the consideration allocated to the points equal to its fair value. The fair value is determined by applying statistical analysis. The fair value of the points issued is deferred and recognized as revenue when the points are redeemed.

#### *Commissions earned on credit cards*

Commissions earned are taken up as income upon receipt from member establishments of charges arising from credit availments by credit cardholders. These commissions are computed based on certain agreed rates and are deducted from amounts remittable to member establishments.

Purchases by the credit cardholders, collectible on installment basis, are recorded at the cost of the items purchased plus certain percentage of cost. The excess over cost is credited to "Unearned and other deferred income" account and is shown as a deduction from "Loans and receivables" in the consolidated balance sheet. The unearned and other deferred income is taken up to income over the installment terms and is computed using the effective interest method.

#### *Commission earned on reinsurance*

Reinsurance commissions are recognized as revenue over the period of the contracts. The portion of the commissions that relates to the unexpired periods of the policies at the end of the reporting period is accounted for as 'Other liabilities' in the consolidated balance sheet.

#### *Dividend income*

Dividend income is recognized when the Group's right to receive payment is established.

#### *Trading and investment securities gains - net*

Trading and investment securities gains - net includes results arising from trading activities and all gains and losses from changes in fair value of financial assets and financial liabilities at FVPL and gains and losses from disposal of AFS investments.

#### *Income on direct financing leases and receivables financed*

Income of the Group on loans and receivables financed is recognized using the effective interest method.



Unearned discounts included under “Unearned and other deferred income” which are amortized over the term of the note or lease using the effective interest method consist of:

- Transaction and finance fees on finance leases and loans and receivables financed with long-term maturities; and
- Excess of the aggregate lease rentals plus the estimated residual value of the leased equipment over its cost.

#### *Premiums revenue*

Gross insurance written premiums comprise the total premiums receivable for the whole period cover provided by contracts entered into during the accounting period. Premiums include any adjustments arising in the accounting period for premiums receivable in respect of business written in prior periods. Premiums from short-duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method except for the marine cargo where the provision for unearned premiums pertains to the premiums for the last two months of the year. The portion of the premiums written that relate to the unexpired periods of the policies at end of reporting period are accounted for as provision for unearned premiums and presented as part of “Other liabilities” in the consolidated balance sheet. The related reinsurance premiums ceded that pertain to the unexpired periods at the end of the reporting periods are accounted for as deferred reinsurance premiums shown as part of “Other noncurrent assets” in the consolidated balance sheet. The net changes in these accounts between end of the reporting periods are credited to or charged against the consolidated statement of income for the year.

#### *Other income*

Income from sale of services is recognized upon rendition of the service. Income from sale of properties is recognized upon completion of the earning process and the collectibility of the sales price is reasonably assured.

#### Costs and Expenses

Costs and expenses are recognized in the consolidated statement of income when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

#### *Cost of sales and services*

Cost of sales and services is recognized as expense where the related goods are sold and the service is rendered.

Cost of real estate sales is recognized consistent with the revenue recognition method applied. Cost of subdivision land and condominium units sold before the completion of the development is determined on the basis of the acquisition cost of the land plus its full development costs, which include estimated costs for future development works, as determined by the Group’s in-house technical staff.

The cost of inventory recognized in profit or loss on disposal is determined with reference to the specific costs incurred on the property, allocated to saleable area based on relative size and takes into account the percentage of completion used for revenue recognition purposes.

#### *Selling and general and administrative expenses*

Selling expenses are costs incurred to sell or distribute merchandise, it includes advertising and promotions and freight and handling, among others. General and administrative expenses constitute costs of administering the business. Selling and general and administrative expenses are expensed as incurred.

#### *Taxes and licenses*

Taxes and licenses include all other taxes, local and national, including gross receipts taxes (GRT), documentary stamp taxes, real estate taxes, licenses and permit fees and are recognized as costs and expenses when incurred.

#### Impairment of Financial Assets

The Group assesses at each reporting date whether there is objective evidence that 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 (or events) 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 borrower or a group of borrowers 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 measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

#### *Financial assets at amortized cost*

For financial assets carried at amortized costs such as loans and receivables, HTM investments, due from BSP and other banks, interbank loans receivable, securities held under agreements to resell and receivable from SPV, the Group 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 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 the estimated future cash flows (excluding future credit losses that have not been incurred). The present value of the estimated future cash flows is discounted at the financial asset’s original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR, adjusted for the original credit risk premium. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If the Group determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors’ ability to pay all amounts due according to the contractual terms of the assets being evaluated. 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 for impairment.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of such credit risk characteristics as industry, collateral type, past-due status and term. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with changes in related observable data from period to period (such changes in property prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

The carrying amount of the asset is reduced through use of an allowance account and the amount of loss is charged to the consolidated statement of income. Interest income continues to be recognized based on the original EIR of the asset. Loans and receivables, together with the associated allowance accounts, are written off when

there is no realistic prospect of future recovery and all collateral has been realized. If subsequently, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amounts formerly charged are credited to the "Provision for impairment and credit losses" account.

#### *Restructured loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews restructured loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR. The difference between the recorded value of the original loan and the present value of the restructured cash flows, discounted at the original EIR, is recognized in "Provision for impairment and credit losses" in the consolidated statement of income.

#### *AFS investments*

For AFS investments, the Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. In case of equity investments classified as AFS investments, this would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income - is removed from equity and recognized in the consolidated statement of income. Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in fair value after impairment are recognized directly in OCI.

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. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of 'Interest income' in the consolidated statement of income. If subsequently, the fair value of a debt instrument increased 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.

#### Policy Loans

Policy loans included under loans and receivables are carried at their unpaid balances plus accrued interest and are fully secured by the policy values on which the loans are made.

#### Reinsurance

The Group cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Recoverable amounts are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contract.

An impairment review is performed at each end of the reporting period or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when objective evidence exists that the Group may not recover outstanding amounts under the terms of the contract and when the impact on the amounts that the Group will receive from the reinsurer can be measured reliably. The impairment loss is charged against the consolidated statement of income.

Ceded reinsurance arrangements do not relieve the Group from its obligations to policyholders.

The Group also assumes reinsurance risk in the normal course of business for insurance contracts. Premiums and claims on assumed reinsurance are recognized as income and expenses in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. Reinsurance liabilities represent balances due to ceding companies. Amounts payable are estimated in a manner consistent with the associated reinsurance contract.

Premiums and claims are presented on a gross basis for both ceded and assumed reinsurance.

Reinsurance assets or liabilities are derecognized when the contractual rights are extinguished or expired or when the contract is transferred to another party.

#### Deferred Acquisition Cost (DAC)

Commission and other acquisition costs incurred during the financial period that vary with and are related to securing new insurance contracts and/or renewing existing insurance contracts, but which relates to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. All other acquisition costs are recognized as an expense when incurred.

Subsequent to initial recognition, these costs are amortized using the 24th method except for marine cargo where the DAC pertains to the commissions for the last two months of the year. Amortization is charged to the consolidated statement of income. The unamortized acquisition costs are shown as "Deferred acquisition costs" in the assets section of the consolidated balance sheet.

An impairment review is performed at each end of the reporting period or more frequently when an indication of impairment arises. The carrying value is written down to the recoverable amount and the impairment loss is charged to the consolidated statement of income. The DAC is also considered in the liability adequacy test for each reporting period.

#### Commissions

Commissions paid to sales or marketing agents on the sale of pre-completed real estate units are initially deferred and recorded as prepaid commissions when recovery is reasonably expected and charged to expense in the period in which the related revenue is recognized as earned. Accordingly, when the percentage of completion method is used, commissions are recognized in the consolidated statement of income in the period the related revenue is recognized.

#### Retirement Benefits

The net defined benefit liability or asset is the aggregate of the present value of the defined benefit obligation at the end of the reporting period reduced by the fair value of plan assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method.

Defined benefit costs comprise the following:

- Service cost
- Net interest on the net defined benefit liability or asset
- Re-measurements of net defined benefit liability or asset

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in profit or loss. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

Net interest on the net defined benefit liability or asset is the change during the period in the net defined benefit liability or asset that arises from the passage of time which is determined by applying the discount rate based on government bonds to the net defined benefit liability or asset. Net interest on the net defined benefit liability or asset is recognized as expense or income in profit or loss.



Re-measurements comprising actuarial gains and losses, return on plan assets and any change in the effect of the asset ceiling (excluding net interest on defined benefit liability) are recognized immediately in other comprehensive income in the period in which they arise. Re-measurements are not reclassified to profit or loss in subsequent periods.

Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the creditors of the Group, nor can they be paid directly to the Group. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations).

The Group's right to be reimbursed of some or all of the expenditure required to settle a defined benefit obligation is recognized as a separate asset at fair value when and only when reimbursement is virtually certain.

#### *Employee leave entitlement*

Employee entitlements to annual leave are recognized as a liability when they are accrued to the employees. The undiscounted liability for leave expected to be settled wholly before twelve months after the end of the annual reporting period is recognized for services rendered by employees up to the end of the reporting period.

#### Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalization of borrowing costs commences when the activities necessary to prepare the asset for intended use are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the asset is available for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as exchange differences arising from foreign currency borrowings used to finance these projects, to the extent that they are regarded as an adjustment to interest costs. All other borrowing costs are expensed as incurred.

#### Debt Issue Costs

Issuance, underwriting and other related expenses incurred in connection with the issuance of debt instruments (other than debt instruments designated at FVPL) are deferred and amortized over the terms of the instruments using the effective interest method. Unamortized debt issuance costs are included in the measurement of the related carrying value of the debt instruments in the consolidated balance sheet.

#### Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- there is a change in contractual terms, other than a renewal or extension of the arrangement;
- a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
- there is a change in the determination of whether fulfillment is dependent on a specified asset; or
- there is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) above, and at the date of renewal or extension period for scenario (b).

#### *The Group as lessor*

Finance leases, where the Group transfers substantially all the risks and benefits incidental to ownership of the leased item to the lessee, are included in the consolidated statement of financial position under 'Loans and receivables' account. A lease receivable is recognized at an amount equivalent to the net investment (asset cost) in the lease. All income resulting from the receivable is included in 'Interest income' in the consolidated statement of income.

Leases where the Group does not transfer substantially all the risks and benefits of the ownership of the asset are classified as operating leases. Fixed lease payments for noncancellable lease are recognized in consolidated statement of income on a straight-line basis over the lease term. Any difference between the calculated rental income and amount actually received or to be received is recognized as deferred rent in the consolidated balance sheet. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the rental income. Variable rent is recognized as income based on the terms of the lease contract.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognized under "Other income" account in the consolidated statement of income.

#### *The Group as lessee*

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments and included in "Property and equipment" account with the corresponding liability to the lessor included in "Other liabilities" account. 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. Finance charges are charged directly to 'Interest expense'.

Capitalized leased assets are depreciated over the shorter of the estimated useful lives of the assets or the respective lease terms, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Fixed lease payments for noncancellable lease are recognized as an expense in the consolidated statement of income on a straight-line basis over the lease term while the variable rent is recognized as an expense based on terms of the lease contract.

#### Residual Value of Leased Assets and Deposits on Finance Leases

The residual value of leased assets, which approximates the amount of guaranty deposit paid by the lessee at the inception of the lease, is the estimated proceeds from the sale of the leased asset at the end of the lease term. At the end of the lease term, the residual value of the leased asset is generally applied against the guaranty deposit of the lessee when the lessee decides to buy the leased asset.

#### Life Insurance Contract Liabilities

##### *Life insurance liabilities*

Life insurance liabilities refer to liabilities of the company that are recognized due to the obligations arising from policy contracts issued by PNB LII. The reserves for life insurance contracts are calculated based on prudent statutory assumptions in accordance with generally accepted actuarial methods that are compliant with existing regulations.

##### *Insurance contracts with fixed and guaranteed terms*

The liability is determined as the expected discounted value of the benefit payments less the expected discounted value of the theoretical premiums that would be required to meet the benefits based on the valuation assumptions used. The liability is based on mortality, morbidity and investment income assumptions that are established at the time the contract is issued.



For unpaid claims and benefits, a provision is made for the estimated cost of all claims and dividends notified but not settled at the reporting date less reinsurance recoveries, using the information available at the time.

Provision is also made for the cost of claims incurred but not reported until after the reporting date based on the PNB LLI's experience and historical data. Differences between the provision for outstanding claims at the reporting date and subsequent revisions and settlements are included in the consolidated statement of income in later years. Policy and contract claims payable forms part of the liability section of the consolidated balance sheet under "Other liabilities - Insurance contract liabilities".

Aggregate reserve for life policies represents the accumulated total liability for policies in force on the statement of financial position date. Such reserves are established at amounts adequate to meet the estimated future obligations of all life insurance policies in force. The reserves are calculated using actuarial methods and assumptions in accordance with statutory requirements and as approved by the Insurance Commission (IC), subject to the minimum liability adequacy test.

#### *Unit-linked insurance contracts*

PNB LLI issues unit-linked insurance contracts. Considerations received from unit-linked insurance contracts, in excess of the portion that is placed under a withdrawable segregated account, are recognized as revenue.

PNB LLI's revenue from unit-linked contracts consists of charges deducted from the policyholder's separate account, in accordance with the unit-linked policy contract. Since the segregated fund assets belong to the unit-linked policyholders, corresponding segregated fund liabilities are set-up equal to the segregated fund assets less redemptions outside the segregated funds. The segregated fund assets are valued at market price. Changes in the segregated fund assets due to investment earnings or market value fluctuations result in the same corresponding change in the segregated fund liabilities. Such changes in fund value have no effect in the consolidated statement of income. Collections received from unit-linked policies are separated to segregated fund assets from which PNB LLI withdraws administrative and cost of insurance charges in accordance with the policy provisions of the unit-linked insurance contracts. After deduction of these charges, the remaining amounts in the segregated fund assets are equal to the surrender value of the unit-linked policyholders, and are withdrawable anytime.

The equity of each unit-linked policyholder in the fund is monitored through the designation of outstanding units for each policy. Hence, the equity of each unit-linked insurance contract in the fund is equal to the total number of outstanding units of the policyholder multiplied by the net asset value per unit (NAVPU). The NAVPU is the market value of the fund divided by the total number of outstanding units.

#### Nonlife Insurance Contract Liabilities

##### *Provision for unearned premiums*

The proportion of written premiums, gross of commissions payable to intermediaries, attributable to subsequent periods or to risks that have not yet expired is deferred as provision for unearned premiums. Premiums from short-duration insurance contracts are recognized as revenue over the period of the contracts using the 24th method except for marine cargo where the provision for unearned premiums pertains to the premiums for the last two months of the year. The portion of the premiums written that relate to the unexpired periods of the policies at the end of reporting period are accounted for as provision for unearned premiums and presented as part of "Insurance contract liabilities" in the liabilities section of the consolidated balance sheet. The change in the provision for unearned premiums is taken to the consolidated statement of income in the order that revenue is recognized over the period of risk. Further provisions are made to cover claims under unexpired insurance contracts which may exceed the unearned premiums and the premiums due in respect of these contracts.

##### *Claims provision and incurred but not reported losses*

Outstanding claims provisions are based on the estimated ultimate cost

to all claims incurred but not settled at the end of the reporting period, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims, therefore the ultimate cost of which cannot be known with certainty at the end of the reporting period. The liability is not discounted for the time value of money and includes provision for IBNR. No provision for equalization or catastrophic reserves is recognized. The liability is derecognized when the contract has expired, discharged or cancelled.

#### Liability Adequacy Test

Liability adequacy tests on life insurance contracts are performed annually to ensure the adequacy of the insurance contract liabilities. In performing these tests, current best estimates of future contractual cash flows, claims handling and policy administration expenses are used. Any deficiency is immediately charged against profit or loss initially by establishing a provision for losses arising from the liability adequacy tests.

For nonlife insurance contracts, liability adequacy tests are performed at the end of each reporting date to ensure the adequacy of insurance contract liabilities, net of related DAC assets. The provision for unearned premiums is increased to the extent that the future claims and expenses in respect of current insurance contracts exceed future premiums plus the current provision for unearned premiums.

#### Reserve for Policyholders' Dividends

A number of insurance contracts are participating and contain a DPF. This feature entitles the policy holder to receive, as a supplement to guaranteed benefits, annual policy dividends that are credited at each policy anniversary, as long as the policy is in force. These annual policy dividends represent a portion of the theoretical investment and underwriting gains from the pool of contracts. Policy dividends are not guaranteed and may change based on the periodic experience review of the Group. Further, in accordance with regulatory requirements, dividends payable in the following year are prudently set-up as a liability in the consolidated balance sheet.

Local statutory regulations and the terms and conditions of these contracts set out the bases for the determination of the annual cash dividends at the time the product is priced. The Group may exercise its discretion to revise the dividend scale in consideration of the emerging actual experience on each block of participating policies. Reserve for dividends to policyholders on contracts with DPF is shown in the consolidated balance sheet under "Other noncurrent liabilities".

#### Foreign Currency-denominated Transaction and Translation

The Group's consolidated financial statements are presented in Philippine peso, which is also LTG's functional currency. Each of the subsidiaries determines its own functional currency and items included in the consolidated financial statements of each entity are measured using that functional currency.

Transactions in foreign currencies are initially recorded by the individual entities in the Group in their respective functional currencies at the foreign exchange rates prevailing at the dates of the transactions. Outstanding monetary assets and liabilities denominated in foreign currencies are translated using the closing foreign exchange rate prevailing at the reporting date. All differences are charged to profit or loss in the consolidated statement of income.

Nonmonetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the dates of initial transactions. Nonmonetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

#### FCDU and Overseas Subsidiaries

As of reporting date, the assets and liabilities of foreign subsidiaries, with functional currencies other than the functional currency of the Company, are translated into the presentation currency of the Group using the closing foreign exchange rate prevailing at the reporting date, and their respective income and expenses are translated at the monthly weighted



average exchange rates for the year. The exchange differences arising on the translation are recognized in other comprehensive income. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation shall be recognized in profit or loss.

#### 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 taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of reporting period.

##### *Deferred income tax*

Deferred income tax is recognized on all temporary differences at the end of reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits from excess of minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that sufficient future taxable profits will be available against which the deductible temporary differences, carryforward benefits of unused tax credits from excess of MCIT over RCIT and unused NOLCO can be utilized. Deferred income tax liabilities are recognized for all taxable temporary differences.

Deferred income tax, however, is not recognized when it 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 or loss nor taxable profit or loss.

Deferred income tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries, associates and interest in joint ventures. With respect to investments in other subsidiaries, associates and interests in joint ventures, 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 income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient future taxable profits will be available to allow all or part of the deferred income tax assets to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting period and are recognized to the extent that it has become probable that sufficient future taxable profits will allow the deferred income tax assets to be recovered. It is probable that sufficient future taxable profits will be available against which a deductible temporary difference can be utilized when there are sufficient taxable temporary difference relating to the same taxation authority and the same taxable entity which are expected to reverse in the same period as the expected reversal of the deductible temporary difference. In such circumstances, the deferred income tax asset is recognized in the period in which the deductible temporary difference arises.

Deferred taxes relating to items recognized directly in OCI are also recognized in OCI and not in the consolidated statement of income.

Deferred income tax assets and deferred income tax 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 end of reporting period.

In the consolidated financial statements, deferred income tax assets and deferred income tax liabilities are offset if a legally enforceable right exists to set-off the current income tax asset against the current income tax liabilities and deferred income taxes relate to the same taxable entity and the same taxation authority.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss. Deferred tax items are recognized in correlation to the underlying transaction either in other comprehensive income or directly in equity.

#### Provisions and Contingencies

Provisions are recognized when the Group 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. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, 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 interest expense. When the Group expects a provision or loss to be reimbursed, the reimbursement is recognized as a separate asset only when the reimbursement is virtually certain and its amount is estimable. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement.

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the consolidated financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the consolidated financial statements.

#### Fiduciary Activities

Assets and income arising from fiduciary activities together with related undertakings to return such assets to customers are excluded from the financial statements where the Group acts in a fiduciary capacity such as nominee, trustee or agent.

#### Equity

*Capital stock* is measured at par value for all shares issued by the Company. When the Company issue more than one class of stock, a separate account is maintained for each class of stock and the number of shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax.

*Capital in excess of par* is the portion of the paid-in capital representing excess over the par or stated value.

*Treasury shares* are owned equity instruments that are reacquired. Where any member of the Group purchases the Company's capital stock (presented as "Shares held by a subsidiary"), the consideration paid, including any directly attributable incremental costs (net of related taxes), is deducted from equity until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transactions costs and the related income tax effect, is included in equity attributable to the equity holders of the Company.

*Deposits for future stock subscription* are cash received from a stockholder for subscription of shares out of the Company's increase in authorized capital stock with pending approval from the Philippine SEC as of the end of the reporting period. These deposits are to be settled only by issuance of a fixed number of equity shares.

*Preferred shares of subsidiaries issued to Parent Company* are owned equity instruments by the Bank Holding Companies that are issued to Tangent (see Note 30).

*Retained earnings* represent the cumulative balance of net income or loss, dividend distributions, prior period adjustments, effects of the changes in accounting policies and other capital adjustments. Unappropriated retained earnings represent that portion which can be declared as dividends to stockholders after adjustments for any unrealized items which are considered not available for dividend declaration. Appropriated retained earnings represent that portion which has been restricted and therefore is not available for any dividend declaration.

*Other comprehensive income (loss)* comprises items of income and expense (including items previously presented under the consolidated statement of changes in equity) that are not recognized in the consolidated statement of income for the year in accordance with PFRS. Other comprehensive income (loss) of the Group includes cumulative translation adjustments, net changes in fair values of AFS investments, re-measurement gains (losses) on defined benefit plans, revaluation increment in property, plant and equipment and share in other comprehensive income of an associate.

*Other equity reserves* include effect of transactions with non-controlling interest and equity adjustments arising from business combination under common control and other group restructuring transactions.

#### Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income for the period attributable to common shareholders by the weighted average number of common shares outstanding during the period after giving retroactive effect to stock dividends declared and stock rights exercised during the period, if any.

Diluted EPS is calculated by dividing the aggregate of net income attributable to common shareholders by the weighted average number of common shares outstanding during the period adjusted for the effects of any dilutive shares.

#### Dividends on Common Shares

Cash dividends on common shares are recognized as a liability and deducted from equity when approved by the BOD of the Company. Stock dividends are treated as transfers from retained earnings to capital stock. Dividends for the year that are approved after the end of reporting period are dealt with as a non-adjusting event after the end of reporting period.

#### Events after the Reporting Period

Events after the end of reporting period that provides additional information about the Group's position at the end of reporting period (adjusting event) are reflected in the consolidated financial statements. Events after the end of reporting period that are not adjusting events, if any, are disclosed when material to the consolidated financial statements.

#### Segment Reporting

The Group's operating segments are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets. Financial information on operating segments is presented in Note 4 to the consolidated financial statements.

### **3. Management's Use of Significant Judgments, Accounting Estimates and Assumptions**

The preparation of the consolidated financial statements requires the Group to exercise judgments, make accounting estimates and use assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the accounting estimates to change. The effects of any change in accounting estimates are reflected in the consolidated financial statements as they become reasonably determinable.

Accounting estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

#### Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effects on amounts recognized in the consolidated financial statements:

#### *Determination of functional currency*

Judgment is exercised in assessing various factors in determining the functional currency of each entity within the Group, including prices of goods and services, competition, cost and expenses and other factors including the currency in which financing is primarily undertaken by each entity.

Additional factors are considered in determining the functional currency of a foreign operation, including whether its activities are carried as an extension of that of a parent company rather than being carried out with significant autonomy.

Each entity within the Group, based on the relevant economic substance of the underlying circumstances, have determined their functional currency to be Philippine peso. It is the currency of the primary economic environment in which the entities in the Group operate.

#### *Classification of financial instruments*

The Group exercises judgment in classifying financial instruments in accordance with PAS 39. The Group classifies a financial instrument, or its components, on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial asset, a financial liability or an equity instrument. The substance of a financial instrument, rather than its legal form, governs its classification in the Group's consolidated balance sheets.

The Group's Bank Holding Companies have redeemable preferred shares which can be redeemed at the option of the Bank Holding companies after seven years from the date of issuance. The Group classified these redeemable preferred shares amounting to P7.4 billion as equity as of December 31, 2013 (see Note 30).

#### *Revenue recognition on real estate sales*

Selecting an appropriate revenue recognition method for a particular real estate sale transaction requires certain judgments based on, among others, the buyer's commitment on the sale which may be ascertained through the significance of the buyer's initial investment and stage of completion of the project. Based on the judgment of the Group, the percentage-of-completion method is appropriate in recognizing revenue on real estate sale transactions in 2013, 2012 and 2011.

#### *Operating lease commitments - the Group as lessor*

The Group has entered into commercial property leases on its investment properties and certain motor vehicles and items of machinery.

The Group has determined, based on an evaluation of the terms and conditions of the lease agreements (i.e., the lease does not transfer ownership of the asset to the lessee by the end of the lease term, the lessee has no option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option is exercisable and the lease term is not for the major part of the asset's economic life), that it retains all the significant risks and rewards of ownership of these properties and so accounts for these leases as operating leases (see Note 35).

#### *Operating lease commitments - the Group as lessee*

Currently, the Group has land lease agreements with several non-related and related parties. Based on an evaluation of the terms and conditions of the arrangements, management assessed that there is no transfer of ownership of the properties by the end of the lease term and the lease term is not a major part of the economic life of the properties. Thus, the Group does not acquire all the significant risks and rewards of ownership of these properties, thus, accounts for the lease agreements as operating leases (see Note 35).



#### *Finance lease commitments - the Group as a lessee*

The Group has also entered into a finance lease agreement covering real estate, certain transportation equipment and various machineries and other types of equipment. The Group has determined that it bears substantially all the risks and benefits incidental to ownership of said properties based on the terms of the contracts (such as existence of bargain purchase option and the present value of minimum lease payments amount to at least substantially all of the fair value of the leased asset) (see Note 35).

#### *Classification of properties*

The Group determines whether a property is classified as real estate inventory, investment property or owner-occupied property. In making its judgment, the Group considers whether the property generates cash flow largely independent of the other assets held by an entity.

Real estate inventory comprises of property that is held for sale in the ordinary course of business. Principally, this is residential property that the Group develops and intends to sell before or on completion of construction. Investment property comprises land and buildings (principally offices, commercial and retail property) which are not occupied substantially for use by, or in the operations of the Group, nor for sale in the ordinary course of business, but are held primarily to earn rental income and for capital appreciation. Owner-occupied properties classified and presented as property, plant and equipment, generate cash flows that are attributable not only to property but also to the other assets used in the production or supply process.

Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions cannot be sold separately as of the financial reporting date, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Group considers each property separately in making its judgment.

#### *Determination of fair value of financial instruments*

Where the fair values of financial assets and financial liabilities recorded in the consolidated balance sheet cannot be derived from active markets, they are determined using valuation techniques that include the use of mathematical models. The input to these models is 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 liquidity and model inputs such as correlation and volatility for longer dated derivatives.

#### *Determination of fair value of financial assets not quoted in an active market*

The Group classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market. Included in the evaluation on whether a financial asset is quoted in an active market is the determination on whether quoted prices are readily and regularly available, and whether those prices represent actual and regularly occurring market transactions on an arm's length basis.

The Group has AFS investments in unquoted equity securities. As of December 31, 2013 and 2012 and January 1, 2012, management assessed that the fair value of these instruments cannot be measured reliably since the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed. Therefore, the instruments are measured at cost less any impairment in value.

As of December 31, 2013 and 2012 and January 1, 2012, investment in unquoted shares of stock amounted to P2.7 billion, P2.3 billion and P1.9 billion, respectively (see Note 7).

#### *Bifurcation of embedded derivatives*

Where a hybrid instrument is not classified as financial assets at FVPL, the Group evaluates whether the embedded derivative should be bifurcated and accounted for separately. This includes assessing whether the embedded derivative has a close economic relationship to the host contract.

#### *Classification of Bank's Product*

The Group classified its unit-linked products as insurance contracts due to the significant insurance risk at issue. All of the Group's products are classified and treated as insurance contracts.

#### *Assessment of control over the entities for consolidation*

The Group has majority owned subsidiaries discussed in Note 2. Management concluded that the Group controls these majority owned subsidiaries arising from voting rights and, therefore, consolidates the entity in its consolidated financial statements. In addition, the Group accounts for its investments in OHBVI as a subsidiary although the Group holds less than 50.00% of OHBVI's issued share capital on the basis of the voting rights of 42.78% assigned by certain stockholders to the Group. Management concluded that the Group has the ability to control the relevant activities and to affect its returns in OHBVI on the basis of the combined voting rights arising from its direct ownership and assigned voting rights of 70.56%.

#### *Estimates and Assumptions*

The key assumptions concerning the future and other key sources of estimation uncertainties at the end of reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

#### *Revenue and cost recognition on real estate sales*

The Group's revenue and cost recognition policies on real estate sales require management to make use of estimates and assumptions that may affect the reported amounts of revenue and costs. The Group's revenue and cost of real estate sales are recognized based on the percentage of completion which is measured principally on the basis of the estimated completion of a physical proportion of the contract work.

The Group recognized revenue from real estate sales amounting to P3.2 billion, P2.3 billion and P4.9 billion and cost of real estate sales amounting to P2.5 billion, P1.7 billion and P3.5 billion in 2013, 2012 and 2011, respectively (see Note 25).

#### *Estimation of allowance for credit losses on loans and receivables and receivables from SPV*

The Group reviews its impaired loans and receivables at each reporting date to assess whether additional provision for credit losses should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of required allowance. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and receivables, the Group also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance takes into consideration any deterioration in the loan or investment rating from the time the account was granted or amended, and such other factors as any deterioration in country risk, industry, and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows and underlying property prices, among others Allowance for credit losses amounted to P17.2 billion, P18.4 billion and P16.9 billion as of December 31, 2013 and 2012 and January 1, 2012 (see Notes 8 and 14).

#### *Impairment of AFS financial assets*

The computation for the impairment of AFS financial assets requires an estimation of the present value of the expected future cash flows and the selection of an appropriate discount rate. An impairment issue arises when there is an objective evidence of impairment, which involves significant judgment. In making this judgment, the Group evaluates the financial health of the issuer, among others. In the case of AFS equity instruments, the Group expands its analysis to consider changes in the issuer's industry performance, legal and regulatory framework, and other factors that affect the recoverability of the Group's investments. Further, the impairment assessment would include an analysis of the significant or prolonged decline in fair value of the investments below its cost. The Group treats "significant" generally as 20% or more and "prolonged" as greater than 12 months for quoted equity securities.



As of December 31, 2013 and 2012 and January 1, 2012, the carrying value of the Group's AFS financial assets amounted to P81.0 billion, P98.5 billion and P94.5 billion, respectively (see Note 7).

#### *Valuation of equity-linked free standing derivatives*

The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument is reliably measurable if: (a) the variability in the range of reasonable fair value estimates is not significant for the instrument; or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, the Group is precluded from measuring the instrument at fair value.

As of December 31, 2012 and January 1, 2012, the Group has concluded that the put option cannot be measured at fair value as the put option is linked to and settled by the delivery of unquoted equity instruments whose fair value cannot be reasonably assessed. In 2013, the put option was cancelled following the termination of the Exit Rights Agreement (see Note 11).

#### *Fair values of structured debt instruments and derivatives*

The fair values of structured debt instruments and derivatives that are not quoted in active markets are determined using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are reviewed before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices.

To the extent practicable, models use only observable data, however, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments. Refer to Note 33 for information on the fair values of these instruments.

#### *Aggregate reserves for life insurance*

In determining the aggregate reserves for life policies estimates are made as to the expected number of deaths, illness or injury for each of the years in which PNB LII is exposed to risk. These estimates are based on standard mortality and morbidity tables as required by the Insurance Code (IC or the Code). The estimated number of deaths, illness or injury determines the value of possible future benefits to be paid out, which will be factored into ensuring sufficient cover by reserves, which in return is monitored against current and future premiums. Estimates are also made as to future investment income arising from the assets backing life insurance contracts. These estimates are based on current market returns, as well as expectations about future economic and financial developments. The carrying values of aggregate reserves for life insurance policies of the Group presented under "Insurance contract liabilities" in "Other Liabilities" amounted to P11.5 billion, P4.1 billion and P3.3 billion as of December 31, 2013 and 2012 and January 1, 2012, respectively.

#### *Valuation of insurance contracts*

Estimates have to be made both for the expected ultimate cost of claims reported at reporting date and for the expected ultimate cost of IBNR at the reporting date. It can take a significant period of time before the ultimate claim costs can be established with certainty. Nonlife insurance contract liabilities are not discounted for the time value of money.

The main assumption underlying the estimation of the claims provision is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. Historical claims development is mainly analyzed by accident years as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

#### *Measurement of NRV of inventories*

The Group's estimates of the NRV of its consumer goods inventories and

materials and supplies are based on the most reliable evidence available at the time the estimates are made, of the amount that the inventories are expected to be realized. These estimates consider the fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period. A new assessment is made of NRV in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is a clear evidence of an increase in NRV because of change in economic circumstances, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised NRV.

With respect to the Group's real estate inventories, cost of its real estate inventories to NRV based on its assessment of the recoverability of cost of the inventories. NRV for completed real estate inventories is assessed with reference to market conditions and prices existing at the reporting date and is determined by the Group in the light of recent market transactions. NRV in respect of real estate inventories under construction is assessed with reference to market prices at the reporting date for similar completed property, less estimated costs to complete construction and less estimated costs to sell. The amount and timing of recorded expenses for any period would differ if different judgments were made or different estimates were utilized.

The Group's inventories carried at cost as of December 31, 2013 and 2012 and January 1, 2012 amounted to P9.3 billion, P9.6 billion and P8.3 billion, respectively. Certain materials and supplies amounting to P1.0 billion, P635.7 million and P614.2 million as of December 31, 2013 and 2012 and January 1, 2012, respectively, are carried at NRV (see Note 9).

#### *Valuation of property, plant and equipment under revaluation basis*

The Group's land and land improvements, plant buildings and building improvements, and machineries and equipment are carried at revalued amounts, which approximate their fair values at the date of the revaluation, less any subsequent accumulated depreciation and amortization and accumulated impairment losses. The valuations of property, plant and equipment are performed by independent appraisers. Revaluations are made every three to five years to ensure that the carrying amounts do not differ materially from those which would be determined using fair values at the end of reporting period.

Property, plant and equipment at appraised values amounted to P37.8 billion, P38.1 billion, and P37.4 billion as of December 31, 2013 and 2012 and January 1, 2012, respectively (see Note 12).

#### *Estimation of useful lives of property, plant and equipment and investment properties*

The Group estimates the useful lives and residual values of property, plant and equipment and investment properties based on internal technical evaluation and experience with similar assets. Estimated useful lives and residual values of property, plant and equipment and investment properties are reviewed periodically and updated if expectations differ from previous estimates due to physical wear and tear, technical and commercial obsolescence and other limits on the use of the assets. 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 item of property and equipment and investment properties would increase the recorded depreciation expenses and decrease the carrying value of property, plant and equipment and investment properties. In 2013 and 2012, there were no significant changes made in the useful lives and residual values of the property, plant and equipment and investment properties (see Notes 12 and 13).

In 2011, the Group reassessed and changed the estimated useful lives of distillery buildings and building improvements, and machineries and equipment (see Note 12).

The total carrying amount of depreciable property, plant and equipment as of December 31, 2013 and 2012, and January 1, 2012 amounted to P24.3 billion, P25.6 billion and P25.2 billion, respectively (see Note 12). The carrying amount of depreciable investment properties, net of accumulated depreciation, as of December 31, 2013 and 2012, and January 1, 2012

amounted to P1.3 billion, P2.6 billion and P2.6 billion, respectively (see Note 13).

#### *Assessment of impairment of nonfinancial assets and estimation of recoverable amount*

The Group assesses at the end of each reporting period whether there is any indication that the nonfinancial assets listed below may be impaired. If such indication exists, the entity shall estimate the recoverable amount of the asset, which is the higher of an asset's fair value less costs to sell and its value-in-use. In determining fair value less costs to sell, an appropriate valuation model is used, which can be based on quoted prices or other available fair value indicators.

In estimating the value-in-use, the Group is required to make an estimate of the expected future cash flows from the cash generating unit and also to choose an appropriate discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amounts of the nonfinancial 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 consolidated financial statements. Future events could indicate that these nonfinancial assets are impaired. Any resulting impairment loss could have a material adverse impact on the financial condition and results of operations of the Group.

The preparation of estimated future cash flows involves significant judgment and estimations. While the Group 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 changes under PFRS.

Assets that are subject 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:

	December 31	January 1,
	2013	2012
	(In Thousands)	
Other current assets (Note 10)	P 5,627,293	P 3,424,742
Investments in associate and joint venture (Note 11)	13,664,449	11,623,387
Property, plant and equipment (Note 12)	42,681,379	42,561,394
Investment properties (Note 13)	26,187,597	28,117,761
Other noncurrent assets (Note 14)	4,607,718	3,554,829

In 2012 and 2011, the Group recognized full impairment losses for certain property, plant and equipment amounting to P33.5 million and P207.6 million, respectively. Reversal of impairment loss recognized in 2013 amounted to P20.2 million (see Notes 12 and 28).

#### *Impairment of goodwill*

The Group determines whether goodwill is impaired on an annual basis every December 31, or more frequently, if events or changes in circumstances indicate that it may be impaired. This requires an estimation of the value in use of the CGU to which the goodwill is allocated. Estimating value in use requires management to make an estimate of the expected future cash flows from the CGU and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Management determined that the goodwill amounting to P252.7 million as of December 31, 2013 and 2012 and January 1, 2012 is not impaired (see Note 14).

#### *Estimation of retirement benefits cost and liability*

The Group's retirement benefits cost and liability is actuarially computed. This entails using certain assumptions with respect to future annual increase in salary, expected annual rate of return on plan assets and discount rate per annum.

Net retirement plan assets as of December 31, 2013 and 2012 and January 1, 2012 amounted to P243.8 million, P1.2 billion and P1.0 billion,

respectively. Accrued retirement benefits amounted to P4.3 billion, P5.4 billion and P6.1 billion as of December 31, 2013 and 2012, and January 1, 2012, respectively (see Note 24).

#### *Provisions and contingencies*

The Group is currently involved in various legal proceedings. The estimate of the probable costs for the resolution of these claims has been developed in consultation with the legal counsel handling the defense in these matters and is based upon the analysis of potential results. The Group currently does not believe these proceedings will have a material adverse effect on the consolidated financial statements. It is possible, however, that future financial performance could be materially affected by changes in the estimates or effectiveness of the strategies relating to these proceedings and assessments.

