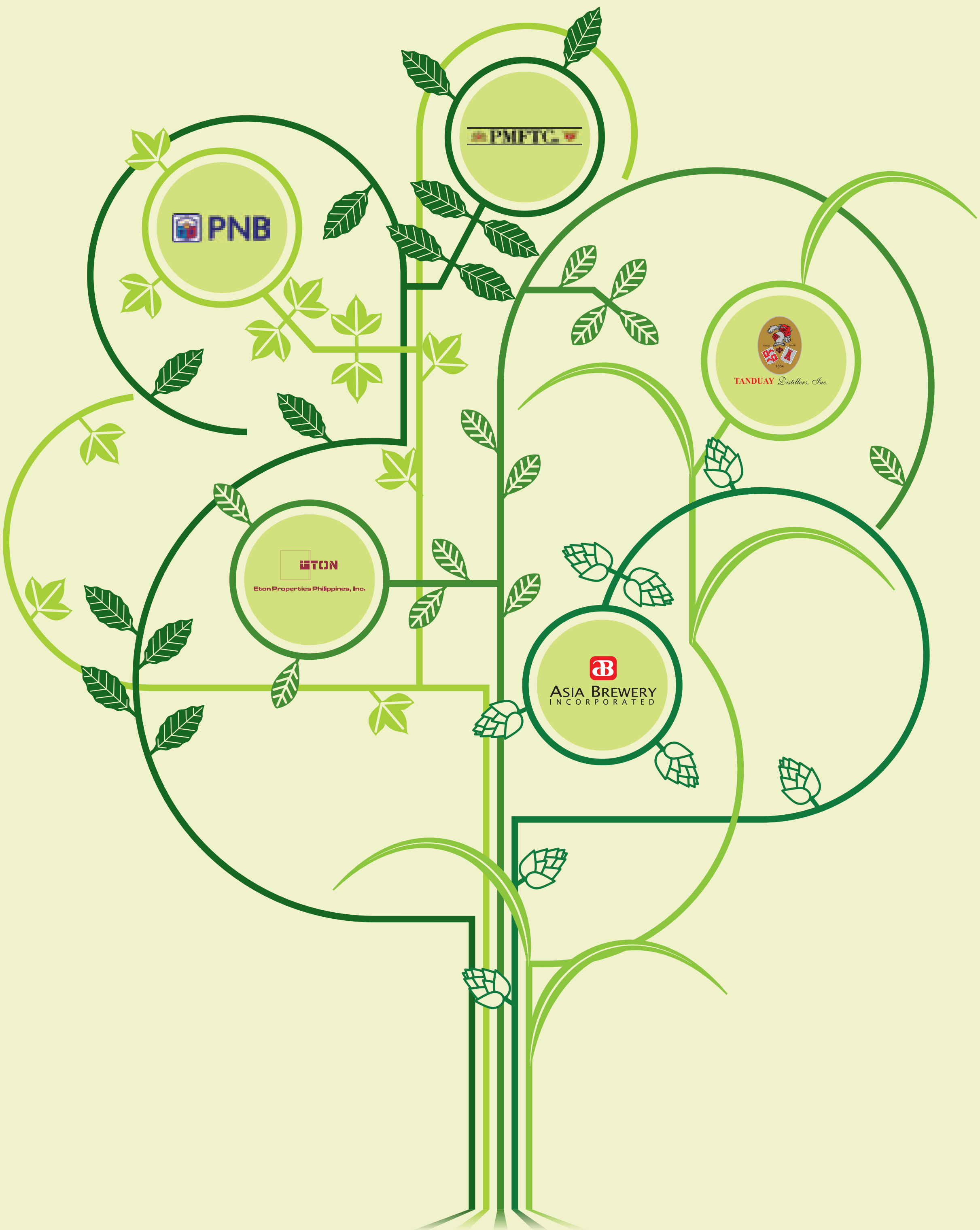
# TOMORROW TOGETHER




LT GROUP, INC.

ANNUAL REPORT 2016

## The LT Group Logo

Strength and solidarity. This is the essence of the LT Group (LTG) logo. The clean balance 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

To be 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 LT 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.

To enhance the welfare of its employees and the communities where it lives and works.

(The Vision and Mission Statements are reviewed and approved annually by the Board of Directors. The latest reviews were on February 9, 2016 and March 14, 2017.)