Provision for legal claims amounted to P1.6 billion as of December 31, 2013 and 2012 and P874.9 million as of January 1, 2012 (see Note 35).

#### *Recognition of deferred income tax assets*

The Group reviews the carrying amounts of the deferred income tax assets at the end of each reporting period and adjusts the balance of deferred income tax assets to the extent that it is no longer probable that sufficient future taxable profits will be available to allow all or part of the deferred income tax assets to be utilized. The Group's assessment on the recognition of deferred income tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income of the subsequent reporting periods. This forecast is based on the Group's past results and future expectations on revenues and expenses as well as future tax planning strategies. However, there is no assurance that the Group will generate sufficient future taxable income to allow all or part of the deferred income tax assets to be utilized.

The Group has NOLCO, excess MCIT and other deductible temporary differences, which relate to certain subsidiaries that have a history of losses and may not be used to offset taxable income elsewhere in the Group. The subsidiaries neither have any taxable temporary difference nor was any tax planning opportunities available that could partly support the recognition of these NOLCO, excess MCIT and other deductible temporary differences as deferred income tax assets. On this basis, the Group has determined that it cannot recognize the deferred income tax assets on these NOLCO, excess MCIT and other deductible temporary differences. If the Group is able to recognize all unrecognized deferred income tax assets, profit and equity would have increased by P5.6 billion, P6.1 billion and P2.6 billion in 2013, 2012 and 2011, respectively (see Note 29).

## **4. Segment Information**

The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The Group's identified operating segments classified as business groups, which are consistent with the segments reported to LTG's BOD, its Chief Operating Decision Maker (CODM), are as follows:

- Banking, provides full range of banking and other financial services to corporate, middle-market and retail customers, the National Government (NG), local government units (LGUs) and government-owned and controlled corporations (GOCCs) and various government agencies, including deposit-taking, lending, bills discounting, foreign exchange dealing, investment banking, fund transfers or remittance servicing and full range of retail banking and trust services. The Group conducts its banking business through PNB and its consolidated subsidiaries.
- Distilled Spirits, which is involved in manufacturing, compounding, bottling, importing, buying and selling of rum, spirit beverages, and liquor products. The Group conducts its distilled spirits business through TDI and its consolidated subsidiaries.
- Beverage, which is engaged in brewing and soft drinks and bottled

water manufacturing in the Philippines. It also operates other plants, which includes commercial glass division and corrugated cartons production facility, to support the requirements of its brewing, bottled water and non-beer products operations. The Group conducts its beverage business through ABI, Interbev, Waterich and Packageworld.

- Tobacco, which is a supplier and manufacturer of cigarettes, casings, tobacco, packaging, labels and filters. The Group conducts its tobacco business through FTC's interest in PMFTC.
- Property Development, which is engaged in ownership, development, leasing and management of residential properties, including but not limited to, all kinds of housing projects, commercial, industrial, urban or other kinds of real property; acquisition, purchasing, development and selling of subdivision lots. The Group conducts its property development business through Eton and its consolidated subsidiaries.
- Others, consist of various holding companies (LTG, Paramount, Saturn, TBI and Bank Holding Companies) that provide financing for working capital and capital expenditure requirements of the operating businesses of the Group.

The BOD reviews the operating results of the business units to make decisions on resource allocation and assesses performance. Segment revenue and segment expenses are measured in accordance with PFRS. The presentation and classification of segment revenues and segment expenses are consistent with the consolidated statements of income. Finance costs (including interest expense) and income taxes are managed per business segment.

The Group's assets are located mainly in the Philippines. The Group operates and derives principally all of its revenue from domestic operations. The Group's banking segment operates in key cities in key cities in the USA, Canada, Western Europe, Middle East and Asia.

Further, the measurement of the segments is the same as those described in the summary of significant accounting and financial reporting policies, except for TDI investment properties which are carried at fair value in TDI's consolidated financial statements and certain assets and liabilities of PNB that were recognized at fair value in PNB's consolidated financial statements upon merger of PNB and ABC. TDI's investment property is adjusted at the consolidated level to carry it at cost in accordance with the Group's policy.

In addition, the business combination involving PNB and ABC was accounted for under the acquisition method under PFRS 3 in PNB's consolidated financial statements, whereas this was accounted for under pooling of interests method in the consolidated financial statements of LTG. Thus certain assets and liabilities of PNB are adjusted at the consolidated level of LTG to reflect the original carrying values prior to the merger.

Segment assets are resources owned and segment liabilities are obligations incurred by each of the operating segments excluding intersegment balances which are eliminated.

Segment revenue and expenses are those directly attributable to the segment except that intersegment revenue and expense are eliminated only at the consolidated level. Transfer prices between operating segments are on an arm's length basis in a manner similar to transactions with third parties.

The components of capital expenditures reported to the CODM are the acquisitions of property, plant and equipment during the period.

The Group's distilled spirits segment derives 99% of its revenue from four major distributors from 2011 to 2013. Revenue from each of the four major distributors averaged 46%, 46%, 6% and 1%, respectively of the total revenue of the segment. The other segments of the Group have no significant customer which contributes 10% or more of their segment revenues.

The following tables present the information about the Group's operating segments:

For the year ended December 31, 2013:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
<i>(In Thousands)</i>							
Segment revenue:							
External customers	P 28,855,871	P 10,425,603	P 12,701,784	P 151,722	P 3,656,950	P –	P 55,791,930
Inter-segment	–	114,240	683,493	–	–	(797,733)	–
	28,855,871	10,539,843	13,385,277	151,722	3,656,950	(797,733)	55,791,930
Cost of sales	6,121,012	8,293,157	9,738,942	153,366	2,680,123	(964,665)	26,021,935
Gross profit	22,734,859	2,246,686	3,646,335	(1,644)	976,827	166,932	29,769,995
Equity in net earnings of an associate	–	–	–	3,704,117	–	–	3,704,117
	22,734,859	2,246,686	3,646,335	3,702,473	976,827	166,932	33,474,112
Selling expenses	–	648,619	1,783,513	–	365,764	(20,950)	2,776,946
General and administrative expenses	19,133,631	894,020	743,202	121,121	515,967	273,070	21,681,011
Operating income	3,601,228	704,047	1,119,620	3,581,352	95,096	(85,188)	9,016,155
Finance costs	–	(416,999)	(37,107)	–	(35,736)	8,950	(480,892)
Finance income	–	404	5,940	116,227	42,833	(26,311)	139,093
Foreign exchange gains – net	1,167,545	2,248	–	67,975	3,853	19,278	1,260,899
Others - net	2,693,949	75,428	285,366	345,256	159,603	89,037	3,648,639
Income before income tax	7,462,722	365,128	1,373,819	4,110,810	265,649	5,766	13,583,894
Provision for income tax	1,228,074	179,757	330,337	174,278	160,575	35,809	2,108,830
Segment profit	P 6,234,648	P 185,371	P 1,043,482	P 3,936,532	P 105,074	(P 30,043)	P 11,475,064
Depreciation and amortization expense	P 1,608,859	P 547,071	P 1,713,053	P 16,414	P 132,433	P 16,380	P 4,034,210
Segment income attributable to:							
Equity holders of the Company	3,435,033	196,463	1,043,482	3,919,999	104,286	(30,043)	8,669,220
Non-controlling interests	2,799,615	(11,092)	–	16,533	788	–	2,805,844



Other financial information of the operating segments as of December 31, 2013 is as follows:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
<i>(In Thousands)</i>							
Assets:							
Current assets	P 276,146,858	P 10,051,486	P 8,103,570	P 7,703,222	P 9,489,339	(P 5,889,454)	P 305,605,021
Noncurrent assets	325,967,220	6,758,658	14,229,436	15,391,255	10,550,852	(52,220)	372,845,201
	P 602,114,078	P 16,810,144	P 22,333,006	P 23,094,477	P 20,040,191	(P 5,941,674)	P 678,450,222
Liabilities:							
Current liabilities	P 498,100,979	P 1,537,568	P 4,622,420	P 378,464	P 8,602,241	(P 29,986,890)	P 483,254,782
Noncurrent liabilities	34,622,189	5,586,397	1,593,065	—	3,480,131	143,058	45,424,840
	P 532,723,168	P 7,123,965	P 6,215,485	P 378,464	P 12,082,372	(P 29,843,832)	P 528,679,622
Investments in an associate and a joint venture	P —	P —	P —	P 13,664,449	P —	P —	P 13,664,449
Equity attributable to:							
Equity holders of the Company	37,418,881	9,562,171	16,117,521	22,606,278	7,928,506	23,902,158	117,535,515
Non-controlling interests	31,972,029	124,008	—	109,735	29,313	—	32,235,085
Additions to noncurrent assets:							
Property, plant and equipment	964,974	780,849	1,396,895	14,464	13,377	16,587	3,187,146
Investment properties	1,632,953	—	—	—	2,197,321	(123,773)	3,706,501
Short-term debts	—	—	300,000	—	—	—	300,000
Long-term debts	9,953,651	4,982,544	10,919	—	2,953,475	(10,919)	17,889,670

For the year ended December 31, 2012:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
<i>(In Thousands)</i>							
Segment revenue:							
External customers	P 32,040,683	P 12,767,679	P 12,188,007	P 2,974,897	P 2,685,795	P —	P 62,657,061
Inter-segment	57,011	181,913	1,263,472	—	—	(1,502,396)	—
	32,097,694	12,949,592	13,451,479	2,974,897	2,685,795	(1,502,396)	62,657,061
Cost of sales	7,666,772	9,925,429	9,752,155	2,769,695	1,835,107	(1,509,436)	30,439,722
Gross profit	24,430,922	3,024,163	3,699,324	205,202	850,688	7,040	32,217,339
Equity in net earnings of an associate	—	—	—	6,498,972	—	—	6,498,972
	24,430,922	3,024,163	3,699,324	6,704,174	850,688	7,040	38,716,311
Selling expenses	—	601,767	1,841,207	—	308,560	(35,416)	2,716,118
General and administrative expenses	21,069,344	599,888	634,875	273,846	495,656	114,288	23,187,897
Operating income	3,361,578	1,822,508	1,223,242	6,430,328	46,472	(71,832)	12,812,296
Finance costs	—	(417,656)	(113,911)	(1,278)	(72,354)	57,012	(548,187)
Finance income	—	6,686	8,767	94,619	54,222	(6,050)	158,244
Foreign exchange gains - net	926,731	(2,745)	—	(100,198)	12,358	(12,110)	824,036
Others - net	3,692,539	107,443	546	524,682	73,042	592,834	4,991,086
Income before income tax	7,980,848	1,516,236	1,118,644	6,948,153	113,740	559,854	18,237,475
Provision for income tax	1,455,436	495,439	331,691	39,550	66,596	302,536	2,691,248
Segment profit	P 6,525,412	P 1,020,797	P 786,953	P 6,908,603	P 47,144	P 257,318	P 15,546,227
Depreciation and amortization expense	P 1,355,893	P 493,158	P 1,644,487	P 61,518	P 107,177	P 15,675	P 3,677,908
Segment income attributable to:							
Equity holders of the Company	3,770,546	1,017,437	786,953	6,879,587	45,348	257,318	12,757,189
Non-controlling interests	2,754,866	3,360	—	29,016	1,796	—	2,789,038

Other financial information of the operating segments as of December 31, 2012 is as follows:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
<i>(In Thousands)</i>							
Assets:							
Current assets	P 213,316,081	P 9,542,269	P 6,569,699	P 18,119,568	P 10,523,262	(P 9,826,435)	P 248,244,444
Noncurrent assets	316,375,506	6,571,040	14,854,851	16,521,113	7,234,915	329,772	361,887,197
	P 529,691,587	P 16,113,309	P 21,424,550	P 34,640,681	P 17,758,177	(P 9,496,663)	P 610,131,641
Liabilities:							
Current liabilities	P 414,426,470	P 2,183,662	P 13,387,910	P 862,603	P 8,712,545	P 18,888,734	P 458,461,924
Noncurrent liabilities	48,333,888	5,623,380	1,568,735	—	2,303,610	133,994	57,963,607
	P 462,760,358	P 7,807,042	P 14,956,645	P 862,603	P 11,016,155	P 19,022,728	P 516,425,531
Investments in an associate and a joint venture	P —	P —	P 20,091	P 13,886,098	P —	P —	P 13,906,189
Equity attributable to:							
Equity holders of the Company	36,203,373	8,171,173	6,467,905	33,621,883	6,710,121	(28,519,391)	62,655,064
Non-controlling interests	30,727,856	135,094	—	156,195	31,901	—	31,051,046
Additions to noncurrent assets:							
Property, plant and equipment	1,088,514	1,061,128	2,020,261	867	39,035	29,080	4,238,885
Investment properties	890,530	—	—	500,004	513,040	3,348	1,906,922
Short-term debts	—	—	1,870,000	—	—	(250,000)	1,620,000
Long-term debts	14,436,122	4,968,295	17,996	—	3,628,284	(2,471,496)	20,579,201



For the year ended December 31, 2011:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
	(In Thousands)						
Segment revenue:							
External customers	P 29,498,704	P 12,256,165	P 11,938,021	P 3,350,002	P 5,191,651	P –	P 62,234,543
Inter-segment	45,263	150,447	1,295,740	–	–	(1,491,450)	–
	29,543,967	12,406,612	13,233,761	3,350,002	5,191,651	(1,491,450)	62,234,543
Cost of sales and services	8,826,010	9,493,585	9,965,660	2,210,839	3,612,181	(1,492,903)	32,615,372
Gross profit	20,717,957	2,913,027	3,268,101	1,139,163	1,579,470	1,453	29,619,171
Equity in net earnings of an associate	–	–	–	4,117,904	–	–	4,117,904
	20,717,957	2,913,027	3,268,101	5,257,067	1,579,470	1,453	33,737,075
Selling expenses	–	599,224	2,007,691	–	472,283	(38,254)	3,040,944
General and administrative expenses	19,006,280	599,508	554,319	554,726	425,915	92,633	21,233,381
Operating income	1,711,677	1,714,295	706,091	4,702,341	681,272	(52,926)	9,462,750
Finance costs	–	(418,547)	(150,085)	–	(9,486)	34,314	(543,804)
Finance income	–	951	1,514	60,894	40,746	419	104,524
Foreign exchange gains - net	1,390,741	1,323	–	–	37	(1,245)	1,390,856
Others - net	4,419,810	223,137	(173,778)	72,004	139,576	13,118	4,693,867
Income before income tax	7,522,228	1,521,159	383,742	4,835,239	852,145	(6,320)	15,108,193
Provision for income tax	1,337,537	504,091	135,030	134,856	118,645	6,217	2,236,376
Segment profit	P 6,184,691	P 1,017,068	P 248,712	P 4,700,383	P 733,500	(P 12,537)	P 12,871,817
Depreciation and amortization expense	P 1,361,582	P 433,358	P 1,602,326	P 66,574	P 102,230	P 15,431	P 3,581,501
Segment income attributable to:							
Equity holders of the Company	3,381,969	1,017,058	248,712	4,680,641	714,874	(12,537)	10,030,717
Non-controlling interests	2,802,722	10	–	19,742	18,626	–	2,841,100

Other financial information of the operating segments as of January 1, 2012 is as follows:

	Banking	Distilled Spirits	Beverage	Tobacco	Property Development	Eliminations, Adjustments and Others	Total
	(In Thousands)						
Assets							
Current assets	P 217,753,356	P 8,642,266	P 6,215,336	P 12,839,979	P 6,892,890	(P 11,902,266)	P 240,441,561
Noncurrent assets	295,920,756	5,969,936	14,593,459	13,383,657	8,424,861	(631,079)	337,661,590
	P 513,674,112	P 14,612,202	P 20,808,795	P 26,223,636	P 15,317,751	(P 12,533,345)	P 578,103,151
Liabilities							
Current liabilities	P 403,546,703	P 1,602,233	P 14,134,650	P 1,007,932	P 7,766,621	P 17,999,560	P 446,057,699
Noncurrent liabilities	48,817,087	5,677,520	1,787,890	–	1,429,518	66,778	57,778,793
	P 452,363,790	P 7,279,753	P 15,922,540	P 1,007,932	P 9,196,139	P 18,066,338	P 503,836,492
Investment in an associate	P –	P –	P –	P 11,623,387	P –	P –	P 11,623,387
Equity attributable to:							
Equity holders of the Company	32,899,386	7,200,378	4,886,255	25,088,555	6,068,978	(30,599,683)	45,543,869
Non-controlling interests	28,410,936	132,071	–	127,149	52,634	–	28,722,790
Additions to noncurrent assets:							
Property, plant and equipment	810,442	637,765	3,396,928	20,678	22,833	–	4,888,646
Investment properties	944,871	7,500	–	–	584,217	(11,388)	1,525,200
Short-term debts	–	250,000	2,164,000	–	–	(1,194,000)	1,220,000
Long-term debts	10,935,265	4,955,148	308,579	–	2,790,930	(2,109,080)	16,880,842

## 5. Cash and Cash Equivalents

Cash and cash equivalents consist of:

	December 31 2013	December 31 2012	January 1, 2012
	(In Thousands)		
Cash and other cash items	P 12,651,411	P 10,081,220	P 9,824,619
Cash equivalents:			
Due from Bangko Sentral ng Pilipinas (BSP)	153,169,330	63,258,002	56,439,098
Due from other banks	14,093,671	15,527,870	17,720,067
Interbank loans receivable and securities held under agreements to resell	8,405,250	37,753,798	48,421,314
	P 188,319,662	P 126,620,890	P 132,405,098

a. Cash and other cash items consist of cash on hand and in banks and short term investments. Cash in banks earn interest at bank deposit rates. Short term investments represent money market placements made for varying periods depending on the immediate cash requirements of the Group.

b. Due from BSP is composed of interest-bearing short-term placements with BSP and a demand deposit account to support the regular operations of PNB.

c. Securities held under agreements to resell represent overnight placements

with the BSP where the underlying securities cannot be sold or replugged. The interest rate applicable is fixed by the BSP through a memorandum.

d. Interest earned on cash and other cash items and cash equivalents are presented under "Finance income" and "Banking revenue", respectively (see Notes 23 and 25).

## 6. Financial Assets at Fair Value through Profit or Loss

Financial assets at fair value through profit or loss consist of:

	December 31 2013	December 31 2012	January 1, 2012
	(In Thousands)		
Financial assets at fair value through profit or loss (FVPL):			
Held for trading:			
Government securities	P 3,355,721	P 8,329,815	P 2,609,581
Private debt securities	830,528	920,822	35,262
Derivative assets (Notes 21 and 36)	258,697	603,262	652,324
Equity securities	249,518	296,936	225,596
	4,694,464	10,150,835	3,522,763
Designated at FVPL:			
Segregated fund assets (Note 16)	7,861,688	3,741,760	1,365,014
Private debt securities	–	1,247,756	4,050,671
	P 12,556,152	P 15,140,351	P 8,938,448

a. As of December 31, 2013, 2012 and 2011, unrealized gain (loss) on government and private debt securities amounted to (P250.5) million, P50.1 million and P31.9 million, respectively. As of December 31, 2013, 2012, and 2011, the effective interest rates range from 0.88% to 5.48%, from 0.67% to 6.72%, and from 1.94% to 6.88% for the government securities, and 2.38% to 7.38%, from 3.93% to 7.20% and from 1.94% to 6.88% for the private debt securities, respectively.

b. The carrying amount of equity securities includes unrealized gain (loss) of (P30.6 million), (P3.9 million) and P4.8 million as of December 31, 2013, 2012 and 2011, respectively.

c. Segregated fund assets designated as financial asset at FVPL refer to the considerations received from unit-linked insurance contracts invested by PNB LII in designated funds.

On March 15, 2005 and June 17, 2005, the IC approved PNB LII's license to sell single-pay and regular-pay unit-linked insurance products, respectively.

Segregated fund assets and the corresponding segregated fund liabilities are designated as financial assets and liabilities at FVPL since they are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. The equity of each policyholder in the segregated fund assets is determined by assigning a number of units to each policyholder, corresponding to the net amount deposited in relation to the market value at the time of contribution. The value per unit may increase or decrease depending on the market value of the underlying assets of the corresponding segregated funds.

As of December 31, 2013, the segregated fund assets consist of P6.0 billion peso funds and P1.8 billion dollar funds. The segregated fund assets include the following equity-linked notes:

Equity-linked notes	Description
Asian Summit	A single-pay variable life insurance product which invests the single premium, net of premium charges, into a five (5)-Year PHP-Linked USD Participation Note which is linked to the performance of a basket of five Asian equity indices.
Summit Select	A single-pay variable life insurance product which invests the single premium, net of premium charges, into a five (5)-Year PHP-Linked USD Participation Note which is linked to the performance of ING Emerging Markets Consumption VT 10.00% Index.
Dollar Income Optimizer	A single-pay variable life insurance product which invests the single premium, net of premium charges, into UBS seven (7)-Year Structured Note which is linked to the performance of a basket of high quality global funds chosen to offer income and potential for capital appreciation.
Variable Unit-Linked Summit Peso and Dollar	A peso and dollar denominated single-pay 5-year linked life insurance plan that provide the opportunity to participate in a risk-managed portfolio of six (6) equally-weighted exchange traded funds of ASEAN member countries via the ING ASEAN Equities VT 10% index.

d. As of December 31, 2012, private debt securities designated at FVPL represent USD-denominated investments in credit-linked note (CLN). The CLNs are part of a group of financial instruments that together are managed on a fair value basis in accordance with the documented risk management and investment strategy of the PNB. Unrealized loss from financial assets designated at FVPL amounted to P16.3 million as of December 31, 2012.

On March 22 and August 17, 2012, PNB pre-terminated investments in CLN designated as financial assets at FVPL with a total face amount of US\$47.5 million or P2.0 billion and US\$15.0 million or P636.3 million, respectively, in which PNB realized trading gain of US\$0.2 million or equivalent to P8.3 million. The carrying amount of the preterminated securities as of pre-termination dates amounted to US\$48.1 million or P2.1 billion and US\$14.8 million or P628.2 million, respectively.

On May 23, 2013, the remaining investments in CLN designated at FVPL with face value of US\$30.0 million matured.

## 7. Available for Sale Investments

Available for sale investments consist of:

	December 31 2013	2012	January 1, 2012
	(In Thousands)		
Government securities (Notes 19 and 35)	P 59,380,333	P 78,441,023	P 73,046,166
Other debt securities	18,654,987	17,261,041	18,981,283
Equity securities			
Quoted	2,663,182	2,331,541	1,899,357
Unquoted	1,185,582	1,437,078	1,574,580
	81,884,084	99,470,683	95,501,386
Allowance for impairment losses	(928,408)	(997,045)	(992,312)
	80,955,676	98,473,638	94,509,074
Noncurrent portion	(78,029,572)	(93,158,186)	(81,038,501)
	P 2,926,104	P 5,315,452	P 13,470,573

a. As of December 31, 2013 and 2012, government securities include the fair value of the AFS investments in the form of Fixed Rate Treasury Notes pledged to fulfill PNB's collateral requirements for the peso rediscounting facility of BSP amounted to P2.4 billion and P2.8 billion, respectively (see Notes 17 and 37). BSP has an obligation to return the securities to PNB once the obligations have been settled. In case of default, BSP has the right to hold the securities and sell them as settlement of the rediscounting facility. There are no other significant terms and conditions associated with the pledged investments.

b. As of December 31, 2013 and 2012, the fair value of the AFS investments in the form of Republic of the Philippines bonds pledged to fulfill its collateral requirements with securities sold under repurchase agreements transactions with counterparties amounted to P2.7 billion and P3.5 billion, respectively (see Note 37). The counterparties have an obligation to return the securities to the PNB once the obligations have been settled. In case of default, BSP has the right to hold the securities and sell them as settlement of the repurchase agreement. There are no other significant terms and conditions associated with the pledged investments.

c. Included in AFS investments are pledged securities for the Surety Bond amounted to P977.4 million issued by PNB Gen. As of December 31, 2013 and 2012, the carrying value of these pledged securities amounted to P928.3 million and P817.1 million, respectively.

d. Other debt securities consist of notes issued by private entities and in 2012 also included the host contracts on the CLN (see Note 21).

e. No impairment loss has been recognized on unquoted debt securities for the years ended December 31, 2013, 2012 and 2011. The unquoted debt securities include the investment in shares of stock of Victorias Milling Company, Inc. (VMC) as of December 31, 2011, which was carried at cost because fair value (i.e., quoted market price) was not readily available due to the suspended trading of its shares. On May 21, 2012, the Philippine Stock Exchange lifted the trading suspension of the shares of stock of VMC, thus, the investment in shares of stock of VMC was reclassified as quoted equity securities as of December 31, 2013 and 2012.

f. As of December 31, effective interest rates for the AFS investments follow:

	2013	2012	2012
Peso-denominated	1.62% to 8.15%	2.35% to 8.15%	2.49% to 8.15%
Foreign-currency denominated	0.22% to 7.40%	0.98% to 5.23%	1.96% to 6.78%

g. Presented below are the movements in the net changes in fair values of AFS financial assets:

	December 31 2013	2012	January 1, 2012
	(In Thousands)		
At beginning of year	P 3,763,651	P 4,443,699	(P 300,829)
Net changes in fair value of AFS financial assets during the year*:			
Fair value changes during the year			
on AFS investments	397,865	6,188,339	8,719,845
Realized gains**(Note 25)	(5,875,570)	(6,868,387)	(3,975,317)
	(5,477,705)	(680,048)	4,744,528
At end of year	(P 1,714,054)	P 3,763,651	P 4,443,699

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Attributable to:			
Equity holders of the Company	(P 875,973)	P 2,087,609	P 2,506,434
Non-controlling interests	(838,081)	1,676,042	1,937,265
	(P 1,714,054)	P 3,763,651	P 4,443,699

\* Net of deferred income tax effect amounting to P84.0 million, P110.1 million and P12.1 million in 2013, 2012 and 2011, respectively.  
\*\* Included in "Trading and securities gains" under "Banking revenue".

h. The movements in allowance for impairment losses of AFS investments follow:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Balance at beginning of year	P 997,045	P 992,312	P 761,876
Provisions during the year	-	4,733	249,869
Disposals, transfers and others	(68,637)	-	(19,433)
Balance at end of year	P 928,408	P 997,045	P 992,312

#### Reclassification of Financial Assets

On October 12, 2011, PNB had identified a clear change of intent to exit or trade in the short term its HTM investments rather than to hold them until maturity, when it disposed of more than an insignificant amount of its HTM investments. This disposal necessitated the reclassification of the remaining HTM investments to AFS securities in accordance with PAS 39. As of the date of reclassification, the amortized cost of HTM investments reclassified to AFS investments amounted to P32.5 billion. Reclassified AFS investments are initially measured at their fair value amounting to P35.7 billion. Any difference between the amortized cost of HTM investments and their fair value at reclassification date is recognized in OCI.

As of December 31, 2013 and 2012, the carrying value of the securities reclassified out of HTM investments to AFS investments amounted to nil and P1.9 billion, respectively.

For the year ended December 31, 2013, 2012 and 2011, the net unrealized gain (loss) reclassified from equity to profit or loss due to sale of investments reclassified to AFS amounted to nil, P299.6 million and P2.5 billion, respectively.

## 8. Loans and Receivables

Loans and receivables consist of:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Finance receivables	P 291,434,545	P 259,656,227	P 241,365,032
Trade receivables	10,784,851	10,907,163	10,368,530
Other receivables	2,918,862	2,166,951	768,729
	305,138,258	272,730,341	252,502,291
Allowance for doubtful accounts and credit losses	(17,203,226)	(18,148,396)	(16,055,446)
	287,935,032	254,581,945	236,446,845
Noncurrent portion	(204,749,366)	(178,818,367)	(167,286,705)
	P 83,185,666	P 75,763,578	P 69,160,140

#### Finance Receivables

Finance receivables pertain to receivables of the banking segment which consist of:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Receivables from customers:			
Loans and discounts	P 237,061,751	P 203,976,377	P 183,995,641
Customers' liabilities on acceptances, letters of credit and trust receipts	10,387,199	11,141,576	12,610,946
Bills purchased (Note 20)	3,827,510	4,521,105	7,128,100
Credit card receivables	4,105,025	4,192,998	3,270,731
Finance lease receivables (Note 35)	2,666,316	2,205,779	1,849,602
	258,047,801	226,037,835	208,855,020
Unquoted debt securities	11,571,023	14,220,913	14,767,613
Other receivables:			
Accounts receivable	10,308,901	7,044,592	5,527,734
Accrued interest receivable	7,514,686	7,887,081	8,216,133
Sales contract receivables	4,647,352	4,956,460	4,702,691
Miscellaneous	499,314	593,433	469,008

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
	22,970,253	20,481,566	18,915,566
	292,589,077	260,740,314	242,538,199
Unearned interest and other deferred income	(1,154,532)	(1,084,087)	(1,173,167)
	291,434,545	259,656,227	241,365,032
Allowance for credit losses	(17,165,122)	(18,132,898)	(16,037,738)
	274,269,423	241,523,329	225,327,294
Noncurrent portion	202,512,151	177,944,077	165,233,836
	P 71,757,272	P 63,579,252	P 60,093,458

a. Loans amounting to P219.1 million and P2.0 billion as of December 31, 2013 and 2012, respectively, have been pledged to the BSP to secure PNB's availments under the BSP rediscounting privileges which are included in Bills payable (see Notes 17 and 37). The pledged loans will be released when the underlying transaction is terminated. In the event of PNB's default, BSP is entitled to apply the collateral in order to settle the rediscounted bills.

#### b. Unquoted Debt Securities

Unquoted debt instruments include the zero-coupon notes received by PNB from Special Purpose Vehicle (SPV) Companies on October 15, 2004, at the principal amount of P803.5 million (Tranche A Note) payable in five (5) years and at the principal amount of P3.4 billion (Tranche B Note) payable in eight (8) years in exchange for the outstanding loans receivable from National Steel Corporation (NSC) of P5.3 billion. The notes are secured by a first ranking mortgage and security interest over the NSC Plant Assets. As of December 31, 2013 and 2012, the notes are carried at their recoverable values. Management assessed that these loans are not fully recoverable as a result of the Partial Award granted by the Arbitration Panel to the SPV Companies. The consortium banks, including PNB, has filed a Petition to set aside the Partial Award with the Singapore High Court on July 9, 2012. The Petition is pending as of the financial statement issuance date (see Note 35).

As of December 31, 2013 and 2012, unquoted debt instruments also include bonds issued by Philippine Sugar Corporation (PSC) amounting to P2.7 billion with accrued interest included under "Accrued interest receivable" amounting to P2.3 billion. The full repayment of principal and accumulated interest to maturity is guaranteed by a sinking fund managed by PNB's Trust Banking Group (TBG). As of December 31, 2013 and 2012, the sinking fund amounted to P5.3 billion and P5.2 billion, respectively, earning an average rate of return of 8.82% per annum. Management expects that the value of the sinking fund in the year 2014 will be more than adequate to cover the full redemption value of PSC bonds. The bonds matured on February 15, 2014 and was settled through liquidation of the sinking fund.

#### c. Finance Lease Receivable

An analysis of the Group's finance lease receivables as of December 31, 2013 and 2012 is presented as follows:

	December 31,	December 31,
	2013	2012
	(In Thousands)	
Gross investment in finance lease receivables		
Due within one year	P 1,002,864	P 793,447
Due beyond one year but not over five years	1,182,830	944,806
Due beyond five years	75,850	85,800
	2,261,544	1,824,053
Residual value of leased equipment		
Due within one year	135,310	125,254
Due beyond one year but not over five years	229,254	256,472
Due beyond five years	40,208	-
	404,772	381,726
Total finance lease receivable	P 2,666,316	P 2,205,779

#### d. Accounts Receivable

On November 27, 1997, Maybank Philippines, Inc. (Maybank) and PNB signed a deed of assignment transferring to PNB certain Maybank assets (included under "Accounts receivable") and liabilities in connection with the sale of PNB's 60.00% equity in Maybank. As of December 31, 2013 and 2012, the balance of these receivables amounted to P3.6 billion and P3.4 billion, respectively, and the transferred liabilities (included under "Bills payable to BSP and local banks" and "Accrued interest payable") amounted to P3.3 billion and P3.1 billion, respectively (see Notes 17 and 18). The excess of the



transferred receivables over the transferred liabilities is fully covered by an allowance for credit losses amounting to P262.5 million as of December 31, 2013 and 2012. The remaining 40% equity ownership of PNB in Maybank was sold in June 2000 (see Note 35).

e. Interest income on loans and receivables consists of (see Note 25):

	2013	2012	2011
	(In Thousands)		
Receivable from customers and sales			
contract receivables	P 13,553,287	P 13,497,201	P 13,059,312
Unquoted debt securities	216,449	582,088	790,652
	<b>P 13,769,736</b>	<b>P 14,079,289</b>	<b>P 13,849,964</b>

As of December 31, 2013 and 2012, 88.3% and 90.9%, respectively, of the total receivable from customers of the Group were subject to interest repricing. Remaining receivables carry annual fixed interest rates ranging from 4.8% to 13.0% as of December 31, 2013, from 2.3% to 13.0% as of December 31, 2012 and from 2.6% to 9.0% as of December 31, 2011 for foreign currency-denominated receivables, and from 0.3% to 24.4% as of December 31, 2013, from 0.9% to 18.5% as of December 31, 2012 and from 5.6% to 15.0% as of December 31, 2011 for peso-denominated receivables.

Sales contract receivables bear fixed interest rate per annum ranging from 4.5% to 21.0%, from 1.8% to 15.0% and from 1.8% to 17.0% as of December 31, 2013, 2012 and 2011, respectively.

Interest income accrued on impaired loans and receivable of the Group amounted to P289.1 million in 2013, P302.8 million in 2012 and P373.3 million in 2011.

#### Trade receivables

Trade receivables consist of:

	December 31 2013	2012	January 1, 2012
	(In Thousands)		
Consumer goods	P 7,787,960	P 8,384,950	P 6,484,027
Contract receivables	2,947,033	2,475,770	3,866,778
Lease receivables	49,858	46,443	17,725
	<b>10,784,851</b>	<b>10,907,163</b>	<b>10,368,530</b>
Allowance for credit losses	(32,590)	(9,984)	(12,194)
	<b>10,752,261</b>	<b>10,897,179</b>	<b>10,356,336</b>
Noncurrent portion of contract receivables	(2,237,215)	(874,290)	(2,052,869)
	<b>P 8,515,046</b>	<b>P 10,022,889</b>	<b>P 8,303,467</b>

a. Trade receivables on consumer goods pertain to receivables from various customers of distilled spirits, beverages and tobacco segments, which are noninterest-bearing and generally have 30 to 90 days' terms.

b. Contracts receivables of the property development segment consist of revenues recognized to date based on percentage of completion less collections received from the respective buyers. Interest income from interest-bearing contracts receivables amounted to P39.4 million, P50.3 million and P20.4 million in 2013, 2012 and 2011, respectively, while interest income pertaining to amortization of the discount arising from noninterest-bearing contracts receivable amounted to P17.0 million in 2011.

c. The Group assigned certain contracts receivables to Banco de Oro Unibank, Inc. (BDO) on a with recourse basis. The total assigned contracts receivables amounted to P463.5 million, P524.8 million, and P423.1 million as of December 31, 2013 and 2012, and January 1, 2012, respectively (see Note 19).

#### Other Receivables

Other receivables are due and demandable and include accrued interest receivable pertaining to interest earned on cash and cash equivalents and unpaid utility charges to tenants and receivables from sale of various assets.

#### Movements of Allowance for Credit Losses

Details and movements of allowance for credit losses, determined using individual and collective assessment follow:

	December 31, 2013			
	Finance Receivables	Trade Receivables	Other Receivables	Total
	(In Thousands)			
Balance at beginning of year	P 9,984	P 18,132,898	P 5,514	P 18,148,396
Provisions during the year (Note 27)	22,606	889,084	—	911,690
Accounts charged off, transfers and others	—	(1,856,860)	—	(1,856,860)
Balance at end of year	<b>P 32,590</b>	<b>P 17,165,122</b>	<b>P 5,514</b>	<b>P 17,203,226</b>

	December 31, 2012			
	Finance Receivables	Trade Receivables	Other Receivables	Total
	(In Thousands)			
Balance at beginning of year	P 12,194	P 16,037,738	P 5,514	P 16,055,446
Provisions during the year (Note 27)	—	2,288,793	—	2,288,793
Accounts charged off, transfers and others	(2,210)	(193,633)	—	(195,843)
Balance at end of year	<b>P 9,984</b>	<b>P 18,132,898</b>	<b>P 5,514</b>	<b>P 18,148,396</b>

	December 31, 2011			
	Finance Receivables	Trade Receivables	Other Receivables	Total
	(In Thousands)			
Balance at beginning of year	P 12,013	P 16,296,604	P 5,514	P 16,314,131
Provisions during the year (Note 27)	181	1,365,105	—	1,365,286
Accounts charged off, transfers and others	—	(1,623,971)	—	(1,623,971)
Balance at end of year	<b>P 12,194</b>	<b>P 16,037,738</b>	<b>P 5,514</b>	<b>P 16,055,446</b>

Below is the breakdown of provision for (reversal of) credit losses by type of loans and receivables.

	For the Years Ended December 31		
	2013	2012	2011
	(In Thousands)		
<b>Individual assessment</b>			
Finance receivables:			
Receivable from customers	P 598,557	P 1,167,011	P 882,234
Unquoted debt securities	—	208,081	240,431
Other receivables	1,833	(129,214)	889
Trade receivables from customers of consumer goods	<b>22,606</b>	<b>—</b>	<b>181</b>
	<b>622,996</b>	<b>1,245,878</b>	<b>1,123,735</b>
<b>Collective assessment</b>			
Finance receivables:			
Receivable from customers	246,156	1,032,034	202,762
Other receivables	42,538	10,881	38,789
	<b>288,694</b>	<b>1,042,915</b>	<b>241,551</b>
	<b>P 911,690</b>	<b>P 2,288,793</b>	<b>P 1,365,286</b>

## 9. Inventories

Inventories consist of:

	December 31		January 1, 2012
	2013	2012	
	(In Thousands)		
At Cost:			
Consumer goods:			
Alcohol	P 2,559,043	P 2,064,430	P 3,319,627
Beverage	1,461,630	1,540,703	1,467,087
Tobacco	—	153,366	468,426
	<b>4,020,673</b>	<b>3,758,499</b>	<b>5,255,140</b>
Real estate inventories:			
Condominium and residential units for sale	2,933,431	3,310,838	1,261,778
Land held for future development	474,665	269,522	952,041
Subdivision land under development	1,524,775	1,915,081	249,024
	<b>4,932,871</b>	<b>5,495,441</b>	<b>2,462,843</b>
Fuel, materials and supplies	329,838	348,863	598,934
	<b>9,283,382</b>	<b>9,602,803</b>	<b>8,316,917</b>
At NRV - Materials and supplies	<b>996,577</b>	<b>635,652</b>	<b>614,242</b>
	<b>P 10,279,959</b>	<b>P 10,238,455</b>	<b>P 8,931,159</b>



Allowance for inventory obsolescence on materials and supplies amounted to P12.3 million, P12.3 million, and P10.4 million as of December 31, 2013 and 2012, and January 1, 2012, respectively.

a. Components of the consumer goods inventories are as follows:

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
Finished goods	P 472,906	P 703,415	P 1,461,398
Work in process	1,018,642	1,268,307	976,344
Raw materials	2,529,125	1,786,777	2,817,398
	P 4,020,673	P 3,758,499	P 5,255,140

Cost of consumer goods inventories recognized as expenses under cost of sales amounted to P10.8 billion, P12.7 billion and P12.1 billion in 2013, 2012 and 2011, respectively (see Note 25).

b. Movements in real estate inventory are set out below:

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
Opening balance at January 1	P 5,495,441	P 2,462,843	P 2,373,199
Land acquired during the year	238,997	2,120,184	63,000
Construction/development costs incurred	1,459,198	2,548,040	3,432,189
Borrowing costs capitalized (Note 19)	229,065	56,576	94,960
Disposals (recognized as cost of real estate sales, Note 25)	(2,489,830)	(1,692,202)	(3,500,505)
	P 4,932,871	P 5,495,441	P 2,462,843

Parcels of land acquired in 2013, 2012 and 2011 will be used for development of condominium units for sale and development as part of the consolidation of properties in Eton City, one of the major projects of the Group's property development segment.

## 10. Other Current Assets

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
Excise tax	P 925,030	P 890,018	P 145,664
Creditable withholding taxes (CWT)	715,174	472,083	545,338
Advances to suppliers	685,740	412,063	365,352
Prepaid expenses	577,580	566,748	703,008
Input VAT	499,167	428,101	194,510
Advances to contractors	404,347	639,815	507,451
Stationeries, office supplies and stamps on hand	248,768	155,288	157,748
Miscellaneous cash and other cash items	182,295	221,535	107,477
Deferred rent	54,544	66,740	59,979
Others	1,334,648	43,700	638,215
	P 5,627,293	P 3,896,091	P 3,424,742

a. Excise tax pertains to advance tax payments to the Bureau of Internal Revenue (BIR) pertaining to sale of alcoholic beverages.

b. CWTs pertain mainly to the amounts withheld from income derived from sale of consumer goods and real estate inventories. The CWTs can be applied against any income tax liability of a company in the Group to which the CWTs relate. The CWTs which the Group expects to be used beyond one year are presented under "Other noncurrent assets" (see Note 14).

c. Advances to suppliers pertain to deposits made for raw material purchases and are realized upon delivery of the related inventories.

d. Prepaid expenses include prepaid commission amounting to P205.4 million, P385.4 million and P301.6 million and prepaid importation charges amounting to P87.6 million, P49.4 million and P171.5 million as of December 31, 2013 and 2012 and January 1, 2012, respectively. Prepaid commission consists of payments to agents and brokers which will be charged to the consolidated statements of income in the period in which the related revenue is recognized. Prepaid importation charges pertain to the purchases of raw materials by the distilled spirits and beverage businesses.

e. Advances to contractors are recouped every progress billing payment based on the percentage of accomplishment of each contract package. The activities to which these advances pertain will be completed within the normal operating cycle.

## 11. Subsidiaries, Associates and Joint Venture

### Investments in Associates and a Joint Venture

The Group has the power to participate in the financial and operating policy decisions in PMFTC, a 49.6%-owned associate, which does not constitute control or joint control. The Group also has 50.0% interest in ABI Pascual Holdings Private Limited (ABI Pascual Holdings), which is a joint controlled entity. The Group's investments in its associate and joint venture are accounted for using equity method of accounting.

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
PMFTC	P 13,664,449	P 13,886,098	P 11,623,387
ABI Pascual Holdings	—	20,091	—
	P 13,664,449	P 13,906,189	P 11,623,387

### Investment in PMFTC

Details of investment in PMFTC are as follows:

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
Acquisition cost	P 13,483,541	P 13,483,541	P 13,483,541
Accumulated equity in net earnings (loss):			
Balance at beginning of year	402,557	(1,860,154)	(2,294,768)
Equity in net earnings	3,704,117	6,498,972	4,117,904
Share in other comprehensive income	27,454	—	—
Less cash dividends (Note 23)	(3,953,220)	(4,236,261)	(3,683,290)
Balance at end of year	180,908	402,557	(1,860,154)
	P 13,664,449	P 13,886,098	P 11,623,387

On February 25, 2010, FTC and PMPMI combined their respective domestic business operations by transferring selected assets and liabilities to PMFTC in accordance with the provisions of the Asset Purchase Agreement (APA) between FTC and its related parties and PMPMI. The establishment of PMFTC allows FTC and PMPMI to benefit from their respective, complementary brand portfolios as well as cost synergies from the resulting integration of manufacturing, distribution and procurement, and the further development and advancement of tobacco growing in the Philippines. FTC and PMPMI hold equal economic interest in PMFTC. Since PMPMI manages the day-to-day operations and has majority members of the BOD, it has control over PMFTC. FTC considers PMFTC as an associate.

As a result of FTC's divestment of its cigarette business to PMFTC, FTC initially recognized the investment amounting to P13.5 billion, representing the fair value of the net assets contributed by FTC, net of unrealized gain of P5.1 billion. The transaction was accounted for similar to a contribution in a joint venture using the Standing Interpretations Committee (SIC) Interpretation 13, *Jointly Controlled Entities-Non-Monetary Contributions by Venturers*, where FTC recognized only that portion of the gain or loss which is attributable to the interests of PMPMI amounting to P5.1 billion in 2010. The portion attributable to FTC is being recognized once the related assets and liabilities are realized, disposed or settled. FTC recognized the gain amounting to P293.0 million each in 2013, 2012 and 2011 and an outright loss of P2.0 billion in 2010, which are included in the "Equity in net earnings" in these periods. Further, as a result of the transfer, portion of the revaluation increment on FTC's property, plant and equipment amounting to P1.9 billion was transferred to retained earnings.

Details of the carrying values of the contributed assets are indicated below *(In thousands)*:

Cash	P 33,090
Inventories	19,084,092
Other current assets	4,382,894
Property, plant and equipment	8,432,235
Trade and other payable	(2,707,797)
Loans payable	(19,000,000)
Deferred income tax liability	(1,818,551)
	P 8,405,963

Also, as a result of the transaction, FTC has obtained the right to sell (put option) its interest in PMFTC to PMPMI, except in certain circumstances, during the period from February 25, 2015 through February 24, 2018, at an agreed-upon value. On December 10,



2013, the BOD of LTG approved the waiver by FTC of its rights under the Exit Rights Agreement entered into with PMI and confirmed the execution of the Termination Agreement.

Summarized financial information of PMFTC, based on its financial statements, and reconciliation with the carrying amount of the investment in the consolidated financial statements are set out below:

	December 31		January 1,
	2013	2012	2012
	(In Millions)		
Current assets	P 37,814	P 23,297	P 20,621
Noncurrent assets	32,973	32,449	32,884
Current liabilities	(29,896)	(15,289)	(6,916)
Noncurrent liabilities	(4,335)	(4,269)	(15,961)
Equity	36,556	36,188	30,628
Proportionate share in equity	49.6%	49.6%	49.6%
	18,132	17,949	15,191
Notional negative goodwill	(629)	(629)	(629)
Cumulative excess of dividends received over proportionate share in dividends declared by PMFTC	2,252	2,950	3,738
Unrealized gain	(6,091)	(6,384)	(6,677)
Carrying amount	P 13,664	P 13,886	P 11,623

Summarized statements of income of PMFTC are as follows:

	Years Ended December 31		
	2013	2012	2011
	(In Millions)		
Revenue	P 89,624	P 78,941	P 74,640
Cost of sales	(67,457)	(50,679)	(52,592)
General and administrative	(12,652)	(11,506)	(10,734)
Others - net	586	1,145	(317)
Income before income tax	10,101	17,901	10,997
Provision for income tax	(2,971)	(5,389)	(3,300)
Net income	7,130	12,512	7,697
Group's share of income for the year	P 3,536	P 6,206	P 3,818

#### Investment in a Joint Venture

On February 15, 2012, ABI and Corporation Empresarial Pascual, S. L. (CEP), an entity organized and existing under the laws of Spain, agreed to form ABI Pascual Holdings, a jointly controlled entity organized and domiciled in Singapore. In accordance with the Agreement, ABI and CEP (the "venturers") will hold 50% interest in ABI Pascual Holdings. Further, the arrangement requires unanimous agreement for financial and operating decisions among venturers.

On November 21, 2012, ABI Pascual Holdings created ABI Pascual Foods Incorporated (ABI Pascual Foods), an operating company, incorporated and domiciled in the Philippines, that will develop a business of marketing and distributing certain agreed products. As part of the joint venture agreement, the venturers also agreed to execute a product distribution agreement.

As of December 31, 2012, ABI has an investment in ABI Pascual Holdings amounting to P20.1 million, while ABI Pascual Holdings has an investment in ABI Pascual Foods amounting to P40.2 million. The joint venture has started operations in September 2013.

Total assets, liabilities and capital deficiency of ABI Pascual Holdings amounted to P66.4 million, P135.5 million and P69.1 million as of December 31, 2013. In 2013, ABI Pascual Holdings incurred a net loss of P108.9 million. The Group recognized share in net loss of ABI Pascual Holdings to the extent of the carrying value of the investment amounting to P20.1 million. The Group discontinued recognition of its share of losses in ABI Pascual Holdings since the carrying value of the Group's investment in ABI Pascual Holdings has been reduced to zero as of December 31, 2013, and the Group has not incurred any obligations or guaranteed any obligations in respect of the joint venture. As of December 31, 2013, the unrecognized amount of the Group's share of losses which has not been equity accounted for amounted to P34.4 million.

#### Disclosures on Subsidiary with Material Non-controlling Interest

The Company has material non-controlling interests of 43.53% in PNB. Following is the financial information of the non-controlling interests in PNB as of and for the years ended December 31:

	2013	2013	2011
	(In Thousands)		
Accumulated balances of material non-controlling interest	P 28,844,411	P 27,902,694	P 25,355,809
Net income allocated to material non-controlling interest	2,647,901	2,906,532	2,606,996
Comprehensive income allocated to material non-controlling interest	959,404	2,550,920	4,621,296
Dividends paid to material non-controlling interest	—	13,059	—

As discussed in Note 1, on February 9, 2013, PNB acquired 100.00% of the voting common stock of ABC. PNB accounted the business combination with ABC under the acquisition method of PFRS 3. In the LTG consolidated financial statements, the merger of PNB and ABC and the acquisition of PNB through the Bank Holding Companies are accounted for under pooling of interest method. Thus, the summarized financial information of PNB below is based on the amounts in the consolidated financial statements of PNB prepared under pooling of interest method before the Group's inter-company eliminations.

#### Statements of Comprehensive Income:

	2013	2012	2011
	(In Thousands)		
Revenue	P 28,855,871	P 32,097,694	P 29,543,967
Cost of services	(6,121,012)	(7,666,772)	(8,826,010)
General and administrative expenses	(19,133,631)	(21,069,344)	(19,006,280)
Foreign exchange gains - net	1,167,545	926,731	1,390,741
Other income - net	2,693,949	3,692,539	4,419,810
Income before income tax	7,462,722	7,980,848	7,522,228
Provision for income tax	(1,228,074)	(1,455,436)	(1,337,537)
Net income	6,234,648	6,525,412	6,184,691
Other comprehensive income (loss)	(3,500,920)	(1,035,144)	4,770,161
Total comprehensive income	P 2,733,728	P 5,490,268	P 10,954,852
Net income attributable to:			
Equity holders of PNB	P 6,082,933	P 6,677,077	P 5,988,964
Non-controlling interests	151,715	(151,665)	195,727
Total comprehensive income attributable to:			
Equity holders of PNB	2,204,005	5,860,141	10,616,347
Non-controlling interests	529,723	(369,873)	338,505

#### Balance Sheets:

	December 31	January 1,
	2013	2012
	(In Thousands)	
Current assets	P 315,217,749	P 260,658,713
Noncurrent assets	286,896,332	269,032,874
Current liabilities	(498,100,982)	(416,280,928)
Noncurrent liabilities	(34,622,189)	(46,479,430)
Equity attributable to:		
Equity holders of PNB	(66,263,291)	(64,106,067)
Non-controlling interest	(3,127,619)	(2,825,162)

#### Statements of Cash Flows:

	2013	2012	2011
	(In Thousands)		
Operating	P 48,744,659	(P 9,626,822)	P 3,858,488
Financing	70,455,937	12,971,712	19,456,772
Investing	(7,555,741)	8,092,588	(2,713,414)
	P 111,644,855	P 11,437,478	P 20,601,846

## December 31, 2013

December 31, 2012 LT GROUP, INC.

December 31, 2011

	At Appraised Values			At Cost							
	Land and Land Improvements	Plant Buildings and Building Improvements	Machineries and Equipment	Subtotal	Office and Administration Buildings and Improvements	Transportation Equipment	Returnable Containers	Furniture, Fixtures and Other Equipment	Construction in progress	Subtotal	Total
<i>(In Thousands)</i>											
<b>Cost</b>											
Balance at beginning of the year	P 15,328,276	P 13,931,478	P 18,317,607	P 47,577,361	P 1,088,607	P 1,490,103	P 4,864,647	P 8,167,069	P 291,649	P 15,902,075	P 63,479,436
Additions	26,850	327,331	1,441,188	1,795,369	143,887	212,765	1,756,254	597,324	383,047	3,093,277	4,888,646
Appraisal increase	894,999	5,409,453	5,373,114	11,677,566	—	—	—	—	—	—	11,677,566
Disposals, transfers and other adjustments											
(Note 28)	320,963	564,020	(1,218,777)	(333,794)	(22,745)	(68,237)	(1,326,091)	(540,589)	(53,606)	(2,011,269)	(2,345,062)
Balance at end of the year	16,571,088	20,232,282	23,913,132	60,716,502	1,209,749	1,634,631	5,294,810	8,223,804	621,090	16,984,084	77,700,586
<b>Accumulated Depreciation, Amortization and Impairment Losses</b>											
Balance at beginning of the year	(401,816)	(5,175,035)	(8,968,274)	(14,545,125)	(678,482)	(1,101,583)	(3,255,839)	(6,099,570)	—	(11,135,474)	(25,680,599)
Depreciation and amortization	(25,709)	(496,586)	(958,087)	(1,480,382)	(96,536)	(150,028)	(663,379)	(712,414)	—	(1,622,357)	(3,102,739)
Revaluation increase	(178,194)	(2,077,757)	(4,567,711)	(6,823,662)	—	—	—	—	—	—	(6,823,662)
Disposals, transfers and other adjustments											
(Note 28)	(178,817)	(175,562)	—	(354,379)	(46,128)	61,359	326,092	688,466	—	1,029,789	675,410
Impairment loss (Note 28)	(26,490)	(63,194)	—	(89,684)	—	—	(117,918)	—	—	(117,918)	(207,602)
Balance at end of the year	(811,026)	(7,988,134)	(14,494,072)	(23,293,232)	(821,146)	(1,902,252)	(3,711,044)	(6,123,518)	—	(11,845,960)	(35,139,192)
<b>Net Book Value</b>	P 15,760,062	P 12,244,148	P 9,419,060	P 37,423,270	P 388,603	P 444,379	P 1,583,766	P 2,100,286	P 621,090	P 5,138,124	P 42,561,394

## Revaluation of Land and Land Improvements and Plant Buildings and Machineries and Equipment

The corresponding fair values of land and land improvements, plant buildings and building improvements, and machineries and equipment are determined based on valuation performed by independent appraisers. The fair value of the land was determined using the market data approach based on available market evidence and the fair values for land improvements, plant buildings, and machineries and equipment were derived using the depreciated replacement cost. The dates of the latest appraisal valuations were December 31, 2011 (see Note 33). Movements in revaluation increment, net of deferred income tax effect, are as follows:

	December 31		January 1,
	2013	2012	2012
(In Thousands)			
Revaluation increment on the property, plant and equipment, net of deferred income tax effect:			
Beginning of year	P 9,475,117	P 9,694,977	P 6,544,779
Revaluation increase	910,415	129,200	3,397,733
Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal	(1,422,368)	(349,060)	(247,535)
	P 8,963,164	P 9,475,117	P 9,694,977
Attributable to:			
Equity holders of the parent company	P 6,378,188	P 6,810,285	P 7,060,676
Non-controlling interests	2,584,976	2,664,832	2,634,301
	P 8,963,164	P 9,475,117	P 9,694,977

If land and land improvements, plant buildings and building improvements, and machineries and equipment were measured using cost model, the carrying amount would be as follows:

	December 31		January 1,
	2013	2012	2012
(In Thousands)			
Cost			
Land and land improvements	P 7,235,779	P 7,228,130	P 7,183,236
Plant buildings and improvements	13,839,217	13,346,438	12,756,091
Machineries and equipment	16,429,028	15,603,918	15,055,225
	37,504,024	36,178,486	34,994,552
Accumulated depreciation			
Plant buildings and improvements	(3,836,248)	(3,017,150)	(4,202,224)
Machineries and equipment	(8,637,769)	(8,616,549)	(7,219,025)
	(12,474,017)	(11,633,699)	(11,421,249)
	P 25,030,007	P 24,544,787	P 23,573,303

## Impairment, Write-off and Disposal of Property, Plant and Equipment

The Group recognized impairment losses for certain property, plant and equipment amounting to P33.5 million and P207.6 million in 2012 and 2011, respectively. Management assessed that the carrying amounts of these assets should be fully impaired since there is no more expected future economic benefit from these assets.

## Depreciation

Depreciation of property, plant and equipment charged to operations is as follows:

	December 31		
	2013	2012	2011
(In Thousands)			
Cost of sales and services (Note 25)	P 1,298,012	P 1,278,879	P 1,153,709
Selling expenses (Note 26)	717,807	683,885	710,262
General and administrative expenses (Note 27)	1,269,830	1,112,413	1,238,768
	P 3,285,649	P 3,075,177	P 3,102,739

The Group has recorded additional depreciation amounting to P32.3 million in 2011 due to the revision of the estimated useful lives of certain buildings and building improvements and machineries and equipment of the distilled spirits business.

Fully depreciated property, plant and equipment that are still used in operations amounted to P2.2 billion, P2.2 billion and P2.1 billion as of December 31, 2013 and 2012, and January 1, 2012, respectively.

## Borrowing Costs

Borrowing costs capitalized as part of property, plant and equipment under construction amounted to P7.1 million in 2011. Unamortized capitalized borrowing costs amounted to P15.1 million, P15.7 million and P15.5 million as of December 31, 2013 and 2012, and January 1, 2012, respectively. The average capitalization rates used to determine the amount of borrowing costs eligible for capitalization is 5.7% in 2011.

## Property, Plant and Equipment Held as Collateral

Interbev used its land property amounting to P46.5 million to partially secure its outstanding long-term debts as of 2011, which were fully paid in 2012 (see Note 19).



### 13. Investment Properties

Movements of the Group's investment properties are as follows *(in thousands)*:

December 31, 2013					
	Land	Buildings and Improvements	Residential Unit	Construction in Progress	Total
<b>Cost</b>					
Beginning balance	P 23,333,720	P 7,947,754	P 7,620	P 306,892	P 31,595,986
Additions	1,486,023	1,191,003	—	1,029,475	3,706,501
Transfers/disposals/others	(2,692,425)	283,189	—	(4,677)	(2,413,913)
Ending balance	22,127,318	9,421,946	7,620	1,331,690	32,888,574
<b>Accumulated Depreciation</b>					
Beginning balance	3,071,137	3,398,207	7,620	—	6,476,964
Depreciation	—	464,690	—	—	464,690
Provision for impairment losses	706,318	59,025	—	—	765,343
Transfer/disposals/others	(441,348)	(564,672)	—	—	(1,006,020)
Ending balance	3,336,107	3,357,250	7,620	—	6,700,977
<b>Net Book Value</b>	<b>P 18,791,211</b>	<b>P 6,064,696</b>	<b>P —</b>	<b>P 1,331,690</b>	<b>P 26,187,597</b>

December 31, 2012					
	Land	Buildings and Improvements and Machineries	Residential Unit	Construction in Progress	Total
<b>Cost</b>					
Beginning balance	P 25,882,931	P 9,356,034	P 7,620	P 363,744	P 35,610,329
Additions	1,117,008	482,725	—	307,189	1,906,922
Transfers/disposals/others	(3,666,219)	(1,891,005)	—	(364,041)	(5,921,265)
Ending balance	23,333,720	7,947,754	7,620	306,892	31,595,986
<b>Accumulated Depreciation</b>					
Beginning balance	3,030,498	4,454,450	7,620	—	7,492,568
Depreciation	—	339,845	—	—	339,845
Provision for (reversal of) impairment losses	(155,331)	21,405	—	—	(133,926)
Transfer/disposals/others	195,970	(1,417,493)	—	—	(1,221,523)
Ending balance	3,071,137	3,398,207	7,620	—	6,476,964
<b>Net Book Value</b>	<b>P 20,262,583</b>	<b>P 4,549,547</b>	<b>P —</b>	<b>P 306,892</b>	<b>P 25,119,022</b>

December 31, 2011					
	Land	Buildings and Improvements and Machineries	Residential Unit	Construction in Progress	Total
<b>Cost</b>					
Beginning balance	P 26,085,954	P 10,392,428	P 7,620	P 2,143	P 36,488,145
Additions	651,014	410,654	—	463,532	1,525,200
Transfers	(854,037)	(1,447,048)	—	(101,931)	(2,403,016)
Ending balance	25,882,931	9,356,034	7,620	363,744	35,610,329
<b>Accumulated Depreciation</b>					
Beginning balance	4,291,771	4,897,604	7,620	—	9,196,995
Depreciation	—	311,291	—	—	311,291
Provision for (reversal of) impairment losses	(371,947)	171,205	—	—	(200,742)
Transfer/disposal	(889,326)	(925,650)	—	—	(1,814,976)
Ending balance	3,030,498	4,454,450	7,620	—	7,492,568
<b>Net Book Value</b>	<b>P 22,852,433</b>	<b>P 4,902,584</b>	<b>P —</b>	<b>P 363,744</b>	<b>P 28,117,761</b>

The Group's investment properties consist of parcels of land for appreciation, residential and condominium units for lease and for sale, and real properties foreclosed or acquired in settlement of loans which are all valued at cost. Foreclosed investment properties still subject to redemption period by the borrowers amounted to P449.5 million and P437.2 million as of December 31, 2013 and 2012, respectively. The Group is exerting continuing efforts to dispose these properties. As discussed in Note 35, investment properties with an aggregate fair value of P300.0 million were mortgaged in favor of BSP as of December 31, 2012.

#### Fair Values of Investment Properties

Below are the fair values of the investment properties which were determined by professionally qualified, independent appraisers based on market values:

	December 31		January 1,
	2013	2012	2012
	<i>(In Thousands)</i>		
Land	P 35,072,992	P 36,100,591	P 28,305,035
Buildings and improvements	4,857,285	5,044,536	7,823,942
	<b>P 39,930,277</b>	<b>P 41,145,127</b>	<b>P 36,128,977</b>

The fair value of investment properties of the Group was arrived at using various acceptable valuation approaches and both observable and unobservable inputs (see Note 33).

#### Rent Income and Direct Operating Expenses of Investment Properties

Rental income and direct operating expenses arising from the investment properties amounted to P448.7 million and P190.3 million in 2013 and P396.8 million and P142.9 million in 2012, P306.9 million and P111.7 million in 2011, respectively (see Note 25).

Depreciation of investment properties charged to operations follows:

	December 31		
	2013	2012	2011
	<i>(In Thousands)</i>		
Cost of rental income (Note 25)	P 94,223	P 70,671	P 69,062
General and administrative expenses (Note 27)	370,467	269,174	242,229
	<b>P 464,690</b>	<b>P 339,845</b>	<b>P 311,291</b>



#### 14. Other Noncurrent Assets

Other noncurrent assets consist of:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Creditable withholding taxes	P 1,103,798	P 1,091,752	P 13,893
Deferred input VAT	539,296	591,050	603,112
Deferred reinsurance premiums	245,157	211,151	—
Deferred charges	121,156	97,912	106,868
Refundable deposits	167,547	124,959	103,133
Other security deposits	105,285	55,558	66,139
Deposit for future investments	355,716	272,533	232,301
Investment in Heritage Park	999,035	1,012,810	1,034,118
Other investments	37,233	24,240	18,857
Software costs	425,928	471,112	453,648
Goodwill	252,671	252,671	252,671
Chattel properties - net	120,615	118,083	71,263
Receivable from SPV - net	500	—	—
Others - net	133,781	502,289	598,826
	P 4,607,718	P 4,826,120	P 3,554,829

a. Deferred input VAT arises mainly from the acquisition of capital goods.

b. Movements in software costs are as follows:

	December 31		2011
	2013	2012	
	(In Thousands)		
Beginning of year	P 471,112	P 453,648	P 525,147
Additions	238,687	280,911	95,972
Disposals	—	(561)	—
Amortization (Note 27)	(283,871)	(262,886)	(167,471)
End of year	P 425,928	P 471,112	P 453,648

c. Refundable deposits consist principally of amounts paid by the property development segment to its utility providers for service applications and guarantee deposit to Makati Commercial Estate Association for plans processing, monitoring fee and development charge of the Group's projects. These refundable deposits amounting to P167.5 million, P125.0 million and P103.1 million as of December 31, 2013 and 2012, and January 1, 2012, respectively, will be refunded upon termination of the service contract and completion of the projects' construction.

d. The Group recognized goodwill pertains to ADI and Eton amounting to P144.7 million and P19.0 million, respectively. As at December 31, 2013, the Group performed its annual impairment testing of goodwill related to ADI, a CGU.

The recoverable amount of ADI is determined based on value in use calculations using cash flow projections from financial budgets approved by management covering a five-year period. The projected cash flows have been updated to reflect the increase in demand for products based on TDI's projected sales volume increase, selling price increase and cost and expenses increase. The pre-tax discount rate applied to the cash flow projection is 8.3%. The growth rate used to extrapolate the cash flows of until beyond the five-year period is 5.5 %. Management assessed that this growth rate is comparable with the average growth for the industry in which ADI operates.

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of ADI to exceed its recoverable amount, which is based on value in use. As of December 31, 2013, value in use of ADI amounted to P12.5 billion.

e. As of December 31, 2013 and 2012, accumulated depreciation on chattel mortgage properties acquired by PNB in settlement of loans amounted to P77.8 million and P56.6 million, respectively.

f. The Group has receivable from SPV, OPIL, which was deconsolidated upon adoption of PFRS 10 (see Note 2).

As of December 31, 2013 and 2012, receivable from SPV represents fully provisioned subordinated notes received by PNB from Golden Dragon Star Equities and its assignee, OPIL, relative to the sale

of the first pool and second pool of its NPAs in December 2006 and March 2007, respectively. The asset sale and purchase agreements (ASPA) between PNB, Golden Dragon Star Equities and OPIL for the sale of the NPAs were executed on December 19, 2006. OPIL was specifically organized to hold, manage, service and resolve the non-performing assets sold to Golden Dragon Star Equities. OPIL has been financed through the issuance of equity securities and subordinated debt securities. No income was recognized from OPIL in 2013.

The more significant terms of the sale are as follows:

a. Certain NPAs of PNB were sold to the SPV and divided into two pools. The sale of the first pool of NPAs with an outstanding balance of P11.7 billion was made on December 29, 2006 for a total consideration of P11.7 billion.

b. The agreed purchase price of the first pool of NPAs shall be paid as follows:

i. An initial amount of P1.1 billion, which was received in full and acknowledged by the PNB on February 14, 2007; and

ii. The balance of P10.6 billion, through issuance of SPV Notes, shall be paid over five (5) years based on a cash flow waterfall arrangement and at an interest equivalent to the 3-month MART prevailing as of the end of the quarter prior to the payment date.

Under the ASPA, the sale of the second pool of NPAs amounting to P7.6 billion with allowance for credit losses of P5.5 billion became effective in March 2007. The agreed purchase price of this pool of NPAs were paid as follows:

a. An initial amount of P751.1 million, which was received in full and acknowledged by PNB on April 26, 2007; and

b. The balance of P6.8 billion through issuance of SPV Notes, shall be paid over five (5) years based on a cash flow waterfall arrangement and at an interest equivalent to the 3-month MART prevailing as of the end of the quarter prior to the payment date. In case of insufficiency of funds for payment of the SPV Notes, the buyer of the NPAs, with the consent of PNB, which consent shall not be unreasonably withheld, may write-off the SPV Notes, including all interest, fees and charges outstanding and payable.

g. Allowance for impairment losses on other noncurrent assets amounting to P857.2 million, P917.2 million and P2.1 billion includes allowance for credit losses on receivable from SPV amounting to P0.5 million, P258.8 million and P833.8 million as of December 31, 2013 and 2012 and January 1, 2012, respectively.

h. Security fund amounting to P0.15 million (included under "Others - net") is maintained by PNB LII in compliance with Sections 365 and 367 of the Insurance Code as of December 31, 2013. The amount of such fund is determined by and deposited with the Insurance Code for the payment of benefit claims against insolvent companies.

#### 15. Deposit Liabilities

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Demand	P 90,428,033	P 70,732,692	P 70,157,833
Savings	284,599,682	260,427,479	254,654,359
Time	51,114,363	47,587,615	58,155,187
	426,142,078	378,747,786	382,967,379
Presented as noncurrent	10,451,554	24,805,196	21,923,074
Presented as current	P 415,690,524	P 353,942,590	P 361,044,305

Of the total deposit liabilities of PNB, P26.1 billion, P12.9 billion and P11.1 billion are non-interest bearing as of December 31, 2013 and 2012 and January 1, 2012, respectively. Annual interest rates of the remaining deposit liabilities follow:

	2013	2012	2011
Foreign-currency denominated deposit liabilities	0.02% to 2.53%	0.09% to 2.55%	0.20% to 7.00%
Peso-denominated deposit liabilities	0.11% to 5.59%	0.25% to 4.32%	0.50% to 10.00%

On March 29, 2012, BSP issued Circular No. 753 which provides for the unification of the statutory and liquidity reserve requirement, non-remuneration of the unified reserve requirement, exclusion of vault cash and demand deposits as eligible forms of reserve requirement compliance, and reduction in the unified reserve requirement ratios.

Under existing BSP regulations, non-FCDU deposit liabilities of PNB and Allied Savings Bank (ASB) are subject to reserves equivalent to 18.00% and 6.00%, respectively. Available reserves follow:

	December 31 2013	2012	January 1, 2012
	(In Thousands)		
Due from BSP	P 63,556,710	P 36,531,047	P 37,513,558
Unquoted debt securities	2,741,000	3,092,529	3,096,485
AFS investments	—	6,965,950	4,559,997
Cash and other cash items	—	—	4,166,007
	P 66,297,710	P 46,589,526	P 49,336,047

As of December 31, 2013 and 2012 and January 1, 2012, PNB and ASB were in compliance with such regulations.

#### Long-term Negotiable Certificates of Time Deposits

Time deposit of the Group includes the following Long-term Negotiable Certificates of Time Deposits (LTNCDs):

Issue Date	Maturity Date	Face Value (In Thousands)	Carrying Value (In Thousands)	Coupon Rate	Interest Repayment Terms
October 21, 2013	April 22, 2019	P 4,000,000	P 3,971,075	3.25%	Quarterly
August 5, 2013	February 5, 2019	P 5,000,000	P 4,968,004	3.00%	Quarterly
November 18, 2011	February 17, 2017	P 3,100,000	P 3,086,513	5.18%	Quarterly
October 22, 2009	October 23, 2014	P 3,500,000	P 3,582,808	7.00%	Quarterly
March 25, 2009	March 31, 2014	P 3,250,000	P 3,248,369	6.50%	Quarterly

Other significant terms and conditions of the above LTNCDs follow:

- Issue price at 100.00% of the face value of each LTNCD.
- The LTNCDs bear interest rate per annum on its principal amount from and including the Issue Date thereof, up to but excluding the Early Redemption Date or Maturity Date (as the case may be).

Interest in respect of the LTNCD will be calculated on an annual basis and will be paid in arrears quarterly on the last day of each successive interest period.

- Unless earlier redeemed, the LTNCDs shall be redeemed by PNB on maturity date at an amount equal to one hundred percent (100%) of the aggregate issue price thereof, plus any accrued and unpaid interest thereon. The LTNCDs may not be redeemed at the option of the holders.
- The LTNCDs constitute direct, unconditional, unsecured, and unsubordinated obligations of PNB, enforceable according to these Terms and Conditions, and shall at all times rank *pari passu* and without any preference or priority among themselves and at least *pari passu* with all other present and future direct, unconditional, unsecured, and unsubordinated obligations of the Issuer, except for any obligation enjoying a statutory preference or priority established under Philippine laws.
- Subject to the "Events of Default" in the Terms and Conditions, the LTNCDs cannot be pre-terminated at the instance of any CD Holder before Maturity Date. In the case of an event of default, none of the CD Holders may accelerate the CDs on behalf of other CD Holders, and a CD Holder may only collect from PNB to the extent of his holdings in the CDs. However, PNB may, subject to the General Banking Law of

2000, Section X233.9 of the Manual of Regulations for Banks, Circular No. 304 Series of 2001 of the BSP and other related circulars and issuances, as may be amended from time to time, redeem all and not only part of the outstanding CDs on any Interest Payment Date prior to Maturity Date, at an Early Redemption Amount equal to the Issue Price plus interest accrued and unpaid up to but excluding the Early Redemption Date.

- The LTNCDs are insured by the PDIC up to a maximum amount of P500,000 subject to applicable laws, rules and regulations, as the same may be amended from time to time.
- Each Holder, by accepting the LTNCDs, irrevocably agrees and acknowledges that: (a) it may not exercise or claim any right of set-off in respect of any amount owed to it by the PNB arising under or in connection with the LTNCDs; and (b) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

Interest expense on deposit liabilities presented under "Cost of banking services" amounted to P3.9 billion, P5.6 billion and P6.4 billion in 2013, 2012 and 2011, respectively (see Note 25).

In 2013, 2012 and 2011, interest expense on LTNCDs for the Group includes amortization of transaction costs amounting to P19.4 million, P9.5 million and P14.6 million, respectively.

#### 16. Financial Liabilities at Fair Value through Profit or Loss (FVPL)

Financial liabilities at fair value through profit or loss consist of:

	December 31 2013	2012	January 1, 2012
	(In Thousands)		
Designated at FVPL			
Segregated fund liabilities	P 7,911,794	P 3,739,576	P 1,365,013
Subordinated notes	—	6,196,070	6,480,154
Derivative liabilities (Notes 21 and 37)	163,101	389,817	261,424
	8,074,895	10,325,463	8,106,591
Presented as noncurrent	7,882,700	6,196,070	6,479,170
Presented as current	P 192,195	P 4,129,393	P 1,627,421

The balance of segregated fund liabilities consists of:

	December 31, 2013
Segregated funds (Note 6)	P 7,861,688
Additional subscriptions	50,106
Segregated fund liabilities	P 7,911,794

As of December 31, 2012, financial liability designated at FVPL represents the P6.0 billion subordinated notes due in 2018 which was issued by PNB on June 19, 2008. The subordinated note is part of a group of financial instruments that together are managed on a fair value basis, in accordance with PNB's documented risk management and investment strategy.

Among the significant terms and conditions of the issuance of such 2008 Notes are:

- Issue price at 100.00% of the principal amount;
- The 2008 Notes bear interest at the rate of 8.50% per annum from and including June 19, 2008 to but excluding June 19, 2013. Interest will be payable quarterly in arrears on the 19th of March, June, September and December of each year, commencing on September 19, 2008. Unless the 2008 Notes are previously redeemed, interest from and including June 19, 2013 to but excluding June 19, 2018 will be reset at the equivalent of the higher of (i) five-year PDST-F Fixed Rate Treasury Notes (FXTN) as of reset date multiplied by 80.00%, plus a step-up spread of 2.0123% per annum or (ii) difference of interest rate and five-year PDST-F FXTN as of issue date multiplied by 150% plus five-year



PDST-F FXTN as of reset date, and such step-up interest rate shall be payable quarterly in arrears on 19th of March, June, September and December of each year, commencing on September 19, 2013. The 2008 Notes will mature on June 19, 2018, if not redeemed earlier;

- c. The 2008 Notes constitute direct, unconditional, unsecured and subordinated obligations of PNB and at all times rank pari passu without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of the PNB;
- d. PNB may redeem the 2008 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the twentieth (20th) interest period from issue date, subject to the prior consent of the BSP and the compliance by PNB with the prevailing requirements for the granting by the BSP of its consent thereof. The 2008 Notes may not be redeemed at the option of the noteholders; and
- e. Each noteholder, by accepting the 2008 Notes, irrevocably agrees and acknowledges that: (i) it may not exercise or claim any right of set-off in respect of any amount owed by PNB arising under or in connection with the 2008 Notes; and (ii) it shall, to the fullest extent permitted by applicable law, waive and be deemed to have waived all such rights of set-off.

On June 18, 2013, PNB exercised its option to redeem the 2008 Notes.

## 17. Bills and Acceptances Payable

Bills and acceptance payable consists of:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Bills payable to:			
BSP and local banks (Note 23)	P 8,522,539	P 10,452,727	P 9,268,748
Foreign banks	2,821,186	4,736,696	2,609,909
Others	1,463,979	2,916,322	1,463,700
	12,807,704	18,105,745	13,342,357
Acceptances outstanding	364,293	336,507	368,367
	13,171,997	18,442,252	13,710,724
Presented as noncurrent	1,748,844	328,654	1,391,525
Presented as current	P 11,423,153	P 18,113,598	P 12,319,199

Annual interest rates are shown below:

	2013	2012	2011
Foreign currency-denominated borrowings	0.12% - 0.99%	0.06% - 1.77%	0.06% - 1.75%
Peso-denominated borrowings	1.09% - 3.50%	0.03% - 12.00%	1.87% - 12.00%

PNB's bills payable to BSP includes the transferred liabilities from Maybank Philippines, Inc. (Maybank) amounting to P1.7 billion, P1.6 billion and P1.7 billion as of December 31, 2013 and 2012 and January 1, 2012, respectively (see Note 8).