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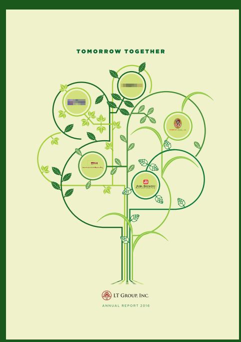



## OUR COVER

The cover artwork is a rendition of a hybrid tree with different types of leaves that represent the businesses of the LT Group (LTG). Asia Brewery is represented by the hops that are used as a flavoring for beer. The mahogany tree can live up to 350 years and has big broad leaves. For Eton, lumber from a tree is an integral component in building houses and other structures. Tobacco leaves are the main raw material in the production of PMFTC's products. PNB is represented by the leaves of the cotton plant. Cotton is a major component in the manufacture of the special paper used for printing money. The leaves of the sugarcane are long, slender and vibrant. The alcohol used for Tanduay's products are from sugarcane.

# THE **LT GROUP**


ASIA BREWERY, INC.

ETON PROPERTIES PHILIPPINES, INC.

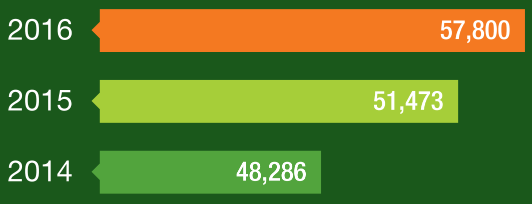
PMFTC, INC.


PHILIPPINE NATIONAL BANK


TANDUAY DISTILLERS, INC.

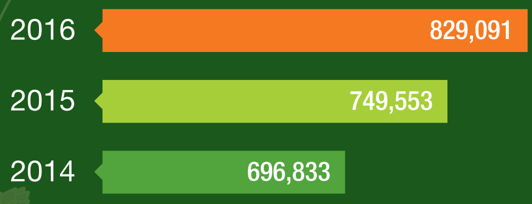
FINANCIAL **SUMMARY**

## REVENUES
*(In Php Millions)*

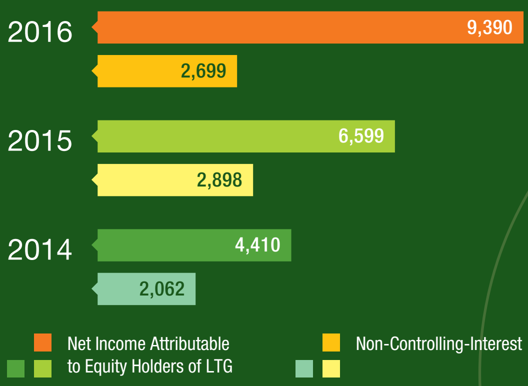



Note: Revenues were restated to exclude ABI's alcoholic beverages, which were spun off into AB Heineken Philippines Inc. in November 2016

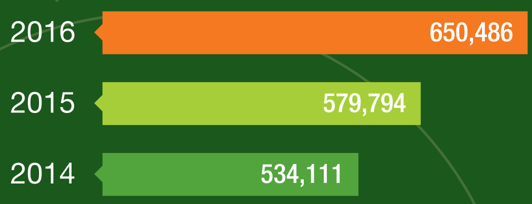
## Total Assets
*(In Php Millions)*



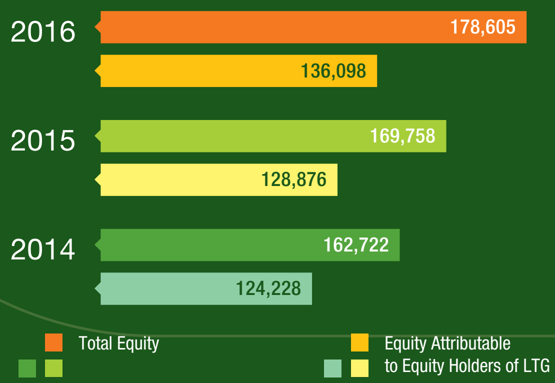

## Net Income
*(In Php Millions)*



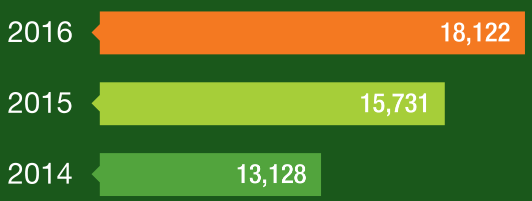

## Total Liabilities
*(In Php Millions)*




## Equity
*(In Php Millions)*




## EBITDA
*(In Php Millions)*




## Ratios