Bills payable includes funding from the Social Security System under which PNB acts as a conduit for certain financing programs of these institutions. Lending to such programs is shown under "Loans and receivables" (see Note 8).

As of December 31, 2013 and 2012 and January 1, 2012, bills payable with a carrying value of P2.2 billion, P3.0 billion and P3.3 billion is secured by a pledge of certain AFS investments with fair value of P2.5 billion, P2.8 billion and P3.0 billion, respectively (see Note 7).

As of December 31, 2013, bills payable under the BSP rediscounting facility with a carrying value of P112.6 million is secured by a pledge of loans and certain AFS investments with fair values of P219.3 million and P2.4 billion, respectively. As of December 31, 2012, bills payable under the BSP rediscounting facility with a carrying value of P1.9 billion and P1.0 billion is secured by a pledge of loans amounting to P2.0 billion and certain AFS investments with face value of P2.6 billion, respectively (see Notes 7 and 8).

Following are the significant terms and conditions of the repurchase agreements entered into by PNB:

- Each party represents and warrants to the other that it is duly authorized to execute and deliver the Agreement, and to perform its obligations and has taken all the necessary action to authorize such execution, delivery and performance;
- The term or life of this borrowing is up to one year;
- Some borrowings bear a fixed interest rate while others have floating interest rate;
- PNB has pledged its AFS investments, in form of US Treasury Notes and ROP Global bonds, in order to fulfill its collateral requirement;
- Haircut from market value ranges from 20.00% to 30.00% depending on the tenor of the bond;
- Substitution of pledged securities is allowed if one party requested and the other one so agrees.

Interest expense on bills payable is included under "Cost of banking services" amounting to P1.1 billion, P1.8 billion and P1.7 billion in 2013, 2012 and 2011, respectively (see Note 25).

## 18. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of:

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Trade payables	P 2,553,547	P 2,700,340	P 2,343,306
Accrued expenses:			
Interest	2,151,329	2,042,051	523,560
Projects development costs	1,686,872	1,880,573	1,144,134
Compensation and benefits	1,295,334	618,218	571,019
Taxes and licenses	798,672	158,801	100,908
Management, directors and other professional fees	472,968	150,296	207,974
PDIC insurance premiums	446,717	399,044	374,987
Purchase of materials and supplies	366,810	376,176	778,053
Information technology-related expenses	239,308	231,256	69,504
Promotional expenses	185,457	144,309	78,991
Rent and utilities payable	162,889	59,497	151,871
Reinstatement premium	152,734	—	—
Others	838,704	513,079	915,410
Retention payable	731,493	706,980	554,393
Nontrade payables	601,965	517,212	898,689
Provision for tax contingencies (Note 35)	335,410	419,398	326,301
Due to government agencies	178,545	216,081	244,767
Output value added tax	99,622	385,519	1,146,203
Advances from customers	2,062	179,788	90,559
Dividends payable	—	—	652,858
Other payables	60,262	106,434	408,863
	P 13,360,700	P 11,805,052	P 11,582,350

### Trade Payables

Trade payables are non-interest bearing and are normally settled on 30-to-60 day terms. Trade payables arise mostly from purchases of inventories, which include raw materials and indirect materials (i.e., packaging materials) and supplies, for use in manufacturing and other operations.

Trade payables also include importation charges related to raw materials purchases, as well as occasional acquisitions of production equipment and spare parts.

### Accrued Expenses

Other accrued expenses consist of accruals for commission, rent, outside services, fuel and oil, utilities, advertising and promotions and professional fees which are individually not significant as to amounts.

### Retention Payable

Retention payable is the amount deducted from the total billing of the contractor which will be paid upon completion of the contracted services of the Eton.

### Other Payables

Other payables include cash bond payable to haulers as security for inventories and payable other than to suppliers of raw materials which include, but not limited to advertising and freight companies.



## 19. Short-term and Long-term Debts

### Short-term Debts

At various dates in 2013, 2012 and 2011, the Group obtained short-term loans from various local banks to meet its working capital requirements. As of December 31, 2013 and 2012 and January 1, 2012, outstanding short term debts amounted to P300.0 million, P1,620.0 million and P1,220.0 million, respectively. The loans, which are payable in lump sum on various dates, are subject to annual interest rates ranging from 3.5% to 5.0%, 5.0% to 6.0% and 3.5% to 7.0%, which are payable lump sum on various dates within one year and subject to renewal upon agreement by the Group and counterparty banks. Short-term debts are unsecured except for a P400.0 million loan which is secured by corporate guaranty of ABI and Interbev as of December 31, 2012.

### Long-term Debts

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Subordinated debts	P 9,953,651	P 14,436,122	P 10,935,265
Bonds payable	4,982,544	4,968,295	4,955,148
Unsecured term loan	1,990,120	-	-
Notes payable	963,355	1,174,784	990,429
	17,889,670	20,579,201	16,880,842
Less current portion	1,009,915	4,777,872	543,650
	P 16,879,755	P 15,801,329	P 16,337,192

### PNB's Subordinated Debts

#### a. 5.88% P3.5 billion Subordinated Notes

On May 9, 2012, PNB's BOD approved the issuance of unsecured subordinated notes of P3.5 billion that qualify as Lower Tier 2 capital.

The 2012 Notes which bear nominal interest of 5.88% and due in 2022 was issued pursuant to the authority granted by the BSP to the Bank on May 27, 2011. EIR on this note is 6.04%.

Among the significant terms and conditions of the issuance of such 2012 Notes are:

- (1) Issue price at 100.00% of the principal amount;
- (2) The 2012 Notes bear interest at the rate of 5.88% per annum from and including May 9, 2012 to but excluding May 9, 2022. Interest will be payable quarterly in arrears on the 9th of August, November, February and June of each year, commencing on May 9, 2012, unless the 2012 Notes are previously redeemed at their principal amount on Maturity date or May 9, 2022. The stepped-up interest will be payable quarterly in arrears on 9th of August, November, February and May of each year, commencing on May 9, 2012;
- (3) The 2011 Notes constitute direct, unconditional, unsecured and subordinated obligations of PNB and at all times rank *pari passu* without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of PNB;
- (4) PNB may redeem the 2012 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the fifteenth (15th) interest period from issue date, subject to the prior consent of the BSP and the compliance by PNB with the prevailing requirements for the granting by the BSP of its consent thereof. The 2012 Notes may not be redeemed at the option of the noteholders; and
- (5) Each noteholder, by accepting the 2012 Notes, irrevocably agrees and acknowledges that it may not exercise or claim any right of set-off in respect of any amount owed by the PNB arising under or in connection with the 2012 Notes.

#### b. 6.75% P6.5 billion Subordinated Notes

On May 15, 2011, the PNB's BOD approved the issuance of unsecured subordinated notes of P6.5 billion that qualify as Lower Tier 2 capital.

The 2011 Notes which bear nominal interest of 6.75% and due in 2021, pursuant to the authority granted by the BSP to PNB on May 27, 2011. EIR on this note is 6.94%.

Among the significant terms and conditions of the issuance of such 2011 Notes are:

- (1) Issue price at 100.00% of the principal amount;
- (2) The 2011 Notes bear interest at the rate of 6.75% per annum from and including June 15, 2011 to but excluding June 15, 2021. Interest will be payable quarterly in arrears on the 15th of September, December, March and June of each year, commencing on June 15, 2011, unless the 2011 Notes are previously redeemed at their principal amount on Maturity date or June 15, 2021. Interest will be payable quarterly in arrears on 15th of September, December, March and June of each year, commencing on June 15, 2011;
- (3) The 2011 Notes constitute direct, unconditional, unsecured and subordinated obligations of PNB and at all times rank *pari passu* without preference among themselves and at least equally with all other present and future unsecured and subordinated obligations of PNB;
- (4) PNB may redeem the 2011 Notes in whole but not in part at a redemption price equal to 100.00% of the principal amount together with accrued and unpaid interest on the day following the last day of the fifteenth (15th) interest period from issue date, subject to the prior consent of the BSP and the compliance by PNB with the prevailing requirements for the granting by the BSP of its consent thereof. The 2011 Notes may not be redeemed at the option of the noteholders; and
- (5) Each noteholder, by accepting the 2011 Notes, irrevocably agrees and acknowledges that it may not exercise or claim any right of set-off in respect of any amount owed by PNB arising under or in connection with the 2011 Notes.

#### c. 7.13% P4.5 billion Subordinated Notes

On July 25, 2007, the BOD of PNB approved and authorized the management to conduct capital raising activity by way of issuance of Lower Tier 2 capital up to the maximum amount of P5.0 billion through a public offering subject to the provisions of BSP Circular No. 280 and BSP Memorandum to all banks and financial institutions dated February 17, 2003.

The issuance of the foregoing subordinated debt was approved by the MB in its Resolution No. 98 dated January 24, 2008.

Relative to this, on March 6, 2008, PNB issued P4.5 billion, 7.13% Subordinated Notes due on 2018, callable with step-up in 2013. Among the significant terms and conditions of the issuance of the subordinated notes are:

- (1) Issue price is at 100.00% of the Principal amount. The Subordinated Notes bear interest at 7.13% per annum, payable to the noteholder for the period from and including the issue date up to the maturity date if the call option is not exercised on the call option date. Interest shall be payable quarterly in arrears on March 6, June 6, September 6 and December 6 of each year, commencing June 6, 2008. The Subordinated Notes will mature on March 6, 2018, if not redeemed earlier.
- (2) The Subordinated Notes will constitute direct, unconditional, unsecured and subordinated obligations of PNB. The Subordinated Notes will, at all times, rank *pari passu* and without any preference among themselves, but in priority to the rights and claims of holders of all classes of equity securities of PNB, including holders of preferences shares.



(3) PNB may redeem the notes in whole, but not in part, at a redemption price equal to 100.00% of the principal amount of the Notes together with accrued and unpaid interest at first banking day after the 20th interest period from issue date subject to at least 30-day prior written notice to noteholders and prior approval of the BSP, subject to the following conditions: (i) the capital adequacy ratio of PNB is at least equal to the required minimum ratio; and (ii) the Subordinated Note is simultaneously replaced with the issues of new capital which are neither smaller in size nor lower in quality than the Subordinated Notes.

(4) The Subordinated Note shall not be redeemable or terminable at the instance of any noteholder before maturity date.

On March 6, 2013, the 2018 Notes were redeemed by PNB at par/face value.

As of December 31, 2013 and 2012 and January 1, 2012, the unamortized transaction cost of subordinated debt amounted to P46.3 million, P61.2 million, and P47.5 million, respectively. In 2013, 2012 and 2011, amortization of transaction costs amounting to P14.8 million, P12.2 million and P18.0 million, respectively, were charged to "Cost of banking services" in the consolidated statements of income (see Note 25).

#### *TDI's P5.0 billion bonds payable*

On November 24, 2009, TDI's and LTG's BOD approved and confirmed the issuance of the retail bonds amounting to P5.0 billion due in 2015 at 8.055% per annum, payable quarterly, to be used for general corporate purposes, including debt refinancing. On February 12, 2010, TDI completed the bond offering and issued the Retail Bonds with an aggregate principal amount of P5.0 billion, which will mature on February 13, 2015. Bond issue cost incurred amounted to P66.7 million. As of December 31, 2013 and 2012 and January 1, 2012, unamortized bond issue cost amounted to P17.6 million, P31.8 million and P44.9 million, respectively (presented as a reduction from the principal loan balance).

The bond provides that TDI may at any time purchase any of the bonds at any price in the open market or by tender or by contract at any price, without any obligation to purchase bonds pro-rata from all bondholders and the bondholders shall not be obliged to sell. Any bonds so purchased shall be redeemed and cancelled and may not be re-issued.

The bond also provides for certain negative covenants on the part of TDI such as:

- TDI shall not create or suffer to exist any lien, security interest or other charge or encumbrance, upon or with respect to any of its properties, whether now owned or hereafter acquired.
- TDI shall not assign any right to receive income for the purpose of securing any other debt, unless at the same time or prior thereto, its obligations under the bond agreement are forthwith secured equally and ratably therewith.
- TDI shall not have the benefit of such other security as shall not be materially less beneficial to the bondholders.
- TDI shall maintain, based on the most recent audited financial statements prepared in accordance with PFRS, a maximum debt-to-equity ratio of 1.75 times and a minimum current ratio of 2.0 times.

As of December 31, 2013 and 2012 and January 1, 2012, TDI has complied with the bond covenants.

#### *Unsecured term loans of Eton*

On January 28, 2013, Eton entered into an unsecured term loan agreement with Banco De Oro Unibank, Inc. (BDO) to finance the construction of its projects. The term loan, which has a face value of P2,000.00 million, was availed by Eton at a discount for total proceeds amounting to P1,987.33 million. The term loan bears a nominal interest rate of 5.53% and will mature on January 26, 2018. Principal repayments will start one year from the date of availment and are due annually while interest payments are due quarterly starting April 28, 2014.

#### *Notes payable of Eton*

Notes payable includes various notes from BDO which arose from assigning the Groups' contracts receivables on a with recourse basis in 2013, 2012

and 2011 (see Note 6). These notes bear interest based on Philippine Dealing System Treasury Fixing (PDSTF) rate for one year plus 1.5% net of gross receipts tax, which ranges from 5.22% to 6.00% in 2013 and 6.00% to 6.66% in 2012 and 2011 subject to annual repricing. Interest is due monthly in arrears during the first two years of the term and thereafter, interest shall be collected with the principal covering the term of three years or the term of the contracts to sell, whichever comes first.

Interest on loans payable from general borrowings capitalized as part of investment properties and real estate inventories amounted to P34.7 million and P68.4 million in 2013, P15.8 million and P103.9 million in 2012 and P21.2 million and P95.0 million in 2011, respectively. Capitalization rates were 4.51% in 2013, 5.30% in 2012 and 5.74% in 2011.

#### *Interbev's term loan facility agreement with BDO*

On June 24, 2011, Interbev entered into a Facility Agreement with BDO for a term loan facility amounting to P1,200.0 million to refinance the its short-term loans and to finance the its capital expenditure requirements for capacity expansion of its Davao and Cagayan de Oro plants and establishment of new bottling lines in San Fernando, Pampanga.

In accordance with the Facility Agreement, Interbev shall be subject to the following terms and conditions:

- Compliance with the following financial ratios: maximum debt to equity ratio of 3.0x in 2011, 2.0x in 2012 and 2013 and 1.0x in succeeding years and minimum debt service coverage ratio of 1.2x in all years;
- Existence of negative pledge on all existing and future assets of Interbev, except for permitted liens;
- Increasing the Interbev paid up capitalization by P100.0 million on or before December 31, 2012 and by P800.0 million on or before December 31, 2013, with the increase in capitalization to come from a new shareholder which is belonging to the Controlling Shareholders; and
- Continuing suretyship of Interbev.

As of December 31, 2013 and 2012 and January 1, 2012, Interbev has not utilized the term loan facility.

## 20. Other Liabilities

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Insurance contract liabilities	P 11,546,043	P 4,073,542	P 3,286,717
Banking accounts payable	9,061,565	8,802,674	6,630,134
Bills purchased - contra (Note 8)	3,417,082	2,553,891	2,296,039
Customers deposits	2,849,147	2,626,388	1,744,780
Provisions (Note 35)	1,771,242	1,575,433	874,950
Payable to landowners	1,296,785	1,296,785	—
Managers' checks and demand drafts outstanding	1,028,301	1,062,164	1,403,050
Reserve for unearned premiums	576,889	509,488	458,178
Deposit on lease contracts	502,293	52,483	401,439
Other dormant credits	437,715	345,017	357,129
Margin deposits and cash letters of credit	393,006	101,415	400,283
Due to Treasurer of the Philippines	311,387	292,973	223,037
Payment order payable	194,628	195,149	152,810
Tenants' rental deposits	161,600	80,004	75,496
Due to BSP	117,821	102,616	102,965
Unearned income and other deferred credits	16,968	186,203	213,367
Transmission liability	90,005	—	—
Advanced rentals	98,658	29,431	35,437
Interest payable	P 4,904	P 217,464	P 1,822,823
Other employee benefits	—	1,002,454	557,149
Due to other banks	—	196,203	1,180,370
Others	1,501,640	1,898,047	1,395,493
	35,377,679	27,199,824	23,611,646
Presented as noncurrent	2,299,948	3,870,370	1,756,306
Presented as current	P 33,077,731	P 23,329,454	P 21,855,340

#### Customers' Deposits

Customers' deposits represent payments from buyers of residential units which will be applied against the corresponding contracts receivables which are recognized based on the revenue recognition policy of the Group. This account includes the excess of collections over the recognized receivables amounting to P2.8 billion, P2.6 billion and P1.7 billion as of December 31, 2013 and 2012 and January 1, 2012, respectively.

## Payables to Landowners

In September 2012, Eton executed a P556.8 million promissory note to a landowner in relation to its purchase of land located at the corner of Dela Rosa and V.A. Rufino Sts., Legaspi Village, Makati City with total purchase price of P742.4 million. In November 2012, Eton again executed a promissory note to a landowner amounting to P740.0 million in relation to its purchase of land located at Don Alejandro Roces Avenue, Barangay Obrero, Quezon City with total purchase P1,000.0 million.

The details of the notes payable are presented below:

Principal amount	Interest rate	Due date
P 556,785,000	PDSTF 3 years + 1.00%	3 years from execution of note
740,000,000	PDSTF 3 years + 0.50%	3 years from execution of note

Accrued interest on the promissory notes capitalized as part of real estate inventories amounted to P29.8 million and P10.2 million in 2013 and 2012, respectively (see Note 9).

## Deposits and Other Deferred Credits

Other liabilities of the property development segment include tenants' rental deposits, advance rentals and other deferred credits. Security deposits pertain to the amounts paid by the tenants at the inception of the lease which is refundable at the end of the lease term. Advance rentals pertain to deposits from tenants which will be applied against receivables either at the beginning or at the end of lease term depending on the lease contract. Deferred credits represent the excess of the principal amount of the security deposits over its fair value. Amortization of deferred credits is included in "Rental income" in the consolidated statements of income.

## Banking Segment Liabilities

Other liabilities of the banking segment include insurance contract liabilities, accounts payable, bills purchased - contra, managers' checks and demand drafts outstanding, margin deposits and cash letters of credit and due to BSP.

## 21. Derivative Financial Instruments

The tables below show the fair values of derivative financial instruments entered into by the Group, recorded as derivative assets or derivative liabilities, together with the notional amounts. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding as of December 31, 2013 and 2012, and January 1, 2012 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

	December 31, 2013				2012				January 1, 2012			
	Assets	Liabilities	Average Forward Rate	Notional Amount*	Assets	Liabilities	Average Forward Rate	Notional Amount*	Assets	Liabilities	Average Forward Rate	Notional Amount*
<b>Freestanding derivatives:</b>												
<b>Currency forwards</b>												
<b>BUY:</b>												
USD	P 61,867	P 1,198	P 43.36	P 126,462	P 5,074	P 220,866	P 42.01	P 327,494	P 60,170	P 18,779	P 43.33	P 217,804
JPY	98	113	0.01	15,000	-	3,706	0.49	300,000	70	-	0.56	300,000
EUR	76	673	1.36	989	31	2	54.48	74	-	77	57.41	150
SGD	23	-	35.02	1,200	74	-	33.65	1,958	-	-	-	-
GBP	-	26	1.64	102	-	-	-	-	25	33	67.97	371
CAD	-	4	1.07	1,065	-	-	-	-	-	-	-	-
CHF	-	-	-	-	-	-	-	-	-	58	46.94	200
<b>SELL:</b>												
USD	1,293	136,372	43.74	264,471	88,836	77,426	41.11	632,903	118,945	107,853	43.79	821,653
JPY	329	321	0.43	477,776	983	573	0.48	540,000	6,060	6,049	0.56	528,000
GBP	97	1,257	1.64	5,100	133	23	66.11	1,790	148	47	68.30	871
EUR	79	1,240	1.56	5,447	1,944	1,276	54.18	7,877	22,112	79	36.88	24,176
CAD	67	-	1.00	2,365	208	-	41.39	510	-	224	42	500
SGD	-	885	0.79	6,200	-	73	33.65	10,608	82	70	33.76	207
AUD	54	-	0.89	250	441	552	43.15	700	45	177	43.75	400
CHF	23	-	1.12	400	10	24	45.05	1,050	320	-	46.83	1,100
HKD	25	-	7.75	158,946	41	2	5.3	90,872	-	-	-	-
SEK	-	-	-	-	-	4	6.32	300	-	-	-	-
NZD	-	-	-	-	-	-	-	-	11	-	33.74	50
<b>Cross currency swaps (CCS)</b>					255,132	-	-	1,086,000	-	51,886	-	1,086,000
<b>Interest rate swaps (Iris)</b>					174,067	83,510	-	62,069,000	280,174	64,309	-	7,319,000
<b>Warrants</b>	28,803	21,012	-	62,680	68,747	-	-	45,152	102,081	-	-	45,152
<b>Embedded derivatives:</b>												
<b>Credit default swaps (USD)</b>												
<b>Call Options:</b>												
USD	-	-	-	-	7,941	-	-	70,000	59,082	9,484	-	110,000
EUR	-	-	-	-	-	652	-	2,000	2,940	2,244	-	48,000
						1,138	-	1,000	59	55	-	500
	<b>P 258,697</b>	<b>P 163,101</b>			<b>P 603,262</b>	<b>P 389,817</b>		<b>P 652,324</b>	<b>P 652,324</b>	<b>P 261,424</b>		

\* The notional amounts pertain to the original currency except for the embedded derivatives, which represent the equivalent USD amounts.



a. In May and June of 2008, the Group entered into CCS agreements with various counterparty banks in which the proceeds from the 2008 Notes were swapped for USD. The aggregate notional amount of the CCS is US\$185.0 million or P8.1 billion while its net positive fair value amounted to P37.4 million as of December 31, 2010. The Group renewed some of these agreements with various counterparty banks in May and June of 2011 with terms to maturities of two years. The aggregate notional amount of these CCS is US\$79.0 million or P3.4 billion while the positive fair value amounted to P190.3 million and P32.3 million as of December 31, 2012 and January 1, 2012, respectively.

On June 21, 2011, the Group entered into a cross currency swap agreement with a notional amount of US\$7.0 million or P299.0 million and will mature on June 17, 2013. Proceeds of the 2011 Notes were swapped for USD. As of December 31, 2013 and 2012, its positive fair value amounted to P11.7 million and P7.5 million, respectively. In order to fulfill collateral requirements, the Group has pledged its cash amounting to US\$2.0 million or P85.4 million and US\$2.0 million or P85.4 million as of December 31, 2012 and January 1, 2012.

b. As of December 31, 2013 and 2012, and January 1, 2012, PNB holds 306,405 shares, 261,515 shares and 261,515 shares of ROP Warrants Series B1 at their fair value of US\$2.19 million, US\$1.44 million and US\$2.09 million, respectively.

c. Embedded derivatives that have been bifurcated are credit derivatives in structured notes with a notional reference of US\$47.5 million with a positive fair value of P0.92 million and a notional reference of US\$70.0 million with a positive fair value of P7.94 million as of December 31, 2013 and 2012, and January 1, 2012, respectively, and call options embedded in debt instruments with notional reference of US\$2.0 million and EUR1.0 million with a positive fair value of P1.8 million as of December 31, 2012. The structured notes and the related credit default swap matured on May 1, 2013.

d. The table below shows the rollforward analysis of net derivatives assets (liabilities):

	December 31		January 1,
	2013	2012	2012
	(In Thousands)		
Balance at beginning of year	P 213,445	P 390,900	P 656,529
Changes in fair value	(194,550)	159,106	144,779
Settlements	76,701	(336,561)	(410,408)
	P 95,596	P 213,445	P 390,900

The changes in fair value of the derivatives are included in "Trading and investments securities gains - net" presented as part of "Banking revenues" in the consolidated statements of income (see Note 25).

## 22. Finance Costs and Finance Income

Details of finance costs and finance income (other than the banking segment) are as follows:

	2013	2012	2011
	(In Thousands)		
Finance costs (Note 19):			
Short-term debts	P –	P 1,759	P 3,729
Bonds payable	402,750	402,750	402,750
Unsecured term loan and notes payable	63,893	130,530	125,257
Amortization of bond issue costs	14,249	13,148	12,068
Finance costs	P 480,892	P 548,187	P 543,804
Finance income:			
Cash and other cash items (Note 5)	P 84,908	P 96,813	P 59,886
Interest-bearing contracts receivable (Note 8)	39,385	50,331	37,438
AFS investments (Note 7)	14,800	11,100	7,200
	P 139,093	P 158,244	P 104,524

## 23. Related Party Transactions

The Company has transacted with its subsidiaries, associates and other related parties as follows:

Parent Company, Subsidiaries, Associate and Joint Venture	Entities Under Common Control
<i>Parent Company</i>	Ascot Holdings, Inc.
Tangent	Pol Holdings, Inc.
	Sierra Holdings & Equities, Inc.
<i>Subsidiaries</i>	Grand Cargo and Warehousing Services, Inc.
TDI and Subsidiaries	Northern Corporation Tobacco Redrying Co., Inc.
ADI	Basic Holdings Corporation
AAC	Dominium Realty & Construction Corp.
TBI	Foremost Farms Inc.
ABI and Subsidiaries	Grandspan Development Corp.
Agua Vida	Himmel Industries Inc.
Interbev	Lapu Lapu Packaging
Waterich	Lucky Travel Corporation
Packageworld	Philippine Airlines, Inc.
FTC	Rapid Movers & Forwarders Co. Inc.
Shareholdings	Upright Profits Ltd.
Saturn	Dyzum Distillery Inc.
Paramount and Subsidiaries	Parity Packaging Corp.
Eton	Heritage Holdings Corp.
Belton	Maxell Holdings, Corp.
Eton City	Networks Holdings & Equities, Inc.
FirstHomes	Cube Factor Holdings, Inc.
Bank Holding Companies <sup>(1)</sup>	Trustmark Holdings Corporation
Allmark Holdings Corp.	Polima International Limited
Dunmore Development Corp.	Cosmic Holdings Corp.
Kenrock Holdings Corp.	Negros Biochem Corporation
Leadway Holdings, Inc.	Grandway Construct, Inc.
Multiple Star Holdings Corp.	Harmonic Holdings Corp.
Pioneer Holdings & Equities, Inc.	Proton Realty & Development Corporation
Donfar Management Ltd.	Billinge Investments Limited
Fast Return Enterprises Ltd.	Step Dragon Co. Limited
Mavelstone International Ltd.	High Above Properties Ltd.
Uttermost Success, Ltd.	Penick Group Limited
Ivory Holdings, Inc.	In Shape Group Ltd.
Merit Holdings & Equities Corp.	Hibersham Assets Ltd.
True Success Profits Ltd.	Orient Legend Developments Ltd.
Key Landmark Investments Ltd.	Complete Best Development Ltd.
Fragile Touch Investments Ltd.	Cormack Investments Ltd.
Caravan Holdings, Corp.	Link Great International Ltd.
Solar Holdings Corp.	Bright Able Holdings Ltd.
All Seasons Realty Corp.	
Dynaworld Holdings Inc.	
Fil-Care Holdings Inc.	
Kentwood Development Corp.	
La Vida Development Corp.	
Profound Holdings Inc.	
Purple Crystal Holdings, Inc.	
Safeway Holdings & Equities Inc.	
Society Holdings Corp.	
Total Holdings Corp.	
PNB and Subsidiaries	
<i>Associate</i>	
PMFTC	
<i>Joint Venture</i>	
ABI Pascual Holdings	
ABI Pascual Foods	

<sup>(1)</sup> In various dates in 2013, LTG acquired these holding companies through subscription of the increase in authorized capital stock of the holding companies.

The consolidated statements of income include the following revenue and other income-related (costs and other expenses) account balances arising from transactions with related parties:

Nature	2013	2012	2011
	(In Thousands)		
<i>Parent Company</i>	Interest income	P –	P –
	Sales	4,372	642
	Professional and management fee	–	–
<i>Associate</i>	Dividend Income	3,953,406	4,236,260
	Outside services	–	(188,713)
	Banking revenue - interest on loans and receivables	184,370	525,607
	Sales of consumer products	21,117	121,000
	Interest income on loans and advances	39,556	23,888
	Rent Income	16,830	28,334
	Other Income	7,672	–
	Freight and handling	(5,364)	(14,144)
<i>Entities Under Common Control</i>	Purchases of inventories	(53,145)	(132,582)
	Cost of banking services - interest expense on deposit liabilities	(18,831)	(10,609)
	Cost of sales and services	(35,168)	(39,663)
	Management and professional fee	(422,866)	(181,285)
	Outside services	(41,672)	(77,200)
	Rent expense	(5,298)	(3,021)
<i>Key Management</i>	Key management compensation	(115,549)	(108,029)





The consolidated balance sheets include the following asset (liability) account balances with related parties:

Financial Statement Account	Terms and Conditions	Amount/Volume		Outstanding Balance	
		December 31		January 1,	
		2013	2012	2013	2012
		(In Thousands)			
Parent Company	Due from related parties	P –	P 145,000	P –	P 5,801,474
	Due to related parties	(7,001,728)	–	(6,956,332)	(28,407,097)
	Dividends receivable	3,953,406	4,236,260	357,855	363,965
Associate	Trade receivables	4,372	642	387	–
	Due from related parties	(2,772)	–	–	2,971
	Finance Receivables			–	–
	Loans with interest rates ranging from 0.5% to 16.5% and maturity terms ranging from one (1) month to 25 years; Collateral includes bank deposit hold-out, real estate and chattel mortgages				
		184,370	525,607	3,390,516	8,556,236
	Trade receivables	21,117	121,000	9,879	499,892
	Other receivables	39,556	23,888	3,361	3,174
	Due from related parties	1,755,327	3,176,552	2,709,994	3,516,016
	Advances to suppliers	40,225	(11,605)	61,447	32,827
Entities Under Common Control	Advances to contractors	(104,490)	105,654	1,164	
	Deposit liabilities				
		18,831	10,609	11,023	(1,196,360)
	Bills payable				
	Foreign currency-denominated bills payable; with fixed annual interest rate of 1.77% and maturity term of 181 days; no collateral				
		40,000	–	(40,000)	–
	Account payable and other liabilities	563,513	447,895	(290,215)	(387,732)
	Due to related parties	(1,150,000)	1,566,201	(388,577)	(1,111,059)
	Other payables	14,280	21,922	(36,202)	(21,922)
Stockholders	Due from related parties	–	–	191	1,766,675
	Due to related parties	(109,459)	–	(691,610)	(801,070)

As of December 31, 2013 and 2012 and January 1, 2012, the outstanding related party balances are unsecured and settlement occurs in cash, unless otherwise indicated. The Group has not recorded any impairment of receivables relating to amounts owed by related parties. This assessment is undertaken each financial year through examining the financial position of the related parties and the market in which these related parties operate.

Other terms and conditions related to the above related party balances and transactions are as follows:

#### *Transactions with Tangent, parent company*

- In May 2013, LTG assumed various advances made by FTC to Tangent amounting to P10.8 billion.
- LTG assigned to Tangent its existing liabilities to Billinge, Penick Group and Step Dragon amounting to P1.9 billion and assumed the liabilities of ABI and Saturn to Tangent amounting to P7.4 billion. In various dates in 2013, LTG paid P7.0 billion to Tangent. In July 2013, all the existing advances to Tangent amounting to P11.0 billion were offset with the existing advances from Tangent.
- On June 19, 2013, LTG declared dividends to stockholders of which P1.2 billion was paid to Tangent.
- In March 2011, LTG applied the advances to Tangent amounting to P389.7 million and interest receivable amounting to P58.8 million against the dividends due to Tangent. The receivable from Tangent in 2011 represents expenses paid in behalf of Tangent.
- On March 20, 2013, the respective BOD's of Tangent and the Bank Holding Companies approved a resolution to convert the debt of the Bank Holding Companies to equity by way of subscription to the latter's preferred shares. On the same date, Tangent entered into Deeds of Assignment with the Bank Holding Companies for the assignment of the debt as payment for the subscription. In various dates in October, November and December 2013, the Philippines SEC approved the increase in authorized capital stock of certain Bank Holding Companies and the subscription of Tangent to all the outstanding preferred shares of these companies (see Note 30).

#### *Transactions with Entities under Common Control*

- Due to related parties include cash advances provided to the Group to support its working capital requirements.
- Several subsidiaries of the Group entered into management service agreement with Basic Holdings Corporation for certain consideration. Management fees are recorded under "Outside services" in "Cost of goods sold" and "Professional fees" in the "General and administrative expenses".
- The Group's sells by-products to Foremost and various packaging materials to Lapu Lapu which ceased to operate in 2012.
- The property development segment purchases parcels of land from other related parties for use in its various projects.
- The Group has outstanding balances to Grandway and Grandspan pertaining to the development of the Group's projects which comprise of advances to contractors and retention payable. In 2013, all advances to Grandway were collected and all retentions payable were settled due to the dissolution of Grandway.
- Several entities under common control maintain peso and foreign currency denominated deposits and short term and long term loans with PNB. Interest income and financing charges related to these transactions are reported under "Banking revenue" and "Cost of banking services", respectively (see Note 25).

#### *Transactions with an Associate*

- FTC has management services agreement with PMFTC. Under the Transitional Service Agreement (TSA), FTC shall render management services in relation to PMFTC's operations such as procurement, marketing, sales and merchandising, human resource, financial and administrative, legal and information systems services. Management fee is computed based on the cost plus 5% mark-up.

- On December 31, 2010, the parties signed an addendum to the TSA for the termination of the TSA effective July 31, 2011. PMFTC paid a cancellation fee amounting to P772.6 million for the salaries and allowances of all employees who rendered services to PMFTC under the TSA.

- Dividend income from PMFTC amounted to P3,953.2 million in 2013, P4,236.3 million in 2012 and P3,683.3 million in 2011 (see Note 11). Dividends receivable from PMFTC as of December 31, 2013 and 2012 are presented as part of nontrade receivables.

#### *Transaction with Joint Venture*

- On February 15, 2012, ABI entered into an agreement with a food company for a joint venture. The parties agreed that their initial ownership will be fifty percent (50%) each (see Note 11).

The following are the transactions among related parties which are eliminated in the consolidated statements of income:

Nature	Costs and expenses recognized by:	Revenue and other income recognized by:	Years Ended December 31		
			2013	2012	2011
(In Thousands)					
Purchase/Sale of commercial bottles and packaging materials	FTC/TDI	ABI/PWI	P 683,493	P 1,263,472	P 1,295,740
Purchase/Sale of raw materials	ABI/Interbev	TDI/ADI	114,241	181,913	150,447
Royalty fees	ABI	TDI	20,949	35,417	46,365
Management fees	TDI	LTG	48,000	48,000	48,000
Interest on loans	ETON	LTG	4,563	—	—
Interest on promissory note from sale of property	ETON	ABI	4,387	—	—
Interest on cash and cash equivalents	PNB	All entities other than PNB	166,931	64,052	46,715
Interest on short term and long term loans	ABI/Interbev/Eton	PNB	—	57,012	45,263
Gain on sale of property	Eton	ABI	228,407	—	—

The following are the balances among related parties which are eliminated in the consolidated balance sheets:

Nature	Assets recognized by:	Liabilities recognized by:	December 31		January 1,
			2013	2012	2011
(In Thousands)					
Due from/to related parties	LTG/FTC	Bank Holding Companies	P 71,465	P 9,925,786	P 5,530,372
	ABI	Eton	444,000	—	—
	LTG	Eton	400,000	150,000	—
	FTC	ABI/Eton/LTG	589	1,119,430	565,175
	LTG	TBI/Paramount/ Saturn	638	253,329	543
	TDI	TBI	10,065	—	—
	Saturn	ABI	—	3,230,714	4,891,030
Trade receivables/ payables	TDI/ADI	ABI/Interbev	122,683	328,416	213,195
	ABI/PWI	FTC/TDI	302,650	684,456	460,840
Sales contract receivable	PNB	Eton	—	105,750	—
Dividends receivable	LTG	TDI	—	—	15,293
Cash and cash equivalents/ deposit liabilities	All entities other than PNB	PNB	34,944,874	8,905,509	5,940,638
Short term and long term loans	PNB	Eton/ABI/Interbev	—	2,703,500	3,277,000
Obligations under finance lease	PNB	ABI/Interbev	10,919	17,996	26,079

**24. Retirement Benefits**

The Group has funded, noncontributory defined benefit retirement plans, administered by a trustee, covering all of its permanent employees. As of December 31, 2013 and 2012 and January 1, 2012, the Group is in compliance with Article 287 of the Labor Code, as amended by Republic Act No. 7641.

Details of the Group's net retirement plan assets and liabilities are as follows:

	December 31, 2013	December 31, 2012 (In Thousands)	January 1, 2012
Net retirement plan assets:			
FIC	P 224,530	P 1,153,147	P 1,023,818
AAC	19,263	19,926	20,736
	<b>P 243,793</b>	<b>P 1,173,073</b>	<b>P 1,044,554</b>
Accrued retirement benefits:			
PNB	P 3,388,863	P 4,502,200	P 5,513,276
ABI and subsidiaries	878,951	712,855	592,551
TDI and ADI	39,090	99,885	12,116
Eton	29,653	32,866	19,440
LTG	9,705	10,210	4,640
	<b>P 4,346,262</b>	<b>P 5,358,016</b>	<b>P 6,142,023</b>

The following tables summarize the components of net retirement plan assets and accrued retirement benefits recognized in the consolidated balance sheets and the net benefit expenses recognized in the consolidated statements of income.

Net retirement plan assets:

	2013	2012 (In Thousands)	2011
	Defined Benefit Obligation	Net Retirement Plan Assets	Defined Benefit Obligation
Beginning balance	P 63,651	(P 1,236,724)	(P 1,032,976)
Net retirement benefits cost in profit or loss:			
Current service cost	5,992	5,992	4,583
Net interest cost	3,276	(61,119)	(60,736)
Curialment gain	9,268	(64,395)	(63,621)
Contributions	—	(55,127)	(56,153)
Benefits paid	(3,836)	—	(92,680)
Plan assets returned to the Company	—	940,820	(7,433)
Past service cost	—	—	—
Re-measurement losses in other comprehensive income - actuarial changes arising from experience adjustments	6,050	43,587	17,490
Ending balance	<b>P 75,033</b>	<b>(P 318,826)</b>	<b>P 63,651</b>
			(P 1,173,073)
			<b>P 48,422</b>
			(P 1,092,976)
			<b>P 27,341</b>
			(P 1,044,554)

Accrued retirement benefits:

	2013	2012 (In Thousands)	2011
	Defined Benefit Obligation	Accrued Retirement Benefits	Defined Benefit Obligation
Beginning balance	P 7,578,184	(P 2,220,168)	(P 2,114,992)
Net retirement benefits cost in profit or loss:			
Current service cost	533,140	533,140	498,235
Net interest cost	306,585	(119,111)	(98,853)
Past service cost	(70,880)	(70,880)	(282,256)
Contributions	768,845	(119,111)	(88,853)
Benefits paid	(1,967,230)	(1,967,230)	(695,428)
Re-measurement losses (gains) in other comprehensive income - actuarial changes arising from changes in:	(541,545)	541,545	(450,564)
Financial assumptions	(603,258)	(603,258)	74,527
Experience adjustments	788,925	138,075	(254,569)
Ending balance	<b>P 7,592,151</b>	<b>(P 3,645,889)</b>	<b>P 7,578,184</b>
			(P 2,220,168)
			<b>P 7,763,905</b>
			(P 1,621,882)
			<b>P 4,485,024</b>
			(P 1,621,882)
			<b>P 1,410,225</b>
			(P 1,044,554)
			<b>P 72,337</b>
			(P 1,482,562)
			<b>P 6,142,023</b>

The fair value of plan assets as of December 31 is as follows:

	2013	2012	2011
	(In Thousands)		
Cash and cash equivalents	<b>P 857,707</b>	P 1,884,229	P 1,309,875
Investments in government securities	<b>956,849</b>	546,533	658,680
Equity investments:			
Financial institutions	<b>1,271,109</b>	712,877	444,770
Manufacturing	<b>32,342</b>	5,106	—
Others	<b>36,553</b>	—	—
Receivables	<b>550,849</b>	161,334	182,613
Others	<b>259,306</b>	146,813	118,920
Fair value of plan assets	<b>P 3,964,715</b>	P 3,456,892	P 2,714,858

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2013	2012	2011
Equity investments	<b>31%</b>	21%	16%
Investments in government securities	<b>25%</b>	16%	24%
Cash and cash equivalents	<b>23%</b>	55%	48%
Receivables	<b>14%</b>	4%	7%
Others	<b>7%</b>	4%	5%
Fair value of plan assets	<b>100%</b>	100%	100%

The overall investment policy and strategy of the Group's defined benefit plans is guided by the objective of achieving an investment return which, together with contributions, ensures that there will be sufficient assets to pay pension benefits as they fall due while also mitigating the various risk of the plans. The plan assets have diverse investments and do not have concentration risk.

The Group's defined pension plan are funded through the contributions made by the Group to the trust.

The principal assumptions used in determining pension benefit obligations for the Group's plans are shown below:

	December 31	January 1,
	2013	2012
Discount rate	<b>5%-6%</b>	5%-7%
Future salary increases	<b>5%-10%</b>	5%-10%

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as of the end of the reporting period, assuming if all other assumptions were held constant:

	Increase (Decrease)	Increase (Decrease) in Present Value of Defined Benefit Obligation
		(In Thousands)
Discount rates	+0.5%	(P45,361)
	-0.5%	149,942
Future salary increases	+1.0%	245,918
	-1.0%	(117,477)

Full actuarial valuations were performed to test the sensitivity of the defined benefit obligation to a 1% increment in salary increase rate, 1% decrement in the discount rate and a 10% improvement in the employee turnover rate. The results also provide a good estimate of the sensitivity of the defined benefit obligation to a 1% decrement in salary increase rate, 1% increment in the discount rate and a 10% increase in the employee turnover rate but with reverse impact.

The Group employs asset-liability matching strategies to maximize investment returns at the least risk to reduce contribution requirements while maintaining a stable retirement plan. Retirement plans are invested to ensure that liquid funds are available when benefits become due, to minimize losses due to investment pre-terminations and maximize opportunities for higher potential returns at the least risk.

The current plan asset of the Group is allocated to cover benefit payments in the order of their proximity to the present time. Expected benefit payments are projected and classified into short-term or long-term liabilities. Investment instruments that would match the liabilities

are identified. This strategy minimizes the possibility of the asset-liability match being distorted due to the Group's failure to contribute in accordance with its general funding strategy.

The Group expects to contribute P1.6 billion to the defined benefit pension plan in 2014.

The average duration of the defined benefit obligation at the end of the reporting period is 21 to 25 years in 2013.

#### Transactions with Retirement Plans

Management of the retirement funds of the banking segment is handled by the PNB Trust Banking Group (TBG). As of December 31, 2013 and 2012 and January 1, 2012, the retirement fund of the Group includes 7,833,795 shares of PNB classified under HFT. No limitations and restrictions are provided and voting rights over these shares are exercised by a trust officer or any of its designated alternate officer of TBG.

As of December 31, 2013 and 2012 and January 1, 2012, AFS and HTM investments include government and private debt securities and various funds. Deposits with other banks pertain to Special Deposit Accounts (SDA) placement with BSP.

The retirement funds of the other companies in the Group are maintained by PNB, as the trustee bank. PNB's retirement funds have no investments in debt or equity securities of the companies in the Group.

#### FTC's Redundancy Program

On June 10, 2011, the BOD approved FTC's redundancy as a result of the Asset Purchase Agreement executed between FTC and PMFTC (see Note 11). In view of said agreement, a number of departments, positions job functions and services have become redundant and no longer necessary for the operations of FTC. FTC made payments amounting to P1.5 billion in 2011 and P65.5 million in 2010. As a result of this redundancy, FTC recognized curtailment gain of P446.2 million in 2011.

In 2013, as a result of management's assessment of the status of FTC's retirement fund, management has decided to withdraw funds in excess of the amount actuarially determined to cover the benefits of all its employees.



## 25. Revenue and Cost of Sales and Services

Revenue consists of:

	2013	2012	2011
		<i>(In Thousands)</i>	
Banking revenue	P 28,855,871	P 32,040,683	P 29,498,704
Sale of consumer goods	23,279,109	27,930,583	26,091,727
Real estate sales	3,208,225	2,288,952	4,884,774
Rental income	448,725	396,843	306,877
Other service income	—	—	1,452,461
	<b>P 55,791,930</b>	<b>P 62,657,061</b>	<b>P 62,234,543</b>

Sale of consumer goods consists of:

	2013	2012	2011
		<i>(In Thousands)</i>	
Gross sales	P 24,390,891	P 29,205,504	P 27,173,612
Less sales returns, discounts and allowances	1,111,782	1,274,921	1,081,885
	<b>P 23,279,109</b>	<b>P 27,930,583</b>	<b>P 26,091,727</b>

Banking revenue consists of:

	2013	2012	2011
		<i>(In Thousands)</i>	
Interest income on:			
Loans and receivables	P 13,769,736	P 14,079,289	P 13,849,964
Trading and investment securities	3,918,460	5,508,929	7,021,221
Deposits with banks and others	1,632,174	1,026,640	1,050,965
Interbank loans receivable	40,696	147,359	256,796
	<b>19,361,066</b>	<b>20,762,217</b>	<b>22,178,946</b>
Trading and securities gains	5,988,853	8,217,085	4,128,619
Service fees and commission income	3,468,845	3,061,381	3,191,139
	<b>P 28,818,764</b>	<b>P 32,040,683</b>	<b>P 29,498,704</b>

Cost of sales and services consists of:

	2013	2012	2011
		<i>(In Thousands)</i>	
Cost of consumer goods sold:			
Materials used and changes in inventories (Note 9)	P 10,764,864	P 12,652,374	P 12,086,292
Taxes and licenses	1,610,239	2,726,153	2,319,220
Depreciation and amortization (Note 12)	1,298,012	1,278,879	1,153,709
Personnel costs	1,155,026	1,170,439	1,099,576
Fuel and power	922,159	1,186,018	1,057,498
Communication, light and water	682,938	698,975	609,463
Repairs and maintenance	390,720	383,994	507,024
Management, consulting, and professional fees	143,370	104,363	93,832
Freight and handling	124,090	240,850	250,817
Others	296,313	559,850	524,286
	<b>17,387,731</b>	<b>21,001,895</b>	<b>19,701,717</b>
Cost of banking services	5,954,081	7,602,720	8,779,295
Cost of real estate sales	2,489,830	1,692,202	3,500,505
Cost of rental income	190,293	142,905	111,676
Cost of other service income	—	—	522,179
Cost of sales and services	<b>P 26,021,935</b>	<b>P 30,439,722</b>	<b>P 32,615,372</b>

Other expenses include insurance, utilities and outside services which are not significant as to amounts.

Cost of banking services consist of:

	2013	2012	2011
		<i>(In Thousands)</i>	
Interest expense on:			
Deposit liabilities	P 3,862,813	P 5,004,656	P 6,438,051
Bills payable and other borrowings	1,126,920	1,801,314	1,684,085
Services fees and commission expense	964,348	796,750	657,159
	<b>P 5,954,081</b>	<b>P 7,602,720</b>	<b>P 8,779,295</b>

## 26. Selling Expenses

	2013	2012	2011
		<i>(In Thousands)</i>	
Advertising and promotions	P 1,258,520	P 1,202,945	P 1,186,964
Depreciation and amortization (Note 12)	717,807	683,885	710,262
Commissions	305,201	199,952	351,469
Personnel costs	122,140	150,636	210,405
Management, consulting and professional fees	91,410	86,513	66,679
Repairs and maintenance	63,888	60,295	73,996
Materials and consumables	60,711	27,821	104,816
Freight and handling	54,706	201,511	240,218
Travel and transportation	41,122	39,237	36,735
Others	61,441	63,323	59,400
	<b>P 2,776,946</b>	<b>P 2,716,118</b>	<b>P 3,040,944</b>



Others include occupancy fees, fuel and oil, insurance, donations, membership and subscription dues, which are individually not significant as to amounts.

## 27. General and Administrative Expenses

	2013	2012	2011
		(In Thousands)	
Personnel costs	P 6,962,114	P 6,700,681	P 7,224,317
Taxes and licenses	2,402,583	2,305,809	2,351,713
Depreciation and amortization (Notes 12, 13 and 14)	1,924,168	1,644,473	1,648,468
Occupancy	1,629,345	1,949,528	1,487,273
Outside services	1,082,625	1,115,928	651,982
Marketing and promotional	976,040	970,977	937,837
Insurance	944,261	921,546	849,371
Provision for doubtful accounts and credit losses (Note 8)	911,690	2,288,793	1,365,286
Increase in aggregate reserve for life policies	732,920	805,884	717,007
Management, consulting and professional fees	719,452	724,856	680,945
Policy benefits and claim benefits	403,417	285,050	203,884
Information technology	394,361	395,755	348,967
Materials and consumables	308,763	313,758	334,408
Communication, light and water	292,247	270,977	239,662
Travel and transportation	285,989	299,576	249,344
Litigation	281,825	339,114	247,597
Repairs and maintenance	193,687	329,128	421,620
Fuel and oil	141,846	112,758	121,667
Freight and handling	98,242	69,380	64,877
Provision for contingencies and other losses - net (Notes 12,13,14 and 25)	88,240	449,396	204,784
Real properties disposition	28,436	30,005	67,013
Entertainment, amusement and recreations	19,592	25,177	19,108
Others	859,168	839,348	796,251
	P 21,681,011	P 23,187,897	P 21,233,381

Others include expense items mainly relating to banking operations, which are individually not significant as to amounts.

## 28. Other Income (Charges) - net

	2013	2012	2011
		(In Thousands)	
Premiums - net of reinsurance	P 1,584,295	P 1,433,580	P 4,727
Net gains on sale or exchange of assets	528,632	620,547	1,499,121
Rental income (Note 13)	469,538	422,814	348,267
Collections from asset pool 1 accounts (Note 35)	306,094	82,743	160,000
Gain (loss) on disposal of AFS investments	290,505	(78)	-
Recovery from charged off assets	91,125	54,037	94,200
Gain on retirement	70,880	-	-
Dividend income	19,123	31,072	30,860
Reversal of deposit for future Certified Emission (Note 35)	-	70,858	-
Commission income	-	-	27,369
Recovery from insurance claim	-	-	186,033
Reversal of losses	-	-	(182,201)
Others	288,447	2,275,513	2,525,491
	P 3,648,639	P 4,991,086	P 4,693,867

Others include income items mainly relating to banking operations, which are individually not significant as to amounts.

- Net gains on sale or exchange of assets includes sale of investment properties of the banking segment in 2013, 2012 and 2011 amounting to P299.4 million, P544.1 million and P998.5 million, respectively.
- In 2013, TDI shut down its Quiapo plant and retrenched its employees assigned to the plant. Past service cost amounting to P70.9 million representing the change in the present value of the defined benefit obligation as a result of the implementation of the retrenchment program was immediately recognized in profit or loss in 2013 (see Note 24).
- On October 14, 2010, a fire broke out at TDI's Cabuyao Plant, which destroyed certain inventories and properties. TDI recorded fire loss amounting to P228.6 million for which recovery claim was filed with the insurance company in December 2010. The carrying value of damaged inventories and properties and equipment amounted to P189.0 million and P39.6 million, respectively. In 2011, TDI recognized P176.9 million from recovery from insurance claims for the properties that were destroyed by fire in 2010. As of December 31, 2011, TDI collected the full amount from the insurance company. TDI also recognized P9.1 million pertaining to recovery from insurance claim on certain assets in 2011 (see Note 11).
- In 2011, others include forfeiture income on real estate sales cancellation and marketing fee amounting to P62.6 million and P30.7 million, respectively.

## 29. Income Taxes

Income taxes include the corporate income tax, discussed below, and final taxes paid which represents final withholding tax on gross interest income from government securities and other deposit substitutes and income from the FCDU transactions. These income taxes, as well as the deferred tax benefits and provisions, are presented as 'Provision for income tax' in the statements of income.

Under Philippine tax laws, PNB and its certain subsidiaries are subject to percentage and other taxes (presented as “Taxes and Licenses” in the statements of income) as well as income taxes. Percentage and other taxes paid consist principally of gross receipts tax and documentary stamp tax.

FCDU offshore income (income from non-residents) is tax-exempt while gross onshore income (income from residents) is generally subject to 10% income tax. In addition, interest income on deposit placement with other FCDUs and offshore banking units (OBUs) is taxed at 7.50%. RA No. 9294 provides that the income derived by the FCDU from foreign currency transactions with non-residents, OBUs, local commercial banks including branches of foreign banks is tax-exempt while interest income on foreign currency loans from residents other than OBUs or other depository banks under the expanded system is subject to 10.00% income tax.

a. Details of the Group's deferred income tax assets and liabilities as of December follow:

	2013	Net Deferred Income Tax Assets <sup>(1)</sup>	Net Deferred Income Tax Liabilities <sup>(2)</sup>	2012	Net Deferred Income Tax Assets <sup>(3)</sup>	Net Deferred Income Tax Liabilities <sup>(4)</sup>	2011	Net Deferred Income Tax Assets <sup>(5)</sup>	Net Deferred Income Tax Liabilities <sup>(6)</sup>
<i>(In Thousands)</i>									
<i>Recognized directly in the consolidated statements of income</i>									
<b>Deferred income tax assets on:</b>									
Allowance for impairment loss on:									
Receivables	P 5,117,961		P 20,206	P 5,075,082		P 19,788	P 4,656,608		P 754,705
Inventories	—		3,882	—		3,882	—		4,130
Property, plant and equipment	6,659		66,660	9,119		66,660	9,119		66,660
Net retirement benefits liabilities	11,745		195,108	12,250		174,995	8,032		148,337
Unamortized past service cost	34,333		2,721	532,263		3,936	572,681		1,393
Accrued expenses	16,937		7,014	5,672		1,190	—		6,721
Reserve for unearned premiums	99,067		—	—		—	—		—
Deferred rent expense	27,808		—	—		—	8,141		—
Provision for losses	47,425		16,329	47,369		16,329	27,346		6,784
Unrealized losses on:									
Foreign exchange	2,803		—	23,076		824	2,803		2
Inventories on hand purchased from subsidiaries	—		—	—		48,092	—		21,437
Sale of property to a subsidiary	—		6,454	—		7,416	—		8,379
Difference between tax and book basis of accounting for real estate and banking transactions	740,069		—	887,376		—	917,908		61,091
NOLCO	37,104		—	120,339		30,559	25,299		—
Reserves, MCIT and others	580,826		314	249,724		—	92,836		15,672
	<b>6,722,737</b>		<b>318,688</b>	<b>6,962,270</b>		<b>373,671</b>	<b>6,320,773</b>		<b>1,095,311</b>
<b>Deferred income tax liabilities on:</b>									
Excess of fair values over carrying values of property, plant and equipment acquired through business combination	—		39,640	—		48,988	—		43,930
Borrowing cost capitalized to property, plant, and equipment	—		19,666	—		21,119	—		22,516
Fair value gain on investment properties	1,731,832		—	2,434,715		—	2,184,845		477,240
Unrealized trading gains on Derivatives	77,584		—	152,441		—	106,777		29,665
Deferred reinsurance premiums	86,013		—	—		—	—		—
Net retirement plan assets	96,471		20,671	404,179		6,532	314,241		60,964
Unrealized foreign exchange gains	10,161		3,101	—		—	15,172		2,240
Deferred rental income	11,233		—	—		—	8,424		—
Difference between tax and book basis of accounting for real estate transactions	52,322		—	—		15,947	—		—
Others	241,272		4,953	360,425		9,548	299,412		42,139
	<b>2,306,888</b>		<b>88,031</b>	<b>3,351,760</b>		<b>102,134</b>	<b>2,928,871</b>		<b>678,694</b>
	<b>P 4,415,849</b>		<b>P 230,657</b>	<b>P 3,610,510</b>		<b>P 271,537</b>	<b>P 3,391,902</b>		<b>P 416,617</b>
<i>Recognized directly in equity</i>									
<b>Deferred income tax assets on:</b>									
Re-measurement losses on retirement benefits	P 29,175		P 81,511	P 16,645		P 62,831	P 8,065		P 25,944
<b>Deferred income tax liabilities on:</b>									
Revaluation increment on property, plant and equipment	1,742,373		1,830,312	1,967,050		1,639,901	923,184		2,831,290
Unrealized gains on AFS financial assets	21,325		297,633	14,291		298,439	41,504		10,442
Re-measurement gains on retirement Benefits	—		—	—		—	820		—
	<b>(1,734,523)</b>		<b>(2,046,434)</b>	<b>(1,964,696)</b>		<b>(1,875,509)</b>	<b>(957,443)</b>		<b>(2,815,788)</b>
	<b>P 2,681,327</b>		<b>(P 1,815,777)</b>	<b>P 1,645,814</b>		<b>(P 1,603,972)</b>	<b>P 2,434,459</b>		<b>(P 2,399,171)</b>

(1) Pertain to LTG, Elton, PNB and FTC

(2) Pertain to Saturn, PLI, AAC, ADI, PWI, TDI, ABI and IPI

(3) Pertain to LTG, Elton, FTC, and PNB

(4) Pertain to TDI, ABI, and IPI

(5) Pertain to LTG, Elton, FTC and PNB

(6) Pertain to ADI, TDI, ABI and IPI

b. Provision for current income tax consists of:

	2013	2012	2011
		<i>(In Thousands)</i>	
RCIT	P 1,624,543	P 1,512,240	P 1,057,921
MCIT	44,623	20,299	579
Final tax	840,340	1,112,495	1,064,676
Provision for current income tax	<b>P 2,509,506</b>	<b>P 2,645,034</b>	<b>P 2,123,176</b>



c. As of December 31, the Group has not recognized deferred income tax assets on certain deductible temporary differences such as NOLCO, excess MCIT and other items based on the assessment that sufficient taxable profit will not be available to allow the deferred income tax assets to be utilized as follows:

	2013	2012	2011
		(In Thousands)	
NOLCO	P 1,761,281	P 535,577	P 206,290
Allowance for doubtful accounts	2,081,671	4,061,544	847,463
Allowance for inventory obsolescence	5,931	5,931	5,931
Accrued retirement benefits	31,054	23,560	997,186
Unamortized past service cost	952,034	1,189,886	743
Unrealized foreign exchange loss	14,537	2,918	
Accrued expenses		169,966	319,119
Derivative liabilities	51,304	85,125	48,925
Others	699,909	70,737	173,114

Details of the Group's NOLCO follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousands)		
2011	P 1,949,358	P 1,480,447	P 468,911	2014
2012	266,575	2	266,573	2015
2013	1,149,477	—	1,149,477	2016
	P 3,365,410	P 1,480,449	P 1,884,961	

Details of the Group's MCIT follow:

Year Incurred	Amount	Used/Expired	Balance	Expiry Year
		(In Thousands)		
2011	P 165,835	P 164,385	P 1,450	2014
2012	211,753	190,729	21,024	2015
2013	32,173	—	32,173	2016
	P 409,761	P 355,114	P 54,647	

d. A reconciliation of the Group's provision for income tax computed based on income before income tax at the statutory income tax rates to the provision for income tax shown in the consolidated statements of income is as follows:

	2013	2012	2011
		(In Thousands)	
Provision for income tax at statutory income tax rate	P 4,075,168	P 5,471,243	P 4,532,458
Adjustments resulting from:			
NOLCO, excess MCIT and other deductible temporary differences for which no deferred income tax assets were recognized	187,626	81,099	569,002
Application of NOLCO, MCIT and other deductible temporary differences for which no deferred income tax assets were recognized in prior years	(10,157)	(23,339)	(1,999)
Nontaxable income	(2,030,276)	(913,610)	(2,169,546)
Income tax holiday	—	40,858	(195,505)
Difference of itemized deduction against 40% of taxable income	19,832	(6,173)	—
Income subjected to final tax	(23,474)	(9,973)	(8,778)
Equity in net earnings of an associate	(1,111,235)	(1,949,692)	(1,235,371)
Derecognition of deferred income tax deemed to be worthless	—	—	5,469
Non-deductible expenses	1,001,346	835	740,646
Provision for income tax	P 2,108,830	P 2,691,248	P 2,236,376

### 30. Equity

#### Capital Stock

Authorized and issued capital stock of the Company are as follows:

	December 31	2012	January 1, 2012
	2013		
Number of shares			
Authorized capital stock at P1 par value:			
At beginning of the period	25,000,000,000	5,000,000,000	5,000,000,000
Increase in authorized capital stock	—	20,000,000,000	—
At end of the period	25,000,000,000	25,000,000,000	5,000,000,000
Issued capital stock at P1 par value:			
At beginning of the year	P 8,981,388,889	P 3,583,250,000	P 3,853,250,000
Issuance	1,840,000,000	5,398,138,889	—
At end of the year	P 10,821,388,889	P 8,981,388,889	P 3,853,250,000

a. Capital stock is held by a total of 572, 408 and 517 stockholders as of December 31, 2013 and 2012 and January 1, 2012, respectively.

b. Track record of registration:

Date	Number of Shares	Issue/Offer Price
	Licensed	
August 1948	100,000	P 1.00
November 1958	500,000	1.00
December 1961	1,000,000	1.00
March 1966	2,000,000	1.00
—	6,000,000	1.00
October 1995	247,500,000	1.00
April 2013	1,840,000,000	20.50



c. As discussed in Note 1 on October 26, 2011, pursuant to the 2-tranche Placing and Subscription Transaction, LTG's BOD accepted the offer of Tangent to subscribe to 398,138,889 new common shares from the Company's unissued capital stock at the offer price of P4.22 each, subject to the approval at the Company's annual shareholders' meeting.

The respective BODs of LTG and Tangent approved the execution of a Memorandum of Agreement setting forth each of their rights and obligations under the Placing and Subscription Transaction, including the undertaking of Tangent to use the offer proceeds to subscribe to additional new shares in LTG's unissued capital stock.

In December 2011, LTG received from Tangent the net offer proceeds amounting to P1.6 billion, net of stock issue cost amounting to P40.7 million, as deposit for future subscription. Subsequently, LTG invested P1.6 billion of the total proceeds in TDI for the latter's capital and operational requirements.

On June 13, 2012, LTG's BOD and stockholders approved the conversion of the deposit for future stock subscription amounting to P1.6 billion into 398,138,889 common shares of LTG which resulted to the recognition of capital stock and corresponding additional paid-in capital amounting to P398.1 million and P1.2 billion, respectively.

d. As discussed in Note 1, in July 2012, the Company received from Tangent P5.0 billion cash in exchange for LTG's 5,000,000,000 common shares. Costs related to the share issuance amounted to P67.5 million and is presented as a deduction to additional paid in capital.

e. In April 2013, LTG issued 1,840.0 million shares for P37.7 billion, where excess over par value amounting to P35.9 billion was recorded as capital in excess of par. Stock issue costs amounting to P1.1 billion were charged against capital in excess of par in 2013. Other offering related expenses amounting to P59.0 million were charged directly to "General and administrative expenses".

#### Retained Earnings and Dividends

a. On June 19, 2013, LTG's BOD and stockholders approved the declaration and distribution of cash dividends of P0.15 per share or a total of P1.6 billion.

b. On March 22, 2011 and December 20, 2011, LTG's BOD and stockholders, respectively, approved the declaration and distribution of cash dividends of P0.12 per share and P0.20 per share or a total of P403.8 million and P702.7 million, respectively.

c. Retained earnings include undistributed earnings amounting to P36.9 billion in 2013, P42.0 billion in 2012 and P28.6 billion in 2011 representing accumulated earnings of subsidiaries and equity in net earnings of associates, which are not available for dividend declaration until received in the form of dividends from the combining entities and associates. Retained earnings are further restricted for the payment of dividends to the extent of the cost of the shares held in treasury, unrealized foreign exchange gains except those attributable to cash and cash equivalents, unrealized actuarial gains, fair value adjustment or gains arising from mark-to-market valuation, deferred income tax assets recognized that reduced the income tax expense and increased net income and retained earnings, and other unrealized gains or adjustments as of December 31, 2013 and 2012, and January 1, 2012.

#### Preferred shares of subsidiaries issued to Parent Company

On March 20, 2013, the respective BOD's and stockholders of various Bank Holding Companies approved the increase in their authorized capital stocks comprising of common shares and preferred shares with par value of P1.00 per share. The preferred shares were subscribed by Tangent through conversion of its advances into investments in certain Bank Holding Companies (see Note 23). Upon approval of the SEC of the increase in authorized capital stock of Bank Holding Companies in various dates in October, November and December 2013, preferred shares amounting to P7.4 billion presented under "Preferred shares of subsidiary issued to Parent Company" were issued to Tangent. Unissued preferred shares amounting to P6.0 billion

which are pending approval of the SEC are presented under "Deposit for future stock subscription".

Upon issuance, the preferred shares shall have the following features: non-voting, non-cumulative and non-participating as to dividends, non-redeemable for a period of seven years from the issuance and redeemable at the option of the Bank Holding Companies after seven years from the issuance thereof.

#### Other Equity Reserves

Other equity reserves consist of:

	2013	2012	2011
	(In Thousands)		
Equity adjustments arising from business combination under common control (Note 1)	P 445,113	P 642,034	P 1,010,412
Equity adjustments from sale of Company's shares held by a subsidiary	193,212	193,212	—
Effect of transaction with non-controlling interest	52,156	52,156	52,156
Effect of sale of a subsidiary to parent company	99,655	99,655	99,655
	P 790,136	P 987,057	P 1,162,223

#### Shares Held by Subsidiaries

Shares held by subsidiaries include 4.9 million shares owned by All Seasons amounting to P12.5 million as of December 31, 2013 and 2012 and January 1, 2012 and 76.5 million shares owned by Saturn amounting to P150.9 million as of January 1, 2012. On July 25, 2012, the shares of stocks owned by Saturn were sold to Tangent at P4.50 per share. As a result, the excess of the selling price over the cost of the treasury shares amounting to P193.2 million is presented as an addition to other equity reserves.

#### Non-controlling Interests

Below are the changes in non-controlling interests:

	2013	2012	2011
	(In Thousands)		
Balance as of January 1	P 31,051,046	P 28,722,790	P 23,793,531
Net income attributable to non-controlling interests	2,805,844	2,789,038	2,841,100
Share in other comprehensive income, net of deferred income tax effect:			
Accumulated translation adjustment	911,051	(674,519)	63,987
Net changes in AFS financial assets (Note 7)	(2,514,123)	(261,223)	2,063,838
Revaluation increment on property, plant and equipment (Note 12)	420,332	61,270	651,212
Remeasurement gains (losses) on defined benefit plans (Notes 2 and 25)	(127,737)	300,345	(613,352)
Dividends received	(64,216)	(15,509)	—
Changes in ownership interest	(247,112)	128,854	(77,526)
Balance as of December 31	P 32,235,085	P 31,051,046	P 28,722,790

### 31. Basic/Diluted Earnings Per Share

Basic/diluted earnings per share were calculated as follows:

	2013	2012	2011
	(In Thousands)		
Net income attributable to equity holders of the Company	P 8,669,220	P 12,757,189	P 10,030,717
Divided by weighted-average number of shares	10,208,056	8,848,676	8,583,250
Basic/diluted EPS for net income attributable to equity holders of the Company	P 0.85	P 1.44	P 1.17

EPS is calculated using the consolidated net income attributable to equity holders of the Company divided by the weighted average number of shares, wherein the 5,000,000,000 additional shares issued in 2012 to effect and fund the group restructuring were recognized as if these shares were issued at the beginning of the earliest period presented (see Note 1).

### 32. Financial Risk Management Objectives and Policies

#### Risk Management Strategies

The Group's financial risk management strategies are handled on a group-wide basis, side by side with those of the other related companies within the Group. The Group's management and the BOD of the various companies comprising the Group review and approve policies for



managing these risks. Management closely monitors the funds and financial transactions of the Group.

#### Risk Management Strategies for the Group other than the Banking Segment

The Group's principal financial instruments comprise of short-term and long-term debts and cash and other cash items (COCI). The main purpose of these financial instruments is to ensure adequate funds for the Group's operations and capital expansion. Excess funds are invested in available-for-sale financial assets with a view to liquidate these to meet various operational requirements when needed. The Group has various other financial assets and financial liabilities such as receivables and accounts payable and accrued expenses which arise directly from its operations.

The main risks arising from the use of financial instruments are credit risk, liquidity risk and market risks (consisting of foreign exchange risk, interest rate risk and equity price risk).

#### Risk Management Strategies Specific for the Banking Segment

The Group's banking activities are principally related to the development, delivery, servicing and use of financial instruments. Risk is inherent in these activities but it is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the banking segment's continuing profitability.

The banking segment monitors its processes associated with the following overall risk categories:

- Credit Risk
- Market Risk
- Liquidity Risk
- Operational Risk
- Information Security and Technology Risk

Further, the banking segment is also cognizant of the need to address various other risks through the primary divisions presented above. The following are also taken into consideration as part of the overall Enterprise Risk Management (ERM) Framework:

- Counterparty Risk
- Business Risk
- Strategic Risk
- Compliance Risk
- Legal Risk
- Reputational Risk
- Concentration Risk
- Country Risk
- Risks arising from the banking segment's shareholdings and equity interests

Managing the level of these risks as provided for by the Group's ERM framework is critical to its continuing profitability. The Risk Oversight Committee (ROC) of the Group's BOD determines the risk policy and approves the principles of risk management, establishment of limits for all relevant risks, and the risk control procedures. The ROC of the Group is also responsible for the risk management of the banking segment.

The RMG provides the legwork for the ROC in its role of formulating the risk management strategy, the management of regulatory capital, the development and maintenance of the internal risk management framework, and the definition of the governing risk management principles. The mandate of the RMG involves:

- Implementing the risk management framework of identifying, measuring, controlling and monitoring the various risk taking activities of the Group, inherent in all financial institutions;
- Providing services to the risk-taking units and personnel in the implementation of risk mitigation strategies; and
- Establishing recommended limits based on the results of its analysis of exposures.

## **Credit Risk**

#### Credit Risk of the Group other than the Banking Segment

The Group manages its credit risk by transacting with counterparties of good financial condition and selecting investment grade securities. The Group trades only with recognized, creditworthy third parties. In addition, receivable balances are monitored on an on-going basis with the result that the Group's exposure to bad debts is not significant. Management closely monitors the fund and financial condition of the Group.

In addition, credit risk of property development segment is managed primarily through analysis of receivables on a continuous basis. The credit risk for contracts receivables is mitigated as the Group has the right to cancel the sales contract without the risk for any court action and can take possession of the subject property in case of refusal by the buyer to pay on time the contracts receivables due. This risk is further mitigated because the corresponding title to the property sold under this arrangement is transferred to the buyers only upon full payment of the contract price.

#### Concentration risk

Concentrations arise when a number of counterparties are engaged in similar business activities having similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location. Such credit risk concentrations, if not properly managed, may cause significant losses that could threaten the Group's financial strength and undermine public confidence. Concentration risk per business segment could arise on the following:

- Distilled spirits segment's sale of alcoholic beverage pertains mainly to four trusted parties with sales to them comprising about 99% of total alcoholic beverage sale.
- Beverage segment annual sales pertain mainly to 13 parties with sales to them comprising about 100% of the total beverage sales.
- Tobacco and property development segments are not exposed to concentration risk because it has diverse base of counterparties.

#### Credit quality per class of financial assets

"Standard grade" accounts consist of financial assets from trusted parties with good financial condition. "Substandard grade" accounts, on the other hand, are financial assets from other counterparties with relatively low defaults. The Group did not regard any financial asset as "high grade" in view of the erratic cash flows or uncertainty associated with the financial instruments. "Past due but not impaired" are items with history of frequent default, nevertheless, the amount due are still collectible. Lastly, "Impaired financial assets" are those that are long-outstanding and have been provided with allowance for doubtful accounts.

The tables below show the credit quality of financial assets and an aging analysis of past due but not impaired accounts of the Group except for the banking segment:

December 31, 2013:

	Neither past due nor impaired		Past due but not impaired				Impaired Financial Assets	Total
	Standard Grade	Sub-standard Grade	31 to 60 days	61 to 90 days	91 to 120 days	Over 120 Days		
	(In Millions)							
Loans and receivables:								
Cash and other cash items	P 1,089	P –	P –	P –	P –	P –	P –	P 1,089
Trade receivables	5,552	–	1,617	642	646	59	32	8,548
Other receivables	2,514	1	5	50	5	338	6	2,919
Due from related parties	2,710	–	–	–	–	–	–	2,710
Refundable deposits	168	–	–	–	–	–	–	168
AFS financial assets	675	–	–	–	–	–	–	675
	P 12,708	P 1	P 1,622	P 692	P 651	P 397	P 38	P 16,109

December 31, 2012:

	Neither past due nor impaired		Past due but not impaired				Impaired Financial Assets	Total
	Standard Grade	Sub- standard Grade	31 to 60 days	61 to 90 days	91 to 120 days	Over 120 Days		
(In Millions)								
Loans and receivables:								
Cash and other cash items	P 593	P –	P –	P –	P –	P –	P –	P 593
Trade receivables	7,400	–	823	422	225	1,153	10	10,033
Other receivables	2,062	–	–	–	–	99	6	2,167
Due from related parties	11,270	–	–	–	–	–	–	11,270
Refundable deposits	125	–	–	–	–	–	–	125
AFS financial assets	427	–	–	–	–	–	–	427
	P 21,877	P –	P 823	P 422	P 225	P 1,252	P 16	P 24,615

January 1, 2012:

	Neither past due nor impaired		Past due but not impaired				Impaired Financial Assets	Total
	Standard Grade	Sub- standard Grade	31 to 60 days	61 to 90 days	91 to 120 days	Over 120 Days		
(In Millions)								
Loans and receivables:								
Cash and other cash items	P 355	P –	P –	P –	P –	P –	P –	P 355
Trade receivables	4,784	1,995	396	380	620	129	12	8,316
Other receivables	137	123	3	2	45	453	6	769
Due from related parties	4,111	–	–	–	–	–	–	4,111
Refundable deposits	103	–	–	–	–	–	–	103
AFS financial assets	129	–	–	–	–	–	–	129
	P 9,619	P 2,118	P 399	P 382	P 665	P 582	P 18	P 13,783

#### Credit Risk of the Banking Segment

For the banking segment, credit risk is the non-recovery of credit exposures (on-and-off balance sheet exposures). Managing credit risk also involves monitoring of migration risk, concentration risk, country risk and settlement risk. The banking segment manages its credit risk at various levels (i.e., strategic level, portfolio level down to individual transaction).

The credit risk management of the entire loan portfolio is under the direct oversight of the ROC and Executive Committee. Credit risk assessment of individual borrower is performed by the business sector and remedial sector. Risk management is embedded in the entire credit process, i.e., from credit origination to remedial management (if needed).

Among the tools used by the banking segment in identifying, assessing and managing credit risk include:

- Documented credit policies and procedures: sound credit granting process, risk asset acceptance criteria, target market and approving authorities;
- System for administration and monitoring of exposure;
- Pre-approval review of loan proposals;
- Post approval review of implemented loans;
- Work out system for managing problem credits;
- Regular review of the sufficiency of valuation reserves;
- Monitoring of the adequacy of capital for credit risk via the Capital Adequacy Ratio (CAR) report;
- Monitoring of breaches in regulatory and internal limits;
- Credit Risk Management Dashboard;
- Diversification;
- Internal Risk Rating System for corporate accounts;
- Credit Scoring for retail accounts; and
- Active loan portfolio management undertaken to determine the quality of the loan portfolio and identify the following:
  - a. portfolio growth
  - b. movement of loan portfolio (cash releases and cash collection for the month)
  - c. loss rate
  - d. recovery rate
  - e. trend of nonperforming loans (NPLs)
  - f. concentration risk (per classified account, per industry, clean exposure, large exposure, contingent exposure, currency, security, facility, demographic, etc.)

The banking segment has moved one step further by collecting data on risk rating of loan borrowers with an asset size of P15.0 million and above as initial requirement in the banking segment's model for internal Probability of Default (PD) and Loss Given Default (LGD).

#### Credit-related commitments

The exposures represent guarantees, standby letters of credit (LCs) issued by the banking segment and documentary/commercial LCs which are written undertakings by the banking segment. To mitigate this risk the banking segment requires hard collaterals, as discussed under *Collateral and other credit enhancement*, for standby LCs lines while commercial LCs are collateralized by the underlying shipments of goods to which they relate.

#### Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the balance sheet.

#### Collateral and other credit enhancement

As a general rule, character is the single most important consideration in granting loans. However, collaterals are requested to mitigate risk. The loan value and type of collateral required depend on the assessment of the credit risk of the borrower or counterparty. The banking segment follows guidelines on the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For corporate accounts - cash, guarantees, securities, physical collaterals (e.g., real estate, chattels, inventory, etc.); as a general rule, commercial, industrial and residential lots are preferred
- For retail lending - mortgages on residential properties and vehicles financed
- For securities lending and reverse repurchase transactions - cash or securities

The disposal of the foreclosed properties is handled by the Asset Management Sector which adheres to the general policy of disposing assets at the highest possible market value. Management regularly monitors the market value of the collateral and requests additional collateral in accordance with the underlying agreement. The existing market value of the collateral is considered during the review of the adequacy of the allowance for credit losses. Generally, collateral is not held over loans and advances to banks except for reverse repurchase agreements. The banking segment is not permitted to sell or repledge the collateral held over loans and advances to counterparty banks and BSP in the absence of default by the owner of the collateral.

The banking segment's maximum exposure to on-balance sheet credit risk is equal to the carrying value of its financial assets except for the following loans and receivables:

	December 31, 2013		December 31, 2012		January 1, 2012	
	Before Collateral	After Financial Effect of Collateral or Credit Enhancement	Before Collateral	After Financial Effect of Collateral or Credit Enhancement	Before Collateral	After Financial Effect of Collateral or Credit Enhancement
(In Millions)						
Securities Held Under Agreements to Resell	P –	P –	P 18,442	P –	P 18,300	P –
Loans and receivables:						
Receivable from customers*:						
Business loans	187,023	83,798	162,956	90,006	149,706	93,106
GOCs and National Government Agencies (NGAs)	25,751	12,397	25,778	28,856	28,769	28,748
LGUs	8,479	1,098	11,229	2,337	5,938	4,832
Consumers	26,060	10,235	17,720	9,683	17,401	5,904
Fringe benefits	603	430	669	194	727	178
Unquoted debt securities	7,546	4,746	10,193	1,662	10,949	1,662
Other receivables	18,413	7,241	15,424	8,746	14,942	9,288
	P 273,875	P 119,945	P 262,411	P 141,484	P 246,732	P 143,718

\* The Group follows the BOD approved policy on the generic classification of loans based on the type of borrowers and the purpose of the loan.

\* Receivables from customers exclude residual value of the leased asset.



For the banking segment, fair values of collateral held for securities held under agreements to resell and loans and receivables amounted to nil and P267.8 billion as of December 31, 2013, respectively and P18.9 billion and P234.7 billion as of December 31, 2012, respectively.

The maximum credit risk, without taking into account the fair value of any collateral and netting agreements, is limited to the amounts on the balance sheet plus commitments to customers such as unused commercial letters of credit, outstanding guarantees and others as disclosed in Note 35 to the financial statements.

#### *Excessive risk concentration*

The banking segment's credit risk concentrations can arise whenever a significant number of borrowers have similar characteristics. The banking segment analyzes the credit risk concentration to an individual borrower, related group of accounts, industry, geographic, internal rating buckets, currency, term and security. For risk concentration monitoring purposes, the financial assets are broadly categorized into (1) loans and receivables and (2) trading and financial investment securities. To mitigate risk concentration, the banking segment constantly checks for breaches in regulatory and internal limits. Clear escalation process and override procedures are in place, whereby any excess in limits are covered by appropriate approving authority to regularize and monitor breaches in limits.

#### **a. Limit per Client or Counterparty**

For loans and receivables, the banking segment sets an internal limit for group exposures which is equivalent to 100.00% of the single borrower's limit (SBL) for loan accounts with credit risk rating (CRR) 1 to CRR 5 or 50.00% of SBL if rated below CRR 5. For trading and investment securities, the Group limits investments to government issues and securities issued by entities with high-quality investment ratings.

#### **b. Geographic Concentration**

The table below shows the banking segment's credit risk exposures, before taking into account any collateral held or other credit enhancements, categorized by geographic location:

	<b>December 31</b>		January 1,
	<b>2013</b>	<b>2012</b>	<b>2012</b>
	<i>(In Millions)</i>		
Philippines	<b>P 516,743</b>	P 444,386	P 426,927
USA and Canada	<b>5,937</b>	8,257	20,400
Asia (excluding the Philippines)	<b>24,551</b>	23,368	13,835
United Kingdom	<b>1,696</b>	6,124	7,302
Other European Union Countries	<b>6,122</b>	6,459	1,292
Middle East	<b>248</b>	2	6
	<b>P 555,297</b>	P 488,596	P 469,762



### c. Concentration by Industry

The table below show the industry sector analysis of the banking segment's financial assets at amounts before taking into account the fair value of the loan collateral held or other credit enhancements:

	December 31 2013	2012	January 1, 2012
	(In Millions)		
<b>Loans and Receivables</b>			
Receivable from customers:			
Primary target industry:			
Public administration and defense	P 24,103	P 23,643	P 22,563
Wholesale and retail	42,565	40,732	37,926
Transport, storage and communication	17,586	25,994	28,416
Electricity, gas and water	38,471	22,453	19,623
Manufacturing	30,352	28,245	26,828
Financial intermediaries	21,357	16,134	11,161
Agriculture, hunting and forestry	1,869	3,539	3,403
Secondary target industry:			
Real estate, renting and business activities	34,126	25,569	23,334
Construction	6,950	4,384	2,443
Others*	30,527	24,937	23,539
Unquoted debt securities:			
Government	7,401	9,650	9,742
Financial intermediaries	33	383	816
Manufacturing	112	160	390
	255,452	225,823	210,184
Other receivables	18,413	15,319	14,942
	273,865	241,142	225,126
<b>Trading and Financial Investment Securities</b>			
Government	62,060	86,344	75,527
Financial intermediaries	6,616	14,972	18,587
Electricity, gas and water	1,542	2,461	1,688
Real estate, renting and business activities	5,182	1,527	1,155
Manufacturing	646	1,733	820
Others**	15,710	4,780	4,043
	91,756	111,817	101,820
<b>Other Financial Assets***</b>			
Financial intermediaries	22,499	34,840	47,842
Government	153,169	81,700	74,739
Others	14,008	19,097	20,235
	189,676	135,637	142,816
	P 555,297	P 488,596	P 469,762

\* Receivables from customers exclude residual value of the leased asset amounting to P404 million, P381 million and P201 million as of December 31, 2013 and 2012 and January 1, 2012, respectively.

\*\* Others include the following sectors - Other community, social and personal services, private household, hotel and restaurant, education, mining and quarrying, and health and social work.

\*\*\* Other financial assets include the following financial assets: "Due from BSP", "Due from other banks", "Interbank loans receivable", "Securities held under agreements to resell", "Receivable from SPV", "Miscellaneous COCI" and "Commitments".

The internal limit of the banking segment based on the Philippine Standard Industry Classification (PSIC) sub-industry is 12.00% for priority industry, 8.00% for regular industry and 30.00% for power industry, versus total loan portfolio.

The banking segment's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. In order to avoid excessive concentrations of risks, identified concentrations of credit risks are controlled and managed accordingly.

#### Credit quality per class of financial assets

The credit quality of financial assets used by the banking segment is assessed and managed using external and internal ratings. For receivable from customers classified as business loans, the credit quality is generally monitored using the 14-grade Credit Risk Rating (CRR) System which is integrated in the credit process particularly in loan pricing and allocation of valuation reserves. The model on risk ratings is assessed and updated regularly.

Validation of the individual internal risk rating is conducted by the Credit Management Division to maintain accurate and consistent risk ratings across the credit portfolio. The rating system has two parts, namely, the borrower's rating and the facility rating. It is supported by a variety of financial analytics, combined with an assessment of management and market information such as industry outlook and market competition to provide the main inputs for the measurement of credit or counterparty risk.

The CRRs of the banking segment's receivables from customers (applied to loans with asset size of P15.0 million and above) are defined below:

- CRR 1 - Excellent  
Loans receivables rated as excellent include borrowers which are

significant in size, with long and successful history of operations, an industry leader, with ready access to all equity and debt markets and have proven its strong debt service capacity.

- CRR 2 - Super Prime  
Loans receivables rated as super prime include borrowers whose ability to service all debt and meet financial obligations remains unquestioned.
- CRR 3 - Prime  
Under normal economic conditions, borrowers in this rating have good access to public market to raise funds and face no major uncertainties which could impair repayment.
- CRR 4 - Very Good  
Loans receivables rated as very good include borrowers whose ability to service all debts and meet financial obligations remain unquestioned, but current adverse economic conditions or changing circumstances have minimal impact on payment of obligations.
- CRR 5 - Good  
Loans receivables rated as good include borrowers with good operating history and solid management, but payment capacity could be vulnerable to adverse business, financial or economic conditions.

#### Standard

- CRR 6 - Satisfactory  
These are loans receivables to borrowers whose ability to service all debt and meet financial obligations remains unquestioned, but with somewhat lesser capacity than in CRR 5 accounts.
- CRR 7 - Average  
These are loans receivables to borrowers having ability to repay the



loan in the normal course of business activity, although may not be strong enough to sustain a major setback.

- CRR 8 - Fair

These are loans receivables to borrowers possessing the characteristics of borrowers rated as CRR7 with slightly lesser quality in financial strength, earnings, performance and/or outlook.

Sub-standard Grade

- CRR 9 - Marginal

These are performing loans receivables from borrowers not qualified as CRRs 1-8. The borrower is able to withstand normal business cycles, although any prolonged unfavorable economic and/or market period would create an immediate deterioration beyond acceptable levels.

- CRR 10 - Watchlist

This rating includes borrower where the credit exposure is not at risk of loss at the moment but the performance of the borrower has weakened and, unless present trends are reversed, could eventually lead to losses.

- CRR 11 - Special Mention

These are loans that have potential weaknesses that deserve management's close attention. These potential weaknesses, if left uncorrected, may affect the repayment of the loan and thus increase credit risk to the Banking segment.

- CRR 12 - Substandard

These are loans or portions thereof which appear to involve a substantial and unreasonable degree of risk to PNB because of unfavorable record or unsatisfactory characteristics.

- CRR 13 - Doubtful

These are loans or portions thereof which have the weaknesses inherent in those classified as CRR 12 with the added characteristics that existing facts, conditions and values make collection or liquidation in full highly improbable and in which substantial loss is probable.

- CRR 14 - Loss

These are loans or portions thereof which are considered uncollectible or worthless.

The banking segment is using the Credit Scoring for evaluating borrowers with assets size below P15.0 million. Credit scoring details the financial capability of the borrower to pay for any future obligation.

GOCCs and LGUs are rated using the "means and purpose" test whereby borrowers have to pass the two major parameters, namely:

- "Means" test - the borrower must have resources or revenues of its own sufficient to service its debt obligations.
- "Purpose" test - the loan must be obtained for a purpose consistent with the borrower's general business.

LGU loans are backed-up by assignment of Internal Revenue Allotment. Consumer loans are covered by mortgages in residential properties and vehicles financed and guarantees from Home Guaranty Corporation. Fringe benefit loans are repaid through automatic salary deductions and exposure is secured by mortgage on house or vehicles financed.



The table below shows the banking segment's receivable from customers, gross of allowance for credit losses and unearned and other deferred income, for each CFR as of December 31, 2013 and 2012 and January 1, 2012 but net of residual values of leased assets. As of December 31, 2013 and 2012 and January 1, 2012, residual value of leased assets of the banking segment amounted to P404.8 million, P381.7 million and P201.3 million, respectively.

	December 31, 2013			December 31, 2012			January 1, 2012		
	Neither Past Due Individually Impaired	Past Due or Individually Impaired	Total	Neither Past Due Individually Impaired	Past Due or Individually Impaired	Total	Neither Past Due Individually Impaired	Past Due or Individually Impaired	Total
<b>Rated Receivable from Customers</b>									
1 – Excellent	P 2,634	P –	P 2,634	P 11,547	P –	P 11,547	P 6,745	P –	P 6,745
2 – Super Prime	57,316	–	57,316	33,705	–	33,705	23,255	–	23,255
3 – Prime	33,365	14	33,379	14,135	–	14,135	7,727	–	7,727
4 – Very Good	4,395	38	4,433	9,591	–	9,591	11,876	–	11,876
5 – Good	19,480	7	19,487	26,463	2	26,465	21,733	73	21,806
6 – Satisfactory	24,546	212	24,758	25,605	–	25,605	33,106	8	33,114
7 – Average	30,005	220	30,225	28,755	19	28,774	19,820	15	19,835
8 – Fair	8,920	25	8,945	13,943	1	13,944	11,864	28	11,892
9 – Marginal	3,860	9	3,869	4,090	5	4,095	3,390	31	3,421
10 – Watchlist	12,990	35	13,025	8,147	989	9,136	5,319	168	5,487
11 – Special Mention	2,664	331	2,995	3,935	75	4,010	2,768	95	2,863
12 – Substandard	1,472	3,103	4,575	476	3,638	4,114	1,426	2,254	3,680
13 – Doubtful	5	2,497	2,502	–	2,595	2,595	–	2,560	2,560
14 – Loss	–	2,724	2,724	154	3,319	3,473	4	4,150	4,154
	201,652	9,215	210,867	180,351	10,643	191,994	149,033	9,382	158,415
<b>Unrated Receivable from Customers</b>									
Business Loans	13,105	870	13,975	8,239	512	8,751	14,995	1,323	16,318
GOCCs and NGAs	2,196	46	2,242	1,391	1,651	3,042	12,168	1,763	13,931
LGUs	7,925	661	8,586	6,868	419	7,287	5,576	398	5,974
Consumers	20,536	908	21,444	13,830	884	14,724	12,397	877	13,274
Fringe Benefits	529	1	530	622	37	659	682	60	742
	44,291	2,486	46,777	30,950	3,513	34,463	45,818	4,421	50,239
	P 245,943	P 11,701	P 257,644	P 211,301	P 14,156	P 225,657	P 194,851	P 13,803	P 208,654

Under PFRS 7, a financial asset is past due when a counterparty has failed to make a payment when contractually due. The table below shows the aging analysis of the banking segment of past due but not impaired loans and receivables per class.

	December 31, 2013				December 31, 2012				January 1, 2012			
	Less than 30 days	31 to 90 days	More than 90 days	Total	Less than 30 days	31 to 90 days	More than 90 days	Total	Less than 30 days	31 to 90 days	More than 90 days	Total
	<i>(In Millions)</i>											
Consumers	P 163	P 142	P 358	P 663	P 61	P 90	P 313	P 464	P 4	P 32	P 419	P 455
Business loans	387	436	1,436	2,259	198	168	743	1,109	77	128	1,175	1,380
LGUs	341	69	34	444	133	—	—	133	85	—	10	95
GOCCs and NGAs	—	—	—	—	—	—	—	—	—	—	2	2
Fringe benefits	1	—	1	2	1	1	12	14	—	—	15	15
<b>Total</b>	<b>P 892</b>	<b>P 647</b>	<b>P 1,829</b>	<b>P 3,368</b>	<b>P 393</b>	<b>P 259</b>	<b>P 1,068</b>	<b>P 1,720</b>	<b>P 166</b>	<b>P 160</b>	<b>P 1,621</b>	<b>P 1,947</b>

Below are the financial assets of the banking segment, excluding receivables from customers, which are monitored using external ratings.

	December 31, 2013					
	Rated			Subtotal	Unrated <sup>6/</sup>	Total
	Aaa to Aa3	A1 to A3	Baa1 and below			
	(In Millions)					
Due from BSP <sup>1/</sup>	P –	P –	P –	P –	P 153,169	P 153,169
Due from other banks	1,580	4,131	4,775	10,486	3,608	14,094
Interbank loans receivables	399	4,490	3,285	8,174	231	8,405
Financial assets at FVPL:						
Held-for-trading:						
Government securities	–	–	2,835	2,835	521	3,356
Private debt securities	–	–	8	8	831	831
Derivative assets <sup>2/</sup>	7	30	20	57	202	259
Equity securities	–	–	–	–	250	250
Designated at FVPL:						
Segregated fund assets	–	7,862	–	7,862	–	7,862
Loans and receivables:						
Unquoted debt securities <sup>4/</sup>	–	–	50	50	7,496	7,546
Others <sup>5/</sup>	1	–	196	197	18,215	18,412
AFS investments <sup>6/</sup> :						
Government securities	1,510	227	56,727	58,464	241	58,705
Other debt securities	898	1,044	5,098	7,040	11,615	18,655
Quoted equity securities	–	–	172	172	1,505	1,677
Unquoted equity securities	–	–	–	–	162	162

1/ 'Due from BSP' is composed of interest-earning short-term placements with the BSP and a demand deposit account to support the regular operations of PNB.

2/ Derivative assets represent the value of credit derivatives embedded in host contracts issued by financial intermediaries and the market-to-market valuation of freestanding derivatives (see Note 21).

3/ Unquoted debt securities represent investments in bonds and notes issued by financial intermediaries, government and private entities that are not quoted in the market, net of allowances.

4/ Loans and receivables - Others is composed of accrued interest receivable, accounts receivable, sales contracts receivable and other miscellaneous receivables, net of allowances (see Note 8).

5/ AFS investments are presented net of allowances (Note 7).

6/ As of December 31, 2013, financial assets that are unrated are neither past due nor impaired.

	December 31, 2012					
	Rated					
	Aaa to Aa3	A1 to A3	Baa1 and below	Subtotal	Unrated <sup>7/</sup>	Total
	(In Millions)					
Due from BSP <sup>1/</sup>	P –	P –	P –	P –	P 63,258	P 63,258
Due from other banks	3,969	5,302	2,471	11,742	3,786	15,528
Interbank loans receivables	3,864	9,825	4,844	18,533	779	19,312
Securities held under agreements to resell <sup>2/</sup>	–	–	142	142	18,300	18,442
Financial assets at FVPL:						
Held-for-trading:						
Government securities	–	–	1,928	1,928	6,402	8,330
Private debt securities	–	311	261	572	349	921
Derivative assets <sup>3/</sup>	2	274	187	463	140	603
Equity securities	–	–	46	46	251	297
Designated at FVPL:						
Private debt securities	–	–	–	–	1,248	1,248
Loans and receivables:						
Unquoted debt securities <sup>4/</sup>	–	–	31	31	10,162	10,193
Others <sup>5/</sup>	–	–	–	–	15,425	15,425
AFS investments <sup>6/</sup> :						
Government securities	748	4	52,447	53,199	24,815	78,014
Other debt securities	3,304	1,352	4,776	9,432	7,829	17,261
Quoted equity securities	484	–	134	618	727	1,345
Unquoted equity securities	–	–	–	–	56	56

1/ 'Due from BSP' is composed of interest-earning short-term placements with the BSP and a demand deposit account to support the regular operations of PNB.

2/ Securities held under agreements to resell represent overnight lending to the BSP collateralized by securities. The interest rate applicable is fixed by the BSP through a memorandum.

3/ Derivative assets represent the value of credit derivatives embedded in host contracts issued by financial intermediaries and the market-to-market valuation of freestanding derivatives (see Note 21).

4/ Unquoted debt securities represent investments in bonds and notes issued by financial intermediaries, government and private entities that are not quoted in the market.

5/ Loans and receivables - Others is composed of accrued interest receivable, accounts receivable, sales contracts receivable and other miscellaneous receivables, net of allowances (see Note 8).

6/ AFS investments are presented net of allowances (Note 7).

7/ As of December 31, 2012, financial assets that are unrated are neither past due nor impaired.

	January 1, 2012					
	Rated					
	Aaa to Aa3	A1 to A3	Baa1 and below	Subtotal	Unrated <sup>7/</sup>	Total
	(In Millions)					
Due from BSP <sup>1/</sup>	P –	P –	P –	P –	P 56,439	P 56,439
Due from other banks	8,371	5,708	2,025	16,104	1,616	17,720
Interbank loans receivables	1,882	6,017	1,913	9,812	20,309	30,121
Securities held under agreements to resell <sup>2/</sup>	–	–	–	–	18,300	18,300
Financial assets at FVPL:						
Held-for-trading:						
Government securities	–	–	2,174	2,174	436	2,610
Private debt securities	1	–	–	1	34	35
Derivative assets <sup>3/</sup>	84	309	123	516	136	652
Equity securities	–	–	–	–	225	225
Designated at FVPL:						
Private debt securities	–	4,051	–	4,051	–	4,051
Segregated fund assets	–	–	–	–	1,365	1,365
Loans and receivables:						
Unquoted debt securities <sup>4/</sup>	–	–	–	–	10,948	10,948
Others <sup>5/</sup>	–	–	–	–	14,942	14,942
AFS investments <sup>6/</sup> :						
Government securities	1,169	405	43,005	44,579	28,338	72,917
Other debt securities	1,262	1,854	6,278	9,394	9,587	18,981
Quoted equity securities	–	–	–	–	837	837
Unquoted equity securities	–	–	131	131	12	143

1/ 'Due from BSP' is composed of interest-earning short-term placements with the BSP and a demand deposit account to support the regular operations of PNB.

2/ Securities held under agreements to resell represent overnight lending to the BSP collateralized by securities. The interest rate applicable is fixed by the BSP through a memorandum.

3/ Derivative assets represent the value of credit derivatives embedded in host contracts issued by financial intermediaries and the market-to-market valuation of freestanding derivatives (see Note 21).

4/ Unquoted debt securities represent investments in bonds and notes issued by financial intermediaries, government and private entities that are not quoted in the market net of allowance.

5/ Loans and receivables - Others is composed of accrued interest receivable, accounts receivable, sales contracts receivable and other miscellaneous receivables, net of allowances (see Note 8).

6/ AFS investments are presented net of allowances (Note 7).

7/ As of January 1, 2012, financial assets that are unrated are neither past due nor impaired.



### Impairment Assessment of the Group

The Group recognizes impairment or credit losses based on the results of specific (individual) and collective assessment of its credit exposures. A possible impairment has taken place when there are presence of known difficulties in the payment of obligation by counterparties, a significant credit rating downgrade takes place, infringement of the original terms of the contract has happened, or when there is an inability to pay principal or interest overdue beyond a certain threshold (e.g., 90 days). These and other factors, either singly or in tandem with other factors, constitute observable events and/or data that meet the definition of an objective evidence of impairment.

The two methodologies applied by the Group in assessing and measuring impairment or credit losses include:

#### a. Specific (individual) assessment

The Group assesses each individually significant credit exposure or advances for any objective evidence of impairment.

Among the items and factors considered by the Group when assessing and measuring specific impairment/credit allowances are:

- the going concern of the borrower's business;
- the ability of the borrower to repay its obligations during financial crises;
- the projected receipts or expected cash flows;
- the availability of other sources of financial support;
- the existing realizable value of collateral; and
- the timing of the expected cash flows.

The impairment or credit allowance, if any, are evaluated every quarter or as the need arises in view of favorable or unfavorable developments.

#### b. Collective assessment

Loans and advances that are not individually significant (e.g., credit cards, housing loans, car loans, development incentives loans, fringe benefit loans) and individually significant loans and advances where there is no apparent evidence of individual impairment are collectively assessed for impairment. A particular portfolio is reviewed every quarter to determine its corresponding appropriate allowances.

Impairment losses are estimated by taking into consideration the following information:

- historical losses of the portfolio;
- current adverse economic conditions that have direct impact on the portfolio;
- losses which are likely to occur but has not yet occurred; and
- expected receipts and recoveries once impaired.

See Notes 7 and 8 for more detailed information on the allowance for credit losses on loans and receivables and other financial assets.

### Liquidity Risk and Funding Management

Liquidity risk is generally defined as the current and prospective risk to earnings or capital arising from the Group's inability to meet its obligations when they come due without incurring unacceptable losses or costs.

#### Liquidity Risk and Funding Management of the Group except for the Banking Segment

The Group's objective is to maintain a balance between continuity of funding and sourcing flexibility through the use of available financial instruments. The Group manages its liquidity profile to meet its working and capital expenditure requirements and service debt obligations. As part of the liquidity risk management program, the Group regularly evaluates and considers the maturity of its financial assets (e.g., trade receivables, other financial assets) and resorts to short-term borrowings whenever its available cash or matured placements is not enough to meet its daily working capital requirements. To ensure availability of short-term borrowings, the Group maintains credit lines with banks on a continuing basis.

The Group relies on budgeting and forecasting techniques to monitor cash flow concerns. The Group also keeps its liquidity risk minimum by prepaying, to the extent possible, interest bearing debt using operating cash flows.

The following tables show the maturity profile of the Group's other financial liabilities (undiscounted amounts of principal and related interest) as well as the financial assets used for liquidity management (in millions):

	December 31, 2013			December 31, 2012			January 1, 2012		
	Less than one year	1 to less than 3 years	Total	Less than one year	1 to less than 3 years	Total	Less than one year	1 to less than 3 years	Total
Cash and other cash items	P 1,092	P –	P 1,092	P 596	P –	P 596	P 362	P –	P 362
Trade receivables	8,515	2,237	10,752	10,023	874	10,897	8,303	2,053	10,356
Other receivables	2,913	–	2,913	2,161	–	2,161	763	–	763
Due from related parties	2,710	–	2,710	11,270	–	11,270	4,111	–	4,111
Refundable deposits	168	–	168	125	–	125	103	–	103
AFS financial assets	675	–	675	427	–	427	129	–	129
	P 16,073	P 2,237	P 18,310	P 24,602	P 874	P 25,476	P 13,771	P 2,053	P 15,824
Short term debts	P 300	P –	P 300	P 1,620	P –	P 1,620	P 1,220	P –	P 1,220
Accounts payable and other liabilities*	7,567	–	7,567	7,356	–	7,356	8,103	–	8,103
Long-term debts	1,010	6,926	7,936	5,249	894	6,143	5,402	544	5,946
Due to related parties	8,037	–	8,037	40,319	–	40,319	35,452	1,350	36,802
Other liabilities	45	1,507	1,552	81	1,363	1,444	51	137	188
	P 16,959	P 8,433	P 25,392	P 54,625	P 2,257	P 56,882	P 50,228	P 2,031	P 52,259

\*Excluding non-financial liabilities amounting to P132.6 million, P420.3 million and P1.2 billion as of December 31, 2013 and 2012 and January 1, 2012.

#### Liquidity Risk and Funding Management of the Banking Segment

The Banking segment's liquidity management involves maintaining funding capacity to accommodate fluctuations in asset and liability levels due to changes in the banking segment's business operations or unanticipated events created by customer behavior or capital market conditions. The banking segment seeks to ensure liquidity through a combination of active management of liabilities, a liquid asset portfolio composed substantially of deposits in primary and secondary reserves, and the securing of money market lines and the maintenance of repurchase facilities to address any unexpected liquidity situations.



Liquidity risk is monitored and controlled primarily by a gap analysis of maturities of relevant assets and liabilities reflected in the maximum cumulative outflow (MCO) report, as well as an analysis of available liquid assets. The MCO focuses on a 12-month period wherein the 12-month cumulative outflow is compared to the acceptable MCO limit set by the BOD. Furthermore, an internal liquidity ratio has been set to determine sufficiency of liquid assets over deposit liabilities.

Liquidity is monitored by the banking segment on a daily basis through the Treasury Group. Likewise, the RMG monitors the static liquidity via the MCO under normal and stressed scenarios.

The table below shows the banking segment's financial assets and financial liabilities' liquidity information which includes coupon cash flows categorized based on the expected date on which the asset will be realized and the liability will be settled. For other assets, the analysis into maturity grouping is based on the remaining period from the end of the reporting period to the contractual maturity date or if earlier, the expected date the assets will be realized.

	December 31, 2013					Total
	Up to 1 month	1 to 3 months	3 to 6 months (In Millions)	6 to 12 months	Beyond 1 year	
<b>Financial Assets</b>						
COCI	P 11,559	P –	P –	P –	P –	P 11,559
Due from BSP and other banks	162,722	1,774	4,300	205	199	169,200
Interbank loans receivable	8,328	150	–	–	–	8,478
Financial assets at FVPL:						
Held-for-trading:						
Government securities	36	16	36	78	4,703	4,869
Equity securities	–	–	–	–	15	15
Private debt securities	–	2	4	7	878	891
Derivative assets:						
Pay	(2,911)	(850)	(1,141)	(216)	(31)	(5,149)
Receive	2,934	859	1,168	222	31	5,214
	23	9	27	6	–	65
Designated at FVPL:						
Designated at FVPL segregated fund liabilities	–	–	–	–	7,862	7,862
Loans receivables - gross	81,505	43,282	16,537	15,135	235,958	392,417
Unquoted debt securities - gross	69	2,855	11	144	9,176	12,255
Other receivables - gross	2,662	3,309	1,868	273	9,030	17,142
AFS investments	1,003	648	937	3,726	101,011	107,325
Total financial assets	P 267,907	P 52,045	P 23,720	P 19,574	P 368,832	P 732,078
<b>Financial Liabilities</b>						
Deposit liabilities:						
Demand	P 127,461	P –	P –	P –	P –	P 127,461
Savings	232,842	24,423	8,593	4,839	13,142	283,839
Time	13,155	13,427	4,406	6,817	20,105	57,910
Financial liability at FVPL						
Derivative liabilities:						
Pay	9,771	1,995	694	–	1,391	13,851
Receive	(9,655)	(1,979)	(676)	–	(1,391)	(13,701)
	116	16	18	–	–	150
Designated at FVPL segregated fund liabilities	–	–	–	–	7,912	7,912
Bills and acceptances payable	8,825	2,129	835	–	1,751	13,540
Subordinated debt	–	147	147	294	13,039	13,627
Accrued interest payable and other liabilities	13,594	362	212	257	6,965	21,390
Total financial liabilities	P 395,993	P 40,504	P 14,211	P 12,207	P 62,914	P 525,829

	December 31, 2012					Total
	Up to 1 month	1 to 3 months	3 to 6 months (In Millions)	6 to 12 months	Beyond 1 year	
<b>Financial Assets</b>						
COCI	P 9,485	P –	P –	P –	P –	P 9,485
Due from BSP and other banks	73,325	1,820	3,184	2,186	–	80,515
Interbank loans receivable	16,483	2,286	543	–	–	19,312
Securities held under agreements to resell	18,304	142	–	–	–	18,446
Financial assets at FVPL:						
Held-for-trading:						
Government securities	1,978	17	19	6,392	677	9,083
Equity securities	251	–	–	46	–	297
Private debt securities	103	1	1	821	29	955
Derivative assets						
Pay	(8,234)	(716)	(22)	(67)	(52)	(9,091)
Receive	8,406	788	24	153	222	9,593
	172	72	2	86	170	502
Designated at FVPL:						
Segregated fund assets	–	–	–	–	3,742	3,742
Private debt securities	4	8	1,255	–	–	1,267
Loans receivables - gross	51,908	28,713	10,686	6,448	179,759	277,514
Unquoted debt securities - gross	4,031	91	27	86	10,268	14,503
Other receivables - gross	20,195	661	132	1	1,228	22,217
AFS investments	998	3,867	3,426	2,354	142,355	153,000
Total financial assets	P 197,237	P 37,678	P 19,275	P 18,420	P 338,228	P 610,838
<b>Financial Liabilities</b>						
Deposit liabilities:						
Demand	P 79,911	P –	P –	P –	P –	P 79,911
Savings	211,334	24,222	8,577	5,274	12,636	262,043
Time	18,473	8,037	4,835	3,111	14,507	48,963
Financial liabilities at FVPL:						
Financial liability designated at FVPL	43	85	6,311	–	–	6,439
Derivative liabilities:						
Pay	18,530	1,162	476	608	213	20,989
Receive	(18,515)	(1,123)	(452)	(518)	(52)	(20,660)
	15	39	24	90	161	329

(Forward)

	December 31, 2012					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1 year	Total
	<i>(In Millions)</i>					
Designated at FVPL - segregated fund liabilities	P –	P –	P –	P –	P 3,740	P 3,740
Bills and acceptances payable	11,568	5,163	1,366	41	333	18,471
Subordinated debt	81	4,638	161	322	11,742	16,944
Accrued interest payable and other liabilities	18,867	392	292	374	3,486	23,391
Total financial liabilities	P 340,292	P 42,576	P 21,546	P 9,212	P 46,605	P 460,231
	January 1, 2012					
	Up to 1 month	1 to 3 months	3 to 6 months	6 to 12 months	Beyond 1 year	Total
	<i>(In Millions)</i>					
<b>Financial Assets</b>						
COCI	P 9,397	P 66	P –	P –	P –	P 9,463
Due from BSP and other banks	60,160	15,348	–	1,114	2	76,624
Interbank loans receivable	17,543	5,725	85	–	–	23,353
Securities held under agreements to resell	25,105	–	–	–	–	25,105
Financial assets at FVPL:						
Held-for-trading:						
Government securities	2,187	16	455	49	730	3,437
Equity securities	175	–	50	–	–	225
Private debt securities	17	–	18	–	8	43
Derivative assets						
Pay	(11,186)	(778)	(1,082)	(304)	–	(13,350)
Receive	11,266	904	1,096	307	85	13,658
	80	126	14	3	85	308
Designated at FVPL:						
Private debt securities	11	22	34	70	4,118	4,255
Loans receivables - gross	37,753	40,934	14,352	6,183	157,038	256,260
Unquoted debt securities - gross	4,418	103	418	288	11,020	16,247
Other receivables - gross	18,030	491	1,141	–	590	20,252
AFS investments	487	6,836	700	4,963	133,481	146,467
Total financial assets	P 175,363	P 69,667	P 17,267	P 12,670	P 307,072	P 582,039
<b>Financial Liabilities</b>						
Deposit liabilities:						
Demand	P 47,738	P 1,744	P 2,616	P 5,232	P 18,920	P 76,250
Savings	77,883	10,061	15,045	30,099	126,161	259,249
Time	5,639	21,860	9,072	3,416	22,010	61,997
Financial liability at FVPL	37	73	110	219	8,025	8,464
Derivative liabilities:						
Pay	13,076	2,221	–	1,415	3,792	20,504
Receive	(13,024)	(2,139)	–	(1,401)	(3,727)	(20,291)
	52	82	–	14	65	213
Bills and acceptances payable	3,868	4,750	3,317	746	1,341	14,022
Subordinated debt	43	138	401	255	11,581	12,418
Accrued interest payable and other liabilities	16,039	585	265	258	2,132	19,279
Total financial liabilities	P 151,299	P 39,293	P 30,826	P 40,239	P 190,235	P 451,892

## Market Risk

Market Risk is the risk to earnings or capital arising from adverse movements in factors that affect the market value of instruments, products, and transactions in an institutions' overall portfolio. Market Risk arises from market making, dealing, and position taking in interest rate, foreign exchange and equity markets.

### Market Risks of the Group other than the Banking Segment

The Group's operating, investing, and financing activities are directly affected by changes in foreign exchange rates and interest rates. Increasing market fluctuations in these variables may result in significant equity, cash flow and profit volatility risks for the Group. For this reason, the Group seeks to manage and control these risks primarily through its regular operating and financing activities.

Management of financial market risk is a key priority for the Group. The Group generally applies sensitivity analysis in assessing and monitoring its market risks. Sensitivity analysis enables management to identify the risk position of the Group as well as provide an approximate quantification of the risk exposures. Estimates provided for foreign exchange risk, cash flow interest rate risk, price interest rate risk and equity price risk are based on the historical volatility for each market factor, with adjustments being made to arrive at what the Group considers to be reasonably possible.

### Equity price risk

Equity price risk is the risk that the fair value of equities will decrease as a result of changes in the levels of equity indices and value of individual stocks. In 2013, 2012 and 2011, changes in fair value of equity instruments held as AFS equity instruments due to a reasonable possible change in equity interest, with all other variables held constant, will increase profit by P43.8 million, P42.6 million and P48.4 million, respectively, if equity prices will increase by 5.2%. An equal change in the opposite direction would have decrease equity by the same amount.

### Foreign exchange risk

The Group's foreign currency risk relates to its US\$-denominated cash in banks and cash equivalents and due to and from related parties. Management closely monitors the fluctuations in exchange rates so as to anticipate the impact of foreign currency risks associated with the financial instruments. The Group currently does not enter into derivative transactions to hedge its currency exposure.

The Group's significant US\$-denominated financial assets (other than the banking segment) pertain to due from related parties as of December 31, 2013 and 2012 and January 1, 2012. Shown below is the impact on the Group's income before income tax of reasonably possible changes in exchange rate of the US\$ against the peso:

	Dollar Value <i>(In Millions)</i>	Peso Equivalent <i>(In Millions)</i>	Change in Foreign Exchange Rate	Effect on Income Before Income Tax <i>(In Millions)</i>
December 31, 2013	\$20	P 888	+1	P 27
			-1	(27)
December 31, 2012	20	821	+1	30
			-1	(30)
January 1, 2012	30	1,315	+1	37
			-1	(37)



The reasonable movement in exchange rates was determined using one-year historical data. There is no other impact on the Group's equity other than those already affecting the profit or loss.

#### Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates would unfavorably affect future cash flows from financial instruments. As of December 31, 2013 and 2012 and January 1, 2012, the Group's long-term debts are not exposed to the risk in changes in market interest rates since the debts are issued at fixed rates. As of January 1, 2012, the Group's exposure pertains only to short-term bank loan. Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk. Repricing of floating rate financial instruments is mostly at interval of three months or six months.

A sensitivity analysis to a reasonable possible change in the market interest rates would show the potential increase or decrease on profit or loss. If the market interest rates for 2011 had been 0.25% higher or lower, income before income tax would increase or decrease by P0.6 million.

#### Market Risks of the Banking Segment

The succeeding sections provide discussion on the impact of market risk on the Banking segment's trading and structural portfolios.

#### Trading market risk

Trading market risk exists in the banking segment as the values of its trading positions are sensitive to changes in market rates such as interest rates, foreign exchange rates and equity prices. PNB is exposed to trading market risk in the course of market making as well as from taking advantage of market opportunities. The banking segment adopts the Parametric Value-at-Risk (VaR) methodology (with 99% confidence level, and one day holding period for FX and equity price risks VaR and ten day holding period for interest rate risk VaR) to measure PNB's trading market risk. Volatilities are updated monthly and are based on historical data for a rolling 260-day period. The RMG reports the VaR utilization and breaches to limits to the risk taking personnel on a daily basis and to the ALCO and Risk Oversight Committee (ROC) on a monthly basis. All risk reports discussed in the ROC meeting are noted by the BOD. The VaR figures are backtested to validate the robustness of the VaR model. Below are the objectives and limitations of the VaR methodology, VaR assumptions and VaR limits.

##### a. Objectives and limitations of the VaR methodology

The VaR models are designed to measure market risk in a normal market environment. The models assume that any changes occurring in the risk factors affecting the normal market environment will follow a normal distribution. The use of VaR has limitations because it is based on historical volatilities in market prices and assumes that future price movements will follow a statistical distribution. Due to the fact that VaR relies heavily on historical data to provide information and may not clearly predict the future changes and modifications of the risk factors, the probability of large market moves may be under estimated if changes in risk factors fail to align with the normal distribution assumption. VaR may also be under- or over- estimated due to the assumptions placed on risk factors and the relationship between such factors for specific instruments. Even though positions may change throughout the day, the VaR only represents the risk of the portfolios at the close of each business day, and it does not account for any losses that may occur beyond the 99.00% confidence level.

##### b. VaR assumptions/parameters

VaR estimates the potential loss on the current portfolio assuming a specified time horizon and level of confidence at 99.00%. The use of a 99.00% confidence level means that, within a one day horizon, losses exceeding the VaR figure should occur, on average, not more than once every one hundred days.

##### c. VaR Limits

Since VaR is an integral part of the banking segment's market risk management, VaR limits have been established annually for all financial trading activities and exposures. Calculated VaR compared against the VaR limits are monitored. Limits are based on the tolerable risk appetite of the banking segment. VaR is computed on an undiversified basis; hence, the banking segment does not consider the correlation effects of the three trading portfolios.

Trading Portfolio	Foreign Exchange*	Interest Rate	Equities Price	Total VaR**
December 31, 2013	P 4.28	P 159.37	P 12.22	P 175.87
Average Daily	8.81	148.81	9.89	167.51
Highest	24.71	497.11	12.97	413.55
Lowest	0.65	30.24	6.69	70.60
December 31, 2012	4.84	80.22	7.80	92.86
Average Daily	6.61	131.09	8.95	146.64
Highest	16.85	340.31	11.17	354.65
Lowest	0.40	60.87	6.00	77.86
December 31, 2011	3.33	113.24	9.54	126.11
Average Daily	8.90	177.18	9.80	195.88
Highest	24.15	312.35	13.14	139.81
Lowest	0.92	73.30	6.11	95.63

\* FX VaR is the bankwide foreign exchange risk

\*\* The high and low for the total portfolio may not equal the sum of the individual components as the highs and lows of the individual trading portfolios may have occurred on different trading day

The table below shows the interest rate VaR for AFS investments:

	2013	2012 (In Millions)	2011
End of year	P 2,283.45	P 2,317.22	P 1,922.71
Average Daily	1,963.52	2,176.61	1,597.70
Highest	2,909.73	2,743.57	2,047.64
Lowest	1,008.20	1,522.48	927.67

#### Structural Market Risk of the Banking Segment

##### Non-trading Market Risk

##### Interest rate risk

The banking segment seeks to ensure that exposure to fluctuations in interest rates are kept within acceptable limits. Interest margins may increase as a result of such changes but may be reduced or may create losses in the event that unexpected movements arise.



Repricing mismatches will expose the banking segment to interest rate risk. PNB measures the sensitivity of its assets and liabilities to interest rate fluctuations by way of a “repricing gap” analysis using the repricing characteristics of its financial instrument positions tempered with approved assumptions. To evaluate earnings exposure, interest rate sensitive liabilities in each time band are subtracted from the corresponding interest rate assets to produce a “repricing gap” for that time band. The difference in the amount of assets and liabilities maturing or being repriced over a one year period would then give the banking segment an indication of the extent to which it is exposed to the risk of potential changes in net interest income. A negative gap occurs when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. Vice versa, positive gap occurs when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities.

During a period of rising interest rates, a company with a positive gap is better positioned because the company’s assets are refinanced at increasingly higher interest rates increasing the net interest margin of the company over time. During a period of falling interest rates, a company with a positive gap would show assets repricing at a faster rate than one with a negative gap, which may restrain the growth of its net income or result in a decline in net interest income.

For risk management purposes, the repricing gap covering the one year period is multiplied by an assumed change in interest rates to yield an approximation of the change in net interest income that would result from such an interest rate movement. The banking segment's BOD sets a limit on the level of earnings at risk (EaR) exposure tolerable to the banking segment. Compliance to the EaR limit is monitored monthly by the RMG. This EaR computation is accomplished monthly, with a quarterly stress test.

The following table sets forth the repricing gap position of the banking segment:

	December 31, 2013					
	Up to 1	1 to 3	3 to 6	6 to 12	Beyond	Total
	Month	Months	Months	months	1 year	
	(In Millions)					
<b>Financial Assets*</b>						
Due from BSP and other banks	P 110,636	P –	P –	P –	P –	P 110,636
Interbank loans receivable	6,188	149	–	–	–	6,337
Receivable from customers and other receivables - gross**	83,078	41,796	8,611	9,077	42,987	185,549
<b>Total financial assets</b>	<b>P 199,902</b>	<b>P 41,945</b>	<b>P 8,611</b>	<b>P 9,077</b>	<b>P 42,987</b>	<b>P 302,522</b>
<b>Financial Liabilities*</b>						
Deposit liabilities:						
Savings	P 91,078	P 17,726	P 10,075	P 5,979	P 4,182	P 129,040
Time	14,999	8,913	4,237	2,154	5,747	36,050
Bills and acceptances payable	9,220	902	242	438	1,279	12,081
<b>Total financial liabilities</b>	<b>P 115,297</b>	<b>P 27,541</b>	<b>P 14,554</b>	<b>P 8,571</b>	<b>P 11,208</b>	<b>P 177,171</b>
<b>Repricing gap</b>	<b>P 84,605</b>	<b>P 14,404</b>	<b>(P 5,943)</b>	<b>P 506</b>	<b>P 31,779</b>	<b>P 125,351</b>
<b>Cumulative gap</b>	<b>84,605</b>	<b>99,009</b>	<b>93,066</b>	<b>93,572</b>	<b>125,351</b>	

\*Financial instruments that are not subject to repricing/rollforward were excluded.

\*\*Receivable from customers excludes residual value of leased assets.

	December 31, 2012					
	Up to 1	1 to 3	3 to 6	6 to 12	Beyond	Total
	Month	Months	Months	months	1 year	
	(In Millions)					
<b>Financial Assets*</b>						
Due from BSP and other banks	P 50,592	P –	P –	P –	P –	P 50,592
Interbank loans receivable	18,078	–	–	–	–	18,078
Securities held under agreements to resell	18,442	–	–	–	–	18,442
Designated at FVPL:						
Private Debt Securities	–	–	1,248	–	–	1,248
Loans receivable - gross	86,858	35,561	7,058	12,296	59,026	200,799
<b>Total financial assets</b>	<b>P 173,970</b>	<b>P 35,561</b>	<b>P 8,306</b>	<b>P 12,296</b>	<b>P 59,026</b>	<b>P 289,159</b>
<b>Financial Liabilities*</b>						
Deposit liabilities:						
Savings	P131,333	P14,908	P 4,607	P 3,156	P 7,083	P 161,087
Time	32,468	3,807	851	4,366	26	41,518
Bills and acceptances payable	12,144	2,456	340	903	2,599	18,442
<b>Total financial liabilities</b>	<b>P 175,945</b>	<b>P 21,171</b>	<b>P 5,798</b>	<b>P 8,425</b>	<b>P 9,708</b>	<b>P 221,047</b>
<b>Repricing gap</b>	<b>(P 1,975)</b>	<b>P 14,390</b>	<b>P 2,508</b>	<b>P 3,871</b>	<b>P 49,318</b>	<b>P 68,112</b>
<b>Cumulative gap</b>	<b>(1,975)</b>	<b>12,415</b>	<b>14,923</b>	<b>18,794</b>	<b>67,825</b>	

\*Financial instruments that are not subject to repricing/rollforward were excluded.

\*\*Receivable from customers excludes residual value of leased assets.

	January 1, 2012					
	Up to 1	1 to 3	3 to 6	6 to 12	Beyond	Total
	Month	Months	Months	months	1 year	
	(In Millions)					
<b>Financial Assets*</b>						
Due from BSP and other banks	P 63,252	P 10,907	P –	P –	P –	P 74,159
Interbank loans receivable	30,033	88	–	–	–	30,121
Securities held under agreements to resell	18,300	–	–	–	–	18,300
Designated at FVPL:						
Private Debt	646	2,095	1,309	–	2	4,052
Loan receivables - gross	92,365	22,603	5,897	13,073	98,454	232,392
Time Loan - Unquoted Debt Securities - gross	247	550	401	1	13,568	14,767
<b>Total financial assets</b>	<b>P 204,843</b>	<b>P 36,243</b>	<b>P 7,607</b>	<b>P 13,074</b>	<b>P 112,024</b>	<b>P 373,791</b>
<b>Financial Liabilities*</b>						
Deposit liabilities:						
Savings	P 131,179	P 17,315	P 3,718	P 1,801	P 100,641	P 254,654
Time	45,335	4,744	839	858	6,380	58,156
Bills and acceptances payable	4,080	3,071	228	4,288	2,042	13,709
<b>Total financial liabilities</b>	<b>P 180,594</b>	<b>P 25,130</b>	<b>P 4,785</b>	<b>P 6,947</b>	<b>P 109,063</b>	<b>P 328,519</b>
<b>Repricing gap</b>	<b>P 24,249</b>	<b>P 11,113</b>	<b>P 2,822</b>	<b>P 6,127</b>	<b>P 2,961</b>	<b>P 47,272</b>
<b>Cumulative gap</b>	<b>24,249</b>	<b>35,362</b>	<b>38,184</b>	<b>44,311</b>	<b>47,272</b>	

\*Financial instruments that are not subject to repricing/rollforward were excluded.

\*\*Receivable from customers excludes residual value of leased assets.



The following table sets forth, for the year indicated, the impact of changes in interest rates on the banking segment's repricing gap for the years ended December 31:

	2013		2012		2011	
	Statement of Income	Equity	Statement of Income	Equity	Statement of Income	Equity
				(In Millions)		
+ 50bps	P 442	P 442	P 60	P 60	P 5	P 5
- 50bps	(442)	(442)	(60)	(60)	(5)	(5)
+ 100bps	885	885	120	120	9	9
- 100bps	(885)	(885)	(120)	(120)	(9)	(9)

As one of the long-term goals in the risk management process, the banking segment has set the adoption of the economic value approach in measuring the interest rate risk in the banking books to complement the earnings approach currently used.

#### Foreign currency risk

Foreign exchange is the risk to earnings or capital arising from changes in foreign exchange rates. The banking segment takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financials and cash flows.

Foreign currency liabilities generally consist of foreign currency deposits in PNB's FCDU books, accounts made in the Philippines or which are generated from remittances to the Philippines by Filipino expatriates and overseas Filipino workers who retain for their own benefit or for the benefit of a third party, foreign currency deposit accounts with PNB and foreign currency-denominated borrowings appearing in the regular books of PNB. Foreign currency deposits are generally used to fund PNB's foreign currency-denominated loan and investment portfolio in the FCDU. Banks are required by the BSP to match the foreign currency liabilities with the foreign currency assets held through FCDUs. In addition, the BSP requires a 30.00% liquidity reserve on all foreign currency liabilities held through FCDUs. Outside the FCDU, PNB has additional foreign currency assets and liabilities in its foreign branch network.

The banking segment's policy is to maintain foreign currency exposure within acceptable limits and within existing regulatory guidelines. The banking segment believes that its profile of foreign currency exposure on its assets and liabilities is within conservative limits for a financial institution engaged in the type of business in which the banking segment is involved.

The table below summarizes the banking segment's exposure to foreign exchange rate risk. Included in the table are the financial assets and liabilities at carrying amounts, categorized by currency (amounts in Philippine peso equivalent).

	December 31, 2013			December 31, 2012			January 1, 2012		
	USD	Others	Total	USD	Others	Total	USD	Others	Total
	(In Millions)								
<b>Assets</b>									
COCI and due from BSP	P 1,017	P 485	P 1,502	P 728	P 186	P 914	P 903	P 142	P 1,045
Due from other banks	9,719	3,589	13,308	2,528	644	3,172	4,692	364	5,056
Interbank loans receivable and securities held under agreements to resell	1,005	1,000	2,005	1,450	1	1,451	455	1	456
Derivative assets	-	-	-	-	1	1	-	-	-
Financial assets at FVPL	-	-	-	27	-	27	4,089	-	4,089
Loans and receivables	10,268	5,269	15,537	5,422	251	5,673	6,160	102	6,262
AFS investments	4,255	2,078	6,333	3,638	1,210	4,848	8,375	40	8,415
Other assets	-	-	-	5	13	18	5,168	283	5,451
<b>Total assets</b>	<b>26,264</b>	<b>12,421</b>	<b>38,685</b>	<b>13,798</b>	<b>2,306</b>	<b>16,104</b>	<b>29,842</b>	<b>932</b>	<b>30,774</b>
<b>Liabilities</b>									
Deposit liabilities	7,621	5,159	12,780	3,442	1,650	5,092	1,309	63	1,372
Bills and acceptances payable	6,437	141	6,578	5,513	89	5,602	7,151	96	7,247
Accrued taxes, interest and other expenses	1,599	201	1,800	1,563	2	1,565	1,642	1	1,643
Other liabilities	4,677	493	5,170	1,688	74	1,761	884	3,493	4,376
<b>Total liabilities</b>	<b>20,334</b>	<b>5,994</b>	<b>26,328</b>	<b>12,206</b>	<b>1,815</b>	<b>14,020</b>	<b>10,986</b>	<b>3,653</b>	<b>14,639</b>
<b>Net Exposure</b>	<b>P 5,930</b>	<b>P 6,427</b>	<b>P 12,357</b>	<b>P 1,592</b>	<b>P 491</b>	<b>P 2,086</b>	<b>P 18,856</b>	<b>(P 2,721)</b>	<b>P 16,135</b>

Information relating to the banking segment's currency derivatives is contained in Note 21.

### 33. Fair Value Measurement

The Group has assets and liabilities that are measured at fair value on a recurring and non-recurring basis in the consolidated balance sheets after initial recognition. Recurring fair value measurements are those that another PFRS requires or permits to be recognized in the consolidated balance sheets at the end of each reporting period. These include financial assets and liabilities at FVPL and AFS investments. Non-recurring fair value measurements are those that another PFRS requires or permits to be recognized in the consolidated balance sheet in particular circumstances. These include land and land improvements, buildings and building improvements and machineries and equipment measured at revalued amount and investment properties measured at cost but with fair value measurement disclosure.

The Group's management determines the policies and procedures for both recurring and non-recurring fair value measurement.

External valuers are involved for valuation of significant assets, such as investment properties, land and land improvements, plant buildings and building improvements and machineries and equipment. Involvement of external valuers is decided upon annually by management. Selection criteria include market knowledge, reputation, independence and whether professional standards are maintained. Management decides, after discussions with the Group's external valuers, which valuation techniques and inputs to use for each case.

At each reporting date, management analyses the movements in the values of assets and liabilities which are required to be re-measured or re-assessed as per the Group's accounting policies. For this analysis, management verifies the major inputs applied in the latest valuation by agreeing the information in the valuation computation to contracts and other relevant documents with relevant external sources to determine whether the change is reasonable.

As of December 31, 2013 and 2012 and January 1, 2012, the carrying values of the Group's financial assets and liabilities approximate their respective fair values, except for the following financial instruments:

	December 31, 2013		December 31, 2012		January 1, 2012	
	Carrying Value	Fair Market Value	Carrying Value	Fair Market Value	Carrying Value	Fair Market Value
<i>(In Thousands)</i>						
<b>Financial Assets:</b>						
Loans and receivables:						
Receivables from customers	P 248,321,931	P 274,331,315	P 218,732,880	P 235,898,813	P 202,740,824	P 219,341,728
Unquoted debt securities	7,545,531	12,692,201	10,193,226	11,928,824	10,948,007	12,301,697
	<b>P 255,867,462</b>	<b>P 287,023,516</b>	<b>P 228,926,106</b>	<b>P 247,827,637</b>	<b>P 213,688,831</b>	<b>P 231,643,425</b>
<b>Financial Liabilities:</b>						
Financial liabilities at amortized cost:						
Deposit liabilities - Time deposits	P 51,114,363	P 52,259,893	P 47,587,615	P 48,262,288	P 58,155,187	P 55,028,138
Long term debts:						
Subordinated debt	9,953,651	10,995,537	14,436,122	15,454,051	10,935,265	12,233,035
Unsecured term loan	1,990,120	2,014,001	—	—	—	—
Bonds payable	4,982,544	5,250,000	4,968,295	5,212,972	4,955,148	5,196,799
Notes payable	963,355	974,916	1,174,784	1,188,881	990,430	1,002,537
Other liabilities:						
Payable to landowners	1,296,785	1,312,839	1,296,785	1,321,178	—	—
Tenants' rental deposits	161,601	150,852	80,004	74,484	75,496	71,753
Advance rentals	98,658	94,594	29,431	27,589	35,438	32,940
	<b>P 70,561,077</b>	<b>P 73,052,632</b>	<b>P 69,573,036</b>	<b>P 71,541,443</b>	<b>P 75,146,964</b>	<b>P 73,565,202</b>

The methods and assumptions used by the Group in estimating the fair value of the financial instruments are:

Cash equivalents - Carrying amounts approximate fair values due to the relatively short-term maturity of these investments.

Debt securities - Fair values are generally based upon quoted market prices. If the market prices are not readily available, fair values are obtained from independent parties offering pricing services, estimated using adjusted quoted market prices of comparable investments or using the discounted cash flow methodology.

Equity securities - fair values of quoted equity securities are based on quoted market prices. While fair values of unquoted equity securities are the same as the carrying value since the fair value could not be reliably determined due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value.

Loans and receivables - For loans with fixed interest rates, fair values are estimated by discounted cash flow methodology, using the Group's current market lending rates for similar types of loans. For loans with floating interest rates, with repricing frequencies on a quarterly basis, the Group assumes that the carrying amount approximates fair value. Where the repricing frequency is beyond three months, the fair value of floating rate loans is determined using the discounted cash flow methodologies. The discount rate used in estimating the fair value of loans and receivables is 3.0% in 2013, from 0.3% to 9.3% in 2012 and from 5.0% to 9.3% in 2011 for peso-denominated receivables. For foreign currency-denominated receivables, discount rate used is 1.0% in 2013 and 3.3% in 2012 and 2011.

Liabilities - Except for time deposit liabilities, subordinated debt, bonds payable, unsecured term loans, notes payable, payable to landowners, tenants' rental deposits and advance rentals, the carrying values approximate fair values due to either the presence of a demand feature or the relatively short-term maturities of these liabilities.

Derivative instruments - Fair values are estimated based on quoted market prices or acceptable valuation models.

Time deposit liabilities and subordinated debt including designated at FVPL - Fair value is determined using the discounted cash flow methodology. The discount rate used in estimating the fair values of the subordinated debt and time deposits ranges from 1.1% to 4.2%, from 1.4% to 3.6% and from 1.2% to 5.0% as of December 31, 2013 and 2012 and January 1, 2012, respectively.

Unsecured term loans, notes payable, payable to landowners, tenants' rental deposits and advance rentals - Fair values are estimated using the discounted cash flow method based on the discounted value of future cash flows using the applicable risk-free rates for similar types of instruments. The discount rates used range from 2.13% to 6.57%, from 3.28% to 6.57% and from 4.51% to 6.57% as of December 31, 2013 and 2012 and January 1, 2012, respectively.

Bonds payable - Fair value is determined by reference to latest transaction price at the end of reporting period.

#### *Fair value hierarchy*

The Group uses the following hierarchy for determining and disclosing the fair value of assets and liabilities by valuation technique. These levels are based in the inputs that are used to determine the fair value and can be summarized in:

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.



The Group held the following assets and liabilities measured at fair value and at cost but which fair values are disclosed and their corresponding level in fair value hierarchy:

December 31, 2013				
	Level 1	Level 2	Level 3	Total
(In Thousands)				
<b>Assets measured at fair value:</b>				
<b>Financial Assets</b>				
Financial assets at FVPL:				
Held-for-trading:				
Government securities	P 2,262,113	P 1,093,608	P –	P 3,355,721
Derivative assets	779,565	50,963	–	830,528
Private debt securities	–	92,834	165,863	258,697
Equity securities	249,518	–	–	249,518
Designated at FVPL:				
Segregated fund assets*	2,481,635	–	5,380,053	7,861,688
	P 5,772,831	P 1,237,405	P 5,545,916	P 12,556,152
<b>AFS investments:</b>				
Government securities	P 33,703,998	P 25,676,335	P –	P 59,380,333
Other debt securities	18,654,987	–	–	18,654,987
Equity securities**	2,663,182	–	–	2,663,182
	P 55,022,167	P 25,676,335	P –	P 80,698,502
<b>Non-financial assets</b>				
Property, plant and equipment***				
Land and land improvements	P –	P –	P 16,613,640	P 16,613,640
Plant buildings and building improvements	–	–	10,966,015	10,966,015
Machineries and equipment	–	–	10,254,872	10,254,872
	P –	P –	P 37,834,527	P 37,834,527
<b>Liabilities measured at fair value:</b>				
<b>Financial liabilities</b>				
Financial liabilities at FVPL:				
Designated at FVPL:				
Segregated fund liabilities*	P 2,481,635	P –	P 5,380,053	P 7,861,688
Derivative liabilities	–	163,101	–	163,101
	P 2,481,635	P 163,101	P 5,380,053	P 8,024,789
<b>Assets for which fair values are disclosed:</b>				
<b>Financial Assets</b>				
Loans and receivables:				
Receivables from customers	P –	P –	P 274,331,315	P 274,331,315
Unquoted debt securities	–	–	12,692,201	12,692,201
	P –	P –	P 287,023,516	P 287,023,516
<b>Non-financial Assets</b>				
Investment properties***				
Land	P –	P –	P 35,072,992	P 35,072,992
Buildings and improvements	–	–	4,857,285	4,857,285
	P –	P –	P 39,930,277	P 39,930,277
<b>Liabilities for which fair values are disclosed:</b>				
<b>Financial liabilities</b>				
Financial liabilities at amortized cost:				
Deposit liabilities:				
Time deposits	P –	P –	P 52,259,893	P 52,259,893
Long term debts:				
Subordinated debt	–	–	10,995,537	10,995,537
Unsecured term loan	–	–	2,014,001	2,014,001
Bonds payable	5,250,000	–	–	5,250,000
Notes payable	–	–	974,916	974,916
Other liabilities:				
Payable to landowners	–	–	1,312,839	1,312,839
Tenants' rental deposits	–	–	150,852	150,852
Advance rentals	–	–	94,594	94,594
	P 5,250,000	P –	P 67,802,632	P 73,052,632

\* Excludes cash component

\*\* Excludes unquoted available-for-sale securities

\*\*\* Based on the fair values from appraisal reports which are different from their carrying amounts which are carried at cost.

December 31, 2012				
	Level 1	Level 2	Level 3	Total
(In Thousands)				
<b>Assets measured at fair value:</b>				
<b>Financial Assets</b>				
Financial assets at FVPL:				
Held-for-trading:				
Government securities	P 8,329,815	P –	P –	P 8,329,815
Private debt securities	–	544,218	59,044	603,262
Derivative assets	920,822	–	–	920,822
Equity securities	296,936	–	–	296,936
Designated at FVPL:				
Segregated fund assets*	P 1,123,625	P –	P 2,615,951	P 3,739,576
Private debt securities	–	1,247,756	–	1,247,756
	P 10,671,198	P 1,791,974	P 2,674,995	P 15,138,167
<b>AFS investments:</b>				
Government securities	P 76,277,068	P 2,163,955	P –	P 78,441,023
Other debt securities	14,243,980	3,017,061	–	17,261,041
Equity securities**	2,331,541	–	–	2,331,541
	P 92,852,589	P 5,181,016	P –	P 98,033,605
<b>Non-financial assets</b>				
Property, plant and equipment***				
Land and land improvements	P –	P –	P 16,128,847	P 16,128,847
Plant buildings and building improvements	–	–	11,765,117	11,765,117
Machineries and equipment	–	–	10,186,704	10,186,704
	P –	P –	P 38,080,668	P 38,080,668

(Forward)



December 31, 2012				
	Level 1	Level 2	Level 3	Total
(In Thousands)				
<b>Liabilities measured at fair value:</b>				
<b>Financial liabilities</b>				
Financial liabilities at FVPL:				
Designated at FVPL:				
Segregated fund liabilities*	P 1,123,625	P –	P 2,615,951	P 3,739,576
Subordinated notes	–	–	6,196,070	6,196,070
Derivative liabilities	–	389,817	–	389,817
	P 1,123,625	P 389,817	P 8,812,021	P 10,325,463
Assets for which fair values are disclosed:				
<b>Financial Assets</b>				
Loans and receivables:				
Receivables from customers	P –	P –	P 235,898,813	P 235,898,813
Unquoted debt securities	–	–	11,928,824	11,928,824
	P –	P –	P 247,827,637	P 247,827,637
<b>Non-financial Assets</b>				
Investment property***				
Land	P –	P –	P 36,100,591	P 36,100,591
Buildings and improvements	–	–	5,044,536	5,044,536
	P –	P –	P 41,145,127	P 41,145,127
<b>Liabilities for which fair values are disclosed:</b>				
<b>Financial liabilities</b>				
Financial liabilities at amortized cost:				
Deposit liabilities:				
Time deposits	P –	P –	P 48,262,288	P 48,262,288
Long term debts:				
Subordinated debt	–	–	15,454,051	15,454,051
Bonds payable	5,212,972	–	–	5,212,972
Notes payable	–	–	1,188,881	1,188,881
Other liabilities:				
Payable to landowners	–	–	1,321,178	1,321,178
Tenants' rental deposits	–	–	74,484	74,484
Advance rentals	–	–	27,589	27,589
	P 5,212,972	P –	P 66,328,471	P 71,541,443

\* Excludes cash component

\*\* Excludes unquoted available-for-sale securities

\*\*\* Based on the fair values from appraisal reports which are different from their carrying amounts which are carried at cost.

January 1, 2012				
	Level 1	Level 2	Level 3	Total
(In Thousands)				
<b>Assets measured at fair value:</b>				
<b>Financial Assets</b>				
Financial assets at FVPL:				
Held-for-trading:				
Government securities	P 2,609,581	P –	P –	P 2,609,581
Derivative assets	–	652,324	–	652,324
Private debt securities	35,262	–	–	35,262
Equity securities	225,596	–	–	225,596
Designated at FVPL:				
Private debt securities	–	4,050,671	–	4,050,671
Segregated fund assets*	801,251	–	563,762	1,365,013
	P 3,671,690	P 4,702,995	P 563,762	P 8,938,447
AFS investments:				
Government securities	P 71,857,035	P 1,189,131	P –	P 73,046,166
Other debt securities	15,303,594	3,677,689	–	18,981,283
Equity securities**	1,899,357	–	–	1,899,357
	P 89,059,986	P 4,866,820	P –	P 93,926,806
<b>Non-financial assets</b>				
Property, plant and equipment***				
Land and land improvements	P –	P –	P 15,760,062	P 15,760,062
Plant buildings and building improvements	–	–	12,244,148	12,244,148
Machineries and equipment	–	–	9,419,060	9,419,060
	P –	P –	P 37,423,270	P 37,423,270
<b>Liabilities measured at fair value:</b>				
<b>Financial liabilities</b>				
Financial liabilities at FVPL:				
Designated at FVPL:				
Segregated fund liabilities*	P 801,251	P –	P 563,762	P 1,365,013
Subordinated notes	–	–	6,479,170	6,479,170
Derivative liabilities	–	261,424	–	261,424
	P 801,251	P 261,424	P 7,042,932	P 8,105,607
<b>Assets for which fair values are disclosed:</b>				
<b>Financial Assets</b>				
Loans and receivables:				
Receivables from customers	P –	P –	P 219,341,728	P 219,341,728
Unquoted debt securities	–	–	12,301,697	12,301,697
	P –	P –	P 231,643,425	P 231,643,425
<b>Non-financial Assets</b>				
Investment property***				
Land	P –	P –	P 28,305,035	P 28,305,035
Buildings and improvements	–	–	7,823,942	7,823,942
	P –	P –	P 36,128,977	P 36,128,977
<b>Liabilities for which fair values are disclosed:</b>				
<b>Financial liabilities</b>				
Financial liabilities at amortized cost:				
Deposit liabilities:				
Time deposits	P –	P –	P 55,028,138	P 55,028,138
Long term debts:				
Subordinated debt	–	–	12,233,035	12,233,035
Bonds payable	5,196,799	–	–	5,196,799

(Forward)



	January 1, 2012			
	Level 1	Level 2	Level 3	Total
		(In Thousands)		
Notes payable	P –	P –	P 1,002,537	P 1,002,537
Other liabilities:				
Tenants' rental deposits	–	–	71,753	71,753
Advance rentals	–	–	32,940	32,940
	P 5,196,799	P –	P 68,368,403	P 73,565,202

\* Excludes cash component

\*\* Excludes unquoted available-for-sale securities

\*\*\* Based on the fair values from appraisal reports which is different from their carrying amounts which are carried at cost.

When fair values of listed equity and debt securities, as well as publicly traded derivatives at the reporting date are based on quoted market prices or binding dealer price quotations, without any deduction for transaction costs, the instruments are included within Level 1 of the hierarchy.

For all other financial instruments, fair value is determined using valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist and other revaluation models.

Instruments included in Level 3 include those for which there is currently no active market. In applying the discounted cash flow analysis to determine the fair value of financial liabilities designated at FVPL, the Group used discount rates ranging from 1.38% to 3.63% and from 1.20% to 4.99% as of December 31, 2013 and 2012, respectively.

As of December 31, 2013 and 2012 and January 1, 2012, 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.

The following table shows a reconciliation of the beginning and closing amount of Level 3 financial assets and liabilities which are recorded at fair value:

	December 31, 2013	December 31, 2012
	(In Thousands)	
<b>Financial assets</b>		
Balance at beginning of year	P 2,674,995	P 563,762
Add acquisition arising from purchase of investments	2,692,915	2,143,908
Add total gain recorded in profit or loss	178,006	(32,675)
Balance at end of year	P 5,545,916	P 2,674,995
<b>Nonfinancial assets</b>		
Balance at beginning of year	P 38,080,668	P 37,423,270
Additions during the year	1,032,360	2,296,065
Revaluation increment during the year	1,300,593	184,572
Depreciation and amortization	(1,805,394)	(1,605,522)
Net carrying value of disposed assets	(796,993)	(184,241)
Reversal of (provision for) impairment loss during the year	23,293	(33,476)
Balance at end of the year	P 37,834,527	P 38,080,668
<b>Financial liabilities</b>		
Balance at beginning of year	P 8,812,021	P 8,408,929
Add acquisition arising from purchase of investments	2,672,177	686,192
Less total gain recorded in profit and loss	(104,145)	(283,100)
Redemption of unsecured subordinated notes	(6,000,000)	–
Balance at end of year	P 5,380,053	P 8,812,021

The table below sets forth the potential effect of reasonably possible change in interest rates (alternative valuation assumption) on the Group's valuation of Level 3 financial instruments as of December 31, 2013.

Type of Financial Instrument	Fair Values as of December 31, 2013	Valuation Technique	Significant Unobservable Input	Range of Estimates	Fair Value Measurement Sensitivity to Unobservable Input
	(In thousands)				
Equity and/or Credit-Linked Notes	P 5,380,053	Statistically-Based Simulation Technique	Credit Spread of the Counterparties	2% - 3%	Significant increase in credit spread would result in lower fair values. Significant reduction would result in higher fair values.
Subordinated Debt Instruments and Time Deposit	61,935,662	Discounted Cash Flow	Risk-adjusted Discount Rate	Spread of 1% above risk-free interest rate of 0.08% - 3.22%	A significant increase in the spread above the risk-free rate would result in lower fair values.

Equity and/or Credit-Linked Notes are shown as Segregated Fund Assets carried at FVPL.

The table below sets forth, the potential effect of reasonably possible change in interest rates (alternative valuation assumption) on the Group's valuation of Level 3 financial instruments:

	December 31, 2012	
	Statement of Income	Equity
	(In millions)	
<b>Financial Liability</b>		
Subordinated debt designated at FVPL		
+50bps	P 14	P 14
- 50bps	(14)	(14)
+100bps	90	90
-100bps	(90)	(90)

The fair values of warrants have been determined using price quotes received from a third-party broker without any pricing adjustments imputed by the Group. The valuation model and inputs used in the valuation which were developed and determined by the third-party broker were not made available to the Group. Under such instance, PFRS 13 no longer requires an entity to create quantitative information to comply with the related disclosure requirements.

Inputs used in estimating fair values of financial instruments carried at cost and categorized under Level 3 include risk-free rates and applicable risk premium.

The fair values of the Group's property, plant and equipment and investment properties have been determined by the appraisal method by independent external and in-house appraisers based on highest and best use of property being appraised.

The table below summarizes the valuation techniques used and the significant unobservable inputs valuation for each type of property, plant and equipment and investment properties held by the Group:

	Valuation Techniques	Significant Unobservable Inputs	Range of Estimates
Property, plant and equipment:			
Land and land improvements	Market Data Approach	Price per square meter	P 6,000-6,200
Plant buildings and building improvements			
Building	Replaceable Fixed Asset Valuation Approach	Replacement cost Estimated total floor area	P 4,287- 10,000 24-1548 sq.m
Building improvements	Replaceable Fixed Asset Valuation Approach	Replacement cost Estimated number of components	P 2.8 million-P 26.5 million 315-723 components
Machineries and equipment			
	Replaceable Fixed Asset Valuation Approach	Replacement cost Estimated number of components	P 3,200-P 8.6 million 465-1,162 components
Investment properties:			
Land	Market Data Approach	Price per square meter, size, location, shape, time element and corner influence	P 800- 100,000
Land and building	Market Data Approach and Replacement Cost Approach	New Reproduction Cost	

Significant favorable (unfavorable) adjustments to the aforementioned factors based on the professional judgment of the independent appraisers would increase (decrease) the fair value of land. Significant increases (decreases) in the current replacement cost would result in significantly higher (lower) appraised values whereas significant increase (decrease) in the remaining useful life of the property, plant and equipment over their total useful life would result in significantly higher (lower) appraised values.

Description of the valuation techniques and significant unobservable inputs used in the valuation of the Group's property, plant and equipment and investment properties are as follows:

	Description
<u>Valuation Techniques</u>	
Market Data Approach	A process of comparing the subject property being appraised to similar comparable properties recently sold or being offered for sale.
Replaceable Fixed Asset Valuation Approach	This method requires an analysis of the buildings and other land improvements by breaking them down into major components. Bills of quantities for each component using the appropriate basic unit are prepared and related to the unit cost for each component developed on the basis of current costs of materials, labor, plant and equipment prevailing in the locality to arrive at the direct costs of the components. Accrued depreciation was based on the observed condition.
Replacement Cost Approach	It is an estimate of the investment required to duplicate the property in its present condition. It is reached by estimating the value of the building "as if new" and then deducting the depreciated cost. Fundamental to the Cost Approach is the estimate of Reproduction Cost New of the improvements.
<u>Significant Unobservable Inputs</u>	
Reproduction Cost New	The cost to create a virtual replica of the existing structure, employing the same design and similar building materials.
Size	Size of lot in terms of area. Evaluate if the lot size of property or comparable conforms to the average cut of the lots in the area and estimate the impact of lot size differences on land value.
Shape	Particular form or configuration of the lot. A highly irregular shape limits the usable area whereas an ideal lot configuration maximizes the usable area of the lot which is associated in designing an improvement which conforms with the highest and best use of the property.
Location	Location of comparative properties whether on a main road, or secondary road. Road width could also be a consideration if data is available. As a rule, properties located along a main road are superior to properties located along a secondary road.
Time Element	"An adjustment for market conditions is made if general property values have appreciated or depreciated since the transaction dates due to inflation or deflation or a change in investors' perceptions of the market over time". In which case, the current data is superior to historic data.
Discount	Generally, asking prices in ads posted for sale are negotiable. Discount is the amount the seller or developer is willing to deduct from the posted selling price if the transaction will be in cash or equivalent.
Corner influence	Bounded by two (2) roads.



### 34. Capital Management

The main thrust of the Group's capital management policy is to ensure that the Group complies with externally imposed capital requirements, maintains a good credit standing and has a sound capital ratio to be able to support its business and maximize the value of its shareholders equity. The Group is also required to maintain debt-to-equity ratios to comply with certain loan agreements and covenants in 2013, 2012 and 2011.

The Group's dividend declaration is dependent on the availability of earnings and operating requirements. The Group manages its capital structure and makes adjustment to it, in light of changes in economic conditions. To maintain or adjust 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 in 2013, 2012 and 2011.

The Group considers its total equity reflected in the consolidated balance sheets as its capital. The Group monitors its use of capital and the Group's capital adequacy by using leverage ratios, specifically, debt ratio (total debt/total equity and total debt) and debt-to-equity ratio (total debt/total equity). Included as debt are the Group's total liabilities while equity pertains to total equity as shown in the consolidated balance sheets.

The table below shows the leverage ratios of the Group:

	December 31, 2013	December 31, 2012	January 1, 2012
	<i>(In Thousands, except ratios)</i>		
Total liabilities	P 528,679,622	P 516,425,531	P 503,836,492
Total equity	149,770,600	93,706,110	74,266,659
Total liabilities and equity	P 678,450,222	P 610,131,641	P 578,103,151
Debt ratio	0.78:1	0.85:1	0.87:1
Debt-to-equity ratio	3.53:1	5.51:1	6.78:1

#### Regulatory Qualifying Capital for the Banking Segment

Under existing BSP regulations, the determination of PNB's compliance with regulatory requirements and ratios is based on the amount of PNB's "unimpaired capital" (regulatory net worth) reported to the BSP, which is determined on the basis of regulatory policies, which differ from PFRS in some respects.

In addition, the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, should not be less than 10.00% for both solo basis (head office and branches) and consolidated basis (parent bank and subsidiaries engaged in financial allied undertakings but excluding insurance companies). Qualifying capital and risk-weighted assets are computed based on BSP regulations. Risk-weighted assets consist of total assets less cash on hand, due from BSP, loans covered by hold-out on or assignment of deposits, loans or acceptances under letters of credit to the extent covered by margin deposits and other non-risk items determined by the MB of the BSP.

PNB and its individually regulated subsidiaries/operations have complied with all externally imposed capital requirement throughout the year.

On January 15, 2013, the BSP issued Circular No. 781, Basel III Implementing Guidelines on Minimum Capital Requirements, which provides the implementing guidelines on the revised risk-based capital adequacy framework particularly on the minimum capital and disclosure requirements for universal banks and commercial banks, as well as their subsidiary banks and quasi-banks, in accordance with the Basel III standards. The circular is effective on January 1, 2014.

The Circular sets out a minimum Common Equity Tier 1 (CET1) ratio of 6.0% and Tier 1 capital ratio of 7.5%. It also introduces a capital conservation buffer of 2.5% comprised of CET1 capital. The BSP's existing requirement for Total CAR remains unchanged at 10% and these ratios shall be maintained at all times.

Further, existing capital instruments as of December 31, 2010 which do

not meet the eligibility criteria for capital instruments under the revised capital framework shall no longer be recognized as capital upon the effectivity of Basel III. Capital instruments issued under BSP Circular Nos. 709 and 716 (the circulars amending the definition of qualifying capital particularly on Hybrid Tier 1 and Lower Tier 2 capitals), starting January 1, 2011 and before the effectivity of BSP Circular No. 781, shall be recognized as qualifying capital until December 31, 2015. In addition to changes in minimum capital requirements, this Circular also requires various regulatory adjustments in the calculation of qualifying capital.

The Group has taken into consideration the impact of the foregoing requirements on the banking segment to ensure that the appropriate level and quality of capital are maintained on an ongoing basis.

#### Internal Capital Adequacy Assessment Process (ICAAP) Implementation

In compliance with BSP Circular 639, PNB (the Bank) has adopted its live ICAAP Document for 2011 to 2013. However, the BOD and the Management recognized that ICAAP is beyond compliance, i.e., it is about how to effectively run the Bank's operations by ensuring that the Bank maintains at all times an appropriate level and quality of capital to meet its business objective and commensurate to its risk profile. In line with its ICAAP principles, the Bank shall maintain a capital level that will not only meet the BSP CAR requirement but will also cover all material risks that it may encounter in the course of its business. The ICAAP process highlights close integration of capital planning/strategic management with risk management. The Bank has in place a risk management framework that involves a collaborative process for assessing and managing identified Pillar 1 and Pillar 2 risks. The Bank complies with the required annual submission of updated ICAAP.

### 35. Commitments, Provision and Contingencies and Other Matters

#### Commitments

##### Operating lease commitments - the Group as lessor

The Group entered into lease agreements with third parties covering its investment property portfolio. These leases generally provide for either (a) fixed monthly rent, or (b) minimum rent or a certain percentage of gross revenues, whichever is higher. The Group records rental income on a straight-line basis over less noncancellable lease term. Any difference between the calculated rental income and amount actually received is recognized as "Deferred rent" (see Note 8).

The Group has security deposits and advance rentals which are presented under "Other noncurrent liabilities." Security deposits pertain to the amounts paid by the tenants at the inception of the lease which is refundable at the end of the lease term. Advance rentals pertain to deposits from tenants which will be applied against receivables either at the beginning or at the end of lease term depending on the lease contract. As of December 31, 2013, 2012 and 2011, security deposits and advance rentals amounted to P65.1 million and P36.2 million, P36.6 million and P25.0 million, and P87.8 million and P49.3 million, respectively.

Future minimum rental receivables under noncancellable operating leases as of December 31 are as follows:

	2013	2012	2011
	<i>(In Thousands)</i>		
Within one year	P 618,586	P 568,212	P 391,509
After one year but not more than five years	807,865	1,206,502	931,103
More than five years	433,423	459,944	254,155
	P 1,859,874	P 2,234,658	P 1,576,767

##### Operating lease commitments - the Group as lessee

The future aggregate minimum lease payments under several operating leases of the Group are as follows:

	2013	2012	2011
	<i>(In Thousands)</i>		
Within one year	P 582,711	P 481,277	P 336,525
Within two to five years	992,924	898,704	572,660
More than five years	1,484,119	1,497,361	1,512,453
	P 3,059,754	P 2,877,342	P 2,421,638

### Trust Operations

Securities and other properties held by PNB in fiduciary or agency capacities for its customers are not included in the accompanying statements of financial position since these are not assets of PNB. Such assets held in trust were carried at a value of P56.3 billion, P97.8 billion and P90.6 billion as of December 31, 2013 and 2012, and January 1, 2012 respectively (see Note 33). In connection with the trust functions of PNB, government securities amounting to P1.3 billion, P1.6 billion and P913.9 million (included under 'AFS investments') as of December 31, 2013 and 2012, respectively, are deposited with the BSP in compliance with trust regulations.

In compliance with existing banking regulations, PNB transferred from surplus to surplus reserves the amounts of P 9.5 million, P153.9 million and P144.5 million in 2013, 2012 and 2011, respectively, which correspond to 10.00% of the net income realized in the preceding years from its trust, investment management and other fiduciary business until such related surplus reserve constitutes 20.00% of its regulatory capital.

### Provisions and Contingencies

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities that are not presented in the financial statements including several suits and claims which remain unsettled. No specific disclosures on such unsettled assets and claims are made because any such specific disclosures would prejudice the Group's position with the other parties with whom it is in dispute. Such exemption from disclosures is allowed under PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. The Group and its legal counsel believe that any losses arising from these contingencies which are not specifically provided for will not have a material adverse effect on the financial statements.

### Asset Pool 1

In November 1994, the BSP, Maybank and PNB executed a Memorandum of Agreement (MA) providing for the settlement of Maybank's P3.0 billion liabilities to the BSP. Under this MA, PNB is jointly and severally liable with Maybank for the full compliance and satisfaction of the terms and conditions therein. The MA provides for the creation of an escrow fund to be administered by the BSP where all collections from conveyed assets and certain annual guaranteed payments required under the MA are to be deposited.

Relative to the sale of PNB's 60% interest in Maybank, PNB has requested the BSP to consider the revision of the terms of the MA to, among others, (a) delete the provision on the annual guaranteed payments in consideration of an immediate payment by PNB of an agreed amount, and (b) exclude Maybank as a party to the MA.

On May 7, 1997, the BSP approved PNB's request to amend the terms of the MA, subject to the following conditions among others:

- a) PNB shall remit P150.0 million to the escrow account out of the proceeds from sale;
- b) PNB shall remit to the escrow account an amount equivalent to 50% of any profit that may be realized by PNB on account of the sale; and
- c) If the amount in the escrow account has not reached the total of P3.0 billion by June 30, 2013, the difference shall be paid by PNB by way of a debit to its regular account with the BSP.

On November 28, 1997, PNB remitted P150.0 million in compliance with item (a).

PNB's remaining investment in Maybank was sold on June 29, 2000. The sale was approved by the BSP on August 16, 2000.

On August 17, 2007, PNB and the BSP amended certain provisions

of the MA as follows:

1. PNB will no longer act as the collecting agent for the BSP on the conveyed assets (Asset Pool 1);
2. PNB will no longer remit the amount collected from the Asset Pool 1 to the escrow account;
3. BSP will revert to PNB all the Asset Pool 1 accounts categorized as sugar and sugar-related accounts; and
4. PNB will submit to BSP acceptable collaterals with an appraised value of at least P300.0 million as substitute for the sugar-related loans under Asset Pool 1.

On the same date, PNB executed a real estate mortgage over certain investment properties with an aggregate fair value of P300.0 million in favor of the BSP (see Note 13).

As of December 31, 2013 and 2012, the total trust assets of the escrow account maintained with the BSP amounted to nil and P2.7 billion, respectively. Average yield during the year was 5.49%.

On February 7, 2013, the BSP accepted PNB's proposal to make an early payment to settle Maybank's P3.0 billion obligation to the BSP in exchange of the assets under the escrow fund. The real estate collaterals pledged to BSP were also released as a result of settlement of the obligation to BSP.

### National Steel Corporation (NSC) Loan

As discussed in Note 8, in 2004, PNB sold the outstanding loans receivable of P5.3 billion from NSC to SPV companies under the provisions of RA No. 9182. On October 10, 2008, simultaneous to the denial of their application in the Philippine courts for injunctive relief, the SPV companies filed a Notice of Arbitration with the Singapore International Arbitration Centre ("SIAC"). Mainly, the SPV companies claimed damages and a suspension of payments on the ground that the consortium of banks (the banks) and the Liquidator breached a duty to settle pre-closing real estate taxes (taxes due as of October 14, 2004) due on the NSC Plant Assets and to deliver to them titles to NSC's Plant Assets free from all liens and encumbrances. However, the banks and the Liquidator dispute the assertions that pre-closing taxes were in arrears, invoking under an installment agreement executed between the Liquidator and the City of Iligan. As part of the agreement to sell the plant assets to the SPV companies, the Liquidator assumed responsibility of settling and paying the Plant Assets' pre-closing real estate taxes, while the SPV companies assumed the responsibility of updating the post-closing taxes (taxes due after October 14, 2004). Consequently, all pre-closing real estate taxes due on the plant assets have been paid in accelerated basis on December 18, 2008.

On October 13, 2008, after the commencement of the arbitration but before the arbitral panel was constituted, the SPV companies filed, as a preservatory measure, a petition for injunctive relief against the NSC Liquidator, NSC Secured Creditors, and NSC Stockholders so that the arbitration proceedings under SIAC will not be rendered moot. On October 14, 2008, the Singapore High Court granted the petition and restrained the NSC Liquidator, the NSC Secured Creditors and the NSC Shareholders, jointly and severally, substantially from declaring the SPV companies in default and declaring all installments due until the arbitration proceeding at the SIAC is settled.

Thereafter, upon application by PNB for a variation of the injunction and an order of the Singapore High court, the SPV companies remitted P750.0 million cash in place of the Standby Letter of Credit which they undertook to provide under the Asset Purchase Agreement, subject to the condition that the amount shall not be subject to any set-off pending an award from the arbitration proceedings.

On January 26, 2009, PNB applied for an Order to compel the SPV companies to issue another Standby Letter of Credit of P1.0 billion which they likewise undertook to provide under the Asset





Purchase Agreement, but this application was denied on March 5, 2009 by the Singapore High Court. The denial of the second variation (the P1.0 billion Standby Letter of Credit) was elevated to the Court of Appeals of Singapore but the same was also denied on September 11, 2009, without prejudice, however, to resort to the same reliefs before the Arbitration Panel.

In April 2010, the Arbitral Panel was constituted. PNB filed therein an application to discharge or vary the injunction. On July 7, 2010, the Arbitration Panel issued a ruling denying PNB's application for a discharge of the injunction issued by the Singapore High Court. On the application to vary the injunction order, no ruling was made by the Arbitration Panel.

Consequently, the main issues for alleged breach of the Asset Purchase Agreement, damages and suspension of payments were heard before the Arbitration Panel. On May 9, 2012, the Arbitration Panel issued a Partial Award in favor of the SPV companies, including such reliefs as payment of a certain sum of money and transfer of clean titles on the plant assets under the name of NSC by the bank consortium and the NSC Liquidator in favor of the SPV companies. The Parent Company, one of the members of the consortium, holds a forty-one percent (41%) interest in the claim, and has already set aside the appropriate reserve provision for the same.

Meanwhile, on July 9, 2012, the bank consortium filed with the Singapore High Court a Petition to Set Aside the Partial Award rendered by the Arbitration Panel, which Petition is pending to date.

Movements of provision for legal claims included in "Other liability" in the consolidated balance sheets for the Group are as follows (see Note 20):

	December 31 2013	December 31 2012	January 1, 2012
	<i>(In Thousands)</i>		
Balance at beginning of the year	P 1,575,433	P 874,950	P 710,172
Provisions	—	834,259	164,778
Reclassification and settlements	6,648	(133,776)	—
	P 1,582,081	P 1,575,433	P 874,950

#### Other Matters

##### Property development tax incentives

- a. Eton's projects namely, Eton Cyberpod Corinthian and Eton Centris, were registered with PEZA on August 27, 2008 and September 19, 2008, respectively, as non-pioneer "ecozone developer/operator". The locations are created and designated as Information Technology Park.
- b. Eton has three Board of Investment (BOI)-registered projects namely, Belton Place (BP), Eton Emerald Lofts (EEL) and One Archers Place (OAP). BP is registered with BOI as a new developer of low-cost housing project on a Non-Pioneer status under the Omnibus Investments Code of 1987 (Executive Order No. 226) on September 15, 2008. This registration entitles the Group to four years ITH from November 2008 or actual commercial operations or selling, whichever is earlier but in no case earlier than the date of registration. The ITH shall be limited only to the revenue generated from this project. Revenue with selling price exceeding P3.0 million shall not be covered by ITH. Likewise, on September 23, 2008, two other projects of the Group namely, OAP and EEL, were registered with the BOI as a new developer of low-cost housing project on a Non-Pioneer status. These two projects shall enjoy the same benefits as BP.

##### Distilled Spirits' Clean Development Mechanism Project (CDM)

On June 30, 2006, the DENR approved the implementation of a greenhouse gas (GHG) reducing project at the ADI's plant in Lian, Batangas. The project is a joint undertaking between TDI (through ADI) and Mitsubishi Corporation (MC) and involves the construction of a waste water treatment digester and methane gas collector in accordance with the CDM of the 1997 Kyoto Protocol.

In accordance with Certified Emission Reductions Purchase Agreement (CERPA), ADI agreed to sell and MC to purchase any and all the CERs generated by the Project up to 480,000 CERs. As of December 31, 2009, MC made US\$1.6 million advance payment or equivalent to P70.9 million. ADI completed the construction and installation of the anaerobic digester and mixing tanks which were put into operation in 2009.

In August 2010, initial validation of CERs was made; however, as of March 4, 2013, no certification on the generated CERs has been issued yet. Since the first CERs generation period has ended on December 31, 2012, ADI's obligation to operate the project regardless of whether there were CERs certified was deemed fulfilled, thus, ADI recognized the deposit for CERs amounting to P70.9 million as income in 2012.

##### Republic Act 10351 (RA 10351)

The new excise tax law or RA 10351 became effective on January 1, 2013, and increased the excise tax rates of, among others, distilled spirits. Another change that was brought in by the new law is the shift in the tax burden of distilled spirits from raw materials to the finished product.

To implement the said law, the Secretary of Finance issued Revenue Regulations No. 17-2012 (RR 17-2012), which, in one of its transitory provisions, disallowed the tax crediting of the excise taxes that were already paid under the old law on the raw materials inventory by end of the year 2012 or by the effectivity of RA 10351 in favor of the excise taxes due on the finished goods inventory.

The Commissioner of Internal Revenue issued on January 9, 2013 Revenue Memorandum Circular (RMC) No. 3-2013. This RMC sought to clarify further certain provisions of RR No. 17-2012 but in effect extended the imposition of the excise tax on both the (1) ethyl alcohol as raw materials in the production of compounded liquors and (2) the manufactured finished product. Per the RMC, both ethyl alcohol and compounded liquor are considered as distinct distilled spirits products and are thus separate taxable items under the new law. This interpretation of the law was however modified with the issuance of RMC No. 18-2013. The new RMC allowed the non-payment of excise tax on ethyl alcohol that were purchased after the issuance of RMC No. 3-2013 to be used as raw materials in the manufacture of compounded liquors provided certain requirements such as posting of surety bonds are complied with. RMC No. 18-2013 however still maintained that taxes previously paid on the raw materials, i.e., ethyl alcohol/ethanol inventory, at the time of the effectivity of the new excise tax law are still not subject to refund/tax credit to the manufacturers.

Under RR No. 17-2012, the amount of excise tax that was disallowed for tax credit was P725.8 million (included under "Other current assets"). Said amount represented taxes paid previously on raw materials and were not allowed to be deducted from the excise taxes that became due on the finished goods as taxed under the new law. TDI is contesting the disallowance of the tax credit and plans to undertake appropriate legal measures to obtain a favorable outcome.

TDI has paid a total of P45.9 million (included under "Other current assets") in excise taxes for the raw materials that were purchased/imported for purposes of compounding during the subsistence of RMC No. 3-2013. TDI also would claim this amount on the basis that the RMC was issued without basis and beyond the authority granted by law to the administrative agency.

## 36. Restatements

Below are the restatements on the Group's consolidated balance sheets as of December 31, 2012 and January 1, 2012 due to the adoption of the new accounting standards (see Note 2) and business combinations involving LTG and entities under common control applying the pooling of interest method (see Note 1).

	December 31, 2012			
	As Previously Reported	Effect of adoption of PAS 19R	Effect of Business Combinations*	As Restated
	(In Millions)			
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash and cash equivalents	P 8,906	P –	P 117,715	P 126,621
Financial assets at fair value through profit or loss	–	–	15,140	15,140
Available-for-sale (AFS) financial assets	–	–	5,315	5,315
Loans and receivables	11,090	–	64,674	75,764
Due from related parties	20,541	–	(9,271)	11,270
Inventories	10,964	–	(726)	10,238
Other current assets	2,719	–	1,177	3,896
<b>Total Current Asset</b>	<b>54,220</b>	<b>–</b>	<b>194,024</b>	<b>248,244</b>
<b>Noncurrent Assets</b>				
Loans and receivables	874	–	177,944	178,818
AFS financial assets	766	–	92,392	93,158
Investment in an associate and a joint venture	13,906	–	–	13,906
Property, plant and equipment				
At appraised values	17,023	–	21,058	38,081
At cost	3,122	–	2,038	5,160
Investment properties	4,568	–	20,551	25,119
Net retirement plan assets	1,216	(43)	–	1,173
Deferred income tax assets	661	19	966	1,646
Other noncurrent assets	1,243	–	3,583	4,826
<b>Total Noncurrent Assets</b>	<b>43,379</b>	<b>(24)</b>	<b>318,532</b>	<b>361,887</b>
<b>TOTAL ASSETS</b>	<b>P 97,599</b>	<b>(P 24)</b>	<b>P 512,556</b>	<b>P 610,131</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current Liabilities</b>				
Deposit liabilities	P –	P –	P 353,943	P 353,943
Financial liabilities at fair value through profit or loss	–	–	4,129	4,129
Bills and acceptances payable	–	–	18,114	18,114
Short-term debt	1,870	–	(250)	1,620
Accounts payable and accrued expenses	7,806	–	3,999	11,805
Income tax payable	237	–	188	425
Current portion of long-term debt	2,741	–	2,037	4,778
Current portion of due to related parties	20,504	–	19,815	40,319
Other current liabilities	2,626	–	20,703	23,329
<b>Total Current Liabilities</b>	<b>35,784</b>	<b>–</b>	<b>422,678</b>	<b>458,462</b>
<b>Noncurrent Liabilities</b>				
Deposit liabilities	–	–	24,805	24,805
Financial liabilities at fair value through profit or loss	–	–	6,196	6,196
Bills and acceptances payable	–	–	329	329
Long-term debt - net of current portion	5,873	–	9,928	15,801
Accrued retirement benefits	534	321	4,504	5,359
Deferred tax liabilities	1,330	(86)	360	1,604
Other noncurrent liabilities	1,468	–	2,402	3,870
<b>Total Noncurrent Liabilities</b>	<b>9,205</b>	<b>235</b>	<b>48,524</b>	<b>57,964</b>
<b>TOTAL LIABILITIES</b>	<b>44,989</b>	<b>235</b>	<b>471,202</b>	<b>516,426</b>
<b>Equity</b>				
Equity attributable to equity holders of LTG:				
Capital stock	8,981	–	–	8,981
Capital in excess of par	1,174	–	–	1,174
Other comprehensive income	4,993	(202)	4,466	9,257
Other equity reserves	797	–	190	987
Retained earnings	30,811	(58)	11,515	42,268
Shares of the Company held by subsidiaries	–	–	(13)	(13)
	46,756	(260)	16,158	62,654
Non-controlling interests	5,854	1	25,196	31,051
<b>Total Equity</b>	<b>52,610</b>	<b>(259)</b>	<b>41,354</b>	<b>93,705</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>P 97,599</b>	<b>(P 24)</b>	<b>P 512,556</b>	<b>P 610,131</b>

\*Includes the PAS 19R impact on the banking segment.

	January 1, 2012			
	As Previously Reported	Effect of adoption of PAS 19R	Effect of Business Combinations*	As Restated
	(In Millions)			
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash and cash equivalents	P 5,167	P –	P 127,238	P 132,405
Financial assets at fair value through profit or loss	–	–	8,938	8,938
Available-for-sale (AFS) financial assets	–	–	13,471	13,471
Loans and receivables	8,952	–	60,208	69,160
Due from related parties	8,883	–	(4,772)	4,111
Inventories	8,931	–	–	8,931
Other current assets	2,462	–	963	3,425
<b>Total Current Assets</b>	<b>34,395</b>	<b>–</b>	<b>206,046</b>	<b>240,441</b>
<b>Noncurrent Assets</b>				
Loans and receivables	P 2,053	P –	P 165,234	P 167,287
AFS financial assets	280	–	80,759	81,039
Investment in an associate and a joint venture	11,623	–	–	11,623
Property, plant and equipment				
At appraised values	16,272	–	21,151	37,423
At cost	3,136	–	2,002	5,138
Investment properties	4,183	–	23,935	28,118
Net retirement plan assets	1,067	(23)	1	1,045
Deferred income tax assets	594	10	1,830	2,434
Other noncurrent assets	1,193	–	2,362	3,555
<b>Total Noncurrent Assets</b>	<b>40,401</b>	<b>(13)</b>	<b>297,274</b>	<b>337,662</b>
<b>TOTAL ASSETS</b>	<b>P 74,796</b>	<b>(P 13)</b>	<b>P 503,320</b>	<b>P 578,103</b>
<b>LIABILITIES AND EQUITY</b>				
<b>Current Liabilities</b>				
Deposit liabilities	P –	P –	P 361,044	P 361,044
Financial liabilities at fair value through profit or loss	–	–	1,627	1,627
Bills and acceptances payable	–	–	12,319	12,319
Short-term debt	2,414	–	(1,194)	1,220
Accounts payable and accrued expenses	9,350	–	2,234	11,584
Income tax payable	140	–	273	413
Current portion of long-term debt	1,525	–	(981)	544
Current portion of due to related parties	9,739	–	25,713	35,452
Other current liabilities	1,745	–	20,110	21,855
<b>Total Current Liabilities</b>	<b>24,913</b>	<b>–</b>	<b>421,145</b>	<b>446,058</b>
<b>Noncurrent Liabilities</b>				
Deposit liabilities	–	–	21,923	21,923
Financial liabilities at fair value through profit or loss	–	–	6,479	6,479
Bills and acceptances payable	–	–	1,392	1,392
Long-term debt - net of current portion	6,529	–	9,808	16,337
Due to related parties	1,350	–	–	1,350
Accrued retirement benefits	444	185	5,514	6,143
Deferred tax liabilities	1,483	(51)	967	2,399
Other noncurrent liabilities	137	–	1,619	1,756
<b>Total Noncurrent Liabilities</b>	<b>9,943</b>	<b>134</b>	<b>47,702</b>	<b>57,779</b>
<b>TOTAL LIABILITIES</b>	<b>34,856</b>	<b>134</b>	<b>468,847</b>	<b>503,837</b>
<b>Equity</b>				
Equity attributable to equity holders of LTG:				
Capital stock	3,583	–	–	3,583
Deposits for future stock subscription	1,639	–	–	1,639
Other comprehensive income	5,334	(86)	5,173	10,421
Other equity reserves	1,593	–	(431)	1,162
Retained earnings	23,297	(62)	5,666	28,901
Shares of the Company held by subsidiaries	(151)	–	(12)	(163)
	35,295	(148)	10,396	45,543
Non-controlling interests	4,645	1	24,077	28,723
<b>Total Equity</b>	<b>39,940</b>	<b>(147)</b>	<b>34,473</b>	<b>74,266</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>P 74,796</b>	<b>(P 13)</b>	<b>P 503,320</b>	<b>P 578,103</b>

\*Includes PAS 19R impact on the banking segment.

Restatements on the consolidated statements of income of the Group for the years ended December 31 are as follows:

	December 31, 2012			
	As Previously Reported	Effect of adoption of PAS 19 (Revised)	Effect of Business Combinations*	As Restated
	<i>(In Millions)</i>			
<b>SALES</b>				
Banking	P –	P –	P 32,041	P 32,041
Beverage	12,188	–	–	12,188
Distilled spirits	12,768	–	–	12,768
Tobacco	2,975	–	–	2,975
Property development	2,686	–	–	2,686
	30,617	–	32,041	62,658
<b>COST OF SALES</b>	22,729	(4)	7,715	30,440
<b>GROSS INCOME</b>	7,888	4	24,326	32,218
<b>EQUITY IN NET EARNINGS OF AN ASSOCIATE</b>	6,499	–	–	6,499
	14,387	4	24,326	38,717
<b>OPERATING EXPENSES</b>				
Selling expenses	P 2,732	(P 1)	(P 15)	P 2,716
General and administrative expenses	2,141	(1)	21,049	23,189
	4,873	(2)	21,034	25,905
<b>OPERATING INCOME</b>	9,514	6	3,292	12,812
<b>OTHER INCOME (CHARGES)</b>				
Finance costs	(605)	–	57	(548)
Finance income	203	–	(45)	158
Foreign exchange gains (losses)	(108)	–	932	824
Others - net	676	–	4,315	4,991
	166	–	5,259	5,425
<b>INCOME BEFORE INCOME TAX</b>	9,680	–	8,551	18,237
<b>PROVISION FOR INCOME TAX</b>				
Current	1,161	–	1,484	2,645
Deferred	(221)	2	265	46
	940	2	1,749	2,691
<b>NET INCOME</b>	P 8,740	P 4	P 6,802	P 15,546
<b>Net income attributable to:</b>				
Equity holders of the Company	P 7,513	P 4	P 5,240	P 12,757
Non-controlling interests	1,227	–	1,562	2,789
	P 8,740	P 4	P 6,802	P 15,546

\*Includes PAS 19R impact on the banking segment.

	December 31, 2011			
	As Previously Reported	Effect of adoption of PAS 19 (Revised)	Effect of Business Combinations*	As Restated
	<i>(In Millions)</i>			
<b>SALES</b>				
Banking	P –	P –	P 29,499	P 29,499
Beverage	11,938	–	–	11,938
Distilled spirits	12,256	–	–	12,256
Tobacco	3,350	–	–	3,350
Property development	5,192	–	–	5,192
	32,736	–	29,499	62,235
<b>COST OF SALES</b>	23,837	(1)	8,779	32,615
<b>GROSS INCOME</b>	8,899	1	20,720	29,620
<b>EQUITY IN NET EARNINGS OF ASSOCIATE</b>	4,118	–	–	4,118
	13,017	1	20,720	33,738
<b>OPERATING EXPENSES</b>				
Selling expenses	3,074	(1)	(32)	3,041
General and administrative expenses	2,144	(1)	19,092	21,235
	5,218	(2)	19,060	24,276
<b>OPERATING INCOME</b>	7,799	3	1,660	9,462
<b>OTHER INCOME (CHARGES)</b>				
Finance costs	(578)	–	34	(544)
Finance income	122	–	(17)	105
Foreign exchange gains (losses)	(1)	–	1,392	1,391
Others - net	223	–	4,471	4,694
	(234)	–	5,880	5,646
<b>INCOME BEFORE INCOME TAX</b>	7,565	3	7,540	15,108
<b>PROVISION FOR INCOME TAX</b>				
Current	754	–	1,369	2,123
Deferred	143	1	(31)	113
	897	1	1,338	2,236
<b>NET INCOME</b>	P 6,668	P 2	P 6,202	P 12,872
<b>Net income attributable to:</b>				
Equity holders of the company	P 5,818	P 2	P 4,211	P 10,031
Non-controlling interests	850	–	1,991	2,841
	P 6,668	P 2	P 6,202	P 12,872

\*Includes PAS 19R impact on the banking segment.



Restatements on the consolidated statements of comprehensive income of the Group for the years ended December 31 are as follows:

	December 31, 2012			As Restated
	As Previously Reported	Effect of adoption of PAS 19 (Revised)	Effect of Business Combinations*	
	<i>(In Millions)</i>			
<b>NET INCOME</b>	P 8,740	P 4	P 6,802	P 15,546
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>				
Other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods:				
Accumulated translation adjustment	–	–	(1,131)	(1,131)
Net changes in fair value of AFS financial assets	196	–	(986)	(790)
Income tax effect	(5)	–	115	110
	191	–	(871)	(680)
Net other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods	191	–	(2,002)	(1,811)
Other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods:				
Re-measurement gains (losses) on defined benefit plans	–	(163)	676	513
Income tax effect	–	46	–	46
	–	(117)	676	559
Revaluation increment on property, plant and equipment	–	–	185	185
Income tax effect	–	–	(55)	(55)
	–	–	130	130
Net other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods	–	(117)	806	689
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX</b>	191	(117)	(1,196)	(1,122)
<b>TOTAL COMPREHENSIVE INCOME</b>	P 8,931	(P 113)	P 5,606	P 14,424
<b>Total comprehensive income attributable to:</b>				
Equity holders of the Company	P 7,700	(P 113)	P 4,622	P 12,209
Non-controlling interests	1,231	–	984	2,215
	P 8,931	(P 113)	P 5,606	P 14,424

\*Includes PAS 19R impact on the banking segment.

	December 31, 2011			As Restated
	As Previously Reported	Effect of adoption of PAS 19 (Revised)	Effect of Business Combinations*	
	<i>(In Millions)</i>			
<b>NET INCOME</b>	P 6,668	P 2	P 6,202	P 12,872
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>				
Other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods:				
Accumulated translation adjustment	–	–	136	136
Net changes in fair value of AFS financial assets	4	–	4,728	4,732
Income tax effect	(1)	–	13	12
	3	–	4,877	4,880
Net other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods	3	–	4,877	4,880
Other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods:				
Re-measurement gains (losses) on defined benefit plans	–	(116)	(1,394)	(1,510)
Income tax effect	–	35	–	35
	–	(81)	(1,394)	(1,475)
Revaluation increment on property, plant and equipment	2,857	–	1,997	4,854
Income tax effect	(857)	–	(599)	(1,456)
	2,000	–	1,398	3,398
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	2,000	(81)	4	1,923
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX</b>	2,003	(81)	4,881	6,803
<b>TOTAL COMPREHENSIVE INCOME</b>	P 8,671	(P 79)	P 11,083	P 19,675
<b>Total comprehensive income attributable to:</b>				
Equity holders of the company	P 7,812	(P 79)	P 6,935	P 14,668
Non-controlling interests	859	–	4,148	5,007
	P 8,671	(P 79)	P 11,083	P 19,675

\*Includes PAS 19R, impact on the banking segment.



The effects of adoption of PAS 19R on the financial statements of the banking segment (PNB and subsidiaries), which were included in the “Effect of Business Combinations” column in the restatements table above, follow:

	2013	2012
	(In Millions)	
Impact on the consolidated balance sheets as at December 31:		
Increase (decrease) in:		
Net retirement plan assets	(P 127)	(P 183)
Accrued retirement benefits	1,259	2,009
Deferred income tax liabilities	(4)	(4)
Other comprehensive income, net of deferred income tax effect	(405)	(780)
Retained earnings	(670)	(806)
Non-controlling interests	(307)	(601)
Impact on profit or loss for the year	137	46
Impact on other comprehensive income (loss) for the year	665	(1,382)

### 37. Offsetting of Financial Assets and Liabilities

The amendments to PFRS 7, which is effective January 1, 2013, require the Group to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreements or similar arrangements. The effects of these arrangements are disclosed in the succeeding tables.

#### Financial assets

December 31, 2013						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Financial instruments	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria Fair value of Financial collateral	Net exposure [c-d]
	[a]	[b]	[c]		[d]	[e]
(In Thousands)						
Derivative assets (Notes 6 and 21)	P 7,853,279	P 7,760,445	P 92,834	P 678	P –	P 92,156

December 31, 2012						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Financial instruments	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria Fair value of Financial collateral	Net exposure [c-d]
	[a]	[b]	[c]		[d]	[e]
(In Thousands)						
Derivative assets (Notes 6 and 21)	P 16,104,206	P 15,639,178	P 465,028	P 295,465	P –	P 169,563
Securities held under agreements to resell (Note 5)	18,442,000	–	18,442,000	–	18,873,894	–
Total	P 34,546,206	P 15,639,178	P 18,907,028	P 295,465	P 18,873,894	P 169,563

January 1, 2012						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Financial instruments	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria Fair value of Financial collateral	Net exposure [c-d]
	[a]	[b]	[c]		[d]	[e]
(In Thousands)						
Derivative assets (Notes 6 and 21)	P 19,108,452	P 18,702,967	P 405,485	P 4,712	P –	P 400,773
Securities held under agreements to resell (Note 5)	18,306,800	–	18,306,800	–	32,425,666	–
Total	P 37,415,252	P 18,702,967	P 18,712,285	P 4,712	P 32,425,666	P 400,773

## Financial liabilities

December 31, 2013						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		Net exposure [c-d]
				Financial instruments	Fair value of Financial collateral	
	[a]	[b]	[c]	[d]		[e]
(In Thousands)						
Derivative liabilities (Notes 16 and 21)	P 14,070,601	P 13,907,534	P 163,067	P 678	P –	P 162,389
Securities sold under agreements to repurchase (Note 17)*	2,246,319	–	2,246,319	–	2,739,206	–
Bills payable (Note 17)	112,646	–	112,646	–	2,585,761	–
Total	P 16,429,566	P 13,907,534	P 2,522,032	P 678	P 5,324,967	P 162,389

December 31, 2012						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria		Net exposure [c-d]
				Financial instruments	Fair value of Financial collateral	
	[a]	[b]	[c]	[d]		[e]
(In Thousands)						
Derivative liabilities (Notes 16 and 21)	P 13,108,902	P 12,821,400	P 287,502	P 205	P –	P 287,298
Securities sold under agreements to repurchase (Note 17)*	4,757,392	–	4,757,392	21,141	5,691,342	–
Bills payable (Note 17)	2,948,934	–	4,288,051	–	4,756,800	–
Total	P 20,815,228	P 12,821,400	P 9,332,946	P 21,346	P 10,448,142	P 287,298

\* Included in bills and acceptances payable in the balance sheet

January 1, 2012						
Financial assets recognized at end of reporting period by type	Gross carrying Amounts (before offsetting)	Gross amounts offset in accordance with the offsetting criteria	Net amount presented in balance sheet [a-b]	Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria	Fair value of Financial collateral	Net exposure [c-d]
	[a]	[b]	[c]	[d]		[e]
(In Thousands)						
Derivative liabilities (Notes 16 and 21)	P 23,944,280	P 23,811,849	P 132,431	P 29,911	P –	P 102,520
Securities sold under agreements to repurchase (Note 17)*	3,297,541	–	3,297,541	–	4,464,807	–
Bills payable (Note 17)	3,467,427	–	3,467,427	–	5,065,594	–
Total	P 30,709,248	P 23,811,849	P 6,897,399	P 29,911	P 9,530,401	P 102,250

\* Included in bills and acceptances payable in the balance sheet

The amounts disclosed in column (d) include those rights to set-off amounts that are only enforceable and exercisable in the event of default, insolvency or bankruptcy. This includes amounts related to financial collateral both received and pledged, whether cash or non-cash collateral, excluding the extent of over-collateralization.

## 38. Notes to Consolidated Statements of Cash Flows

### Non-cash Investing Activities

- In 2013, the Group assumed in various advances from related parties amounting to P12.8 billion and converted existing advances amounting to P13.5 billion to investment in subsidiaries.
- As of December 31, 2013, due from related parties include accrued interest receivable amounting to P24.5 million.
- As of December 31, 2013 and 2012 and January 1, 2012, unpaid additions to property, plant and equipment amounted to P106.0 million, P56.3 million and P121.4 million, respectively, which is included as part of "Accounts payable and accrued expenses".

- d. In 2011, the Group recorded investment properties amounting to P7.5 million on account (see Note 12).
- e. As of December 31, 2013 and 2012 and January 1, 2012, accrued interest receivable amounted to P8.3 million, P54.7 million and P46.8 million, respectively. Interest income includes amortization of the discount arising from non-interest bearing contracts receivables amounting to P17.0 million in 2011.
- f. On December 4, 2012, LTG assumed certain receivables of Tangent from various holding companies amounting to P9.9 billion, thereby increasing its payable to Tangent by the same amount.

*Non-cash Financing Activities*

- a. In July 2013, all the existing advances to Tangent amounting to P11.0 billion were offset with the existing advances from the Tangent.
- b. In 2011, LTG applied P448.5 million of its dividends payable to Tangent against LTG's advances to and interest receivable from Tangent amounting to P389.7 million and P58.8 million, respectively. As of January 1, 2012, outstanding dividends payable amounted to P668.2 million.
- c. As of December 31, 2013 and 2012 and January 1, 2012, accrued interest payable amounted to P2.2 billion, P2.3 billion and P2.3 billion, respectively. Finance costs include amortization of bond issue costs amounting to P14.2 million, P13.1 million and P12.1 million, respectively.

As discussed in Note 7, LTG issued additional common shares to Tangent amounting to P5.4 billion upon conversion of its deposit for future stock subscription of P1.6 billion resulting in an increase in additional paid in capital of P1.2 billion. Transactions costs incurred for the share issuance in 2012 amounted to P67.5 million which is deducted from additional paid in capital.

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### **39. Events After Reporting Date**

PNB's Stock Rights Offering

PNB has successfully completed its stock rights offering of common shares following the closure of the offer period on February 3, 2014. LTG fully subscribed to its entitlement of the Rights Offer. A total of 162,931,262 Rights Shares were issued to Eligible Shareholders at a proportion of fifteen Rights Share for every one hundred existing Common Shares held as of the Record Date at the Offer price of P71.00 per Right Share. Out of 162,931,262 Rights Shares, 33,218,348 common shares were listed on February 11, 2014 while the remaining shares would be reported for listing upon receipt of the BSP and SEC approval on the application for increase in authorized capital stock of the PNB.

The Offer raised gross proceeds of P11.6 billion, out of this, LTG provided P6.9 billion. Part of the proceeds will be used as capital injection into Allied Savings Bank (ASB) to build and refocus ASB's consumer lending business. The Offer also strengthens ASB's capital position under BASEL III standards, effective January 1, 2014.



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### **Stockholder Services and Assistance**

For matters concerning dividend payments, account status, lost or damaged stock certificates or change of address, please write or call:

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**MICHAEL G. TAN**  
President & Chief Operating Officer



**JUANITA T. TAN LEE**  
Director/Treasurer



**DR. LUCIO C. TAN**  
Chairman & Chief Executive Officer

## BOARD OF **DIRECTORS**

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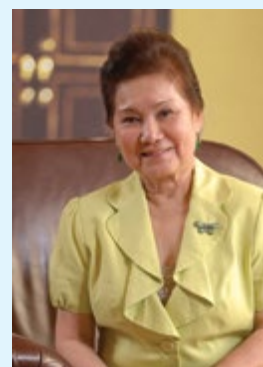
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Director



**LUCIO K. TAN, JR.**  
Director



**FLORENCIA G. TARRIELA**  
Independent Director



**WILSON T. YOUNG**  
Director

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Chief Financial Officer



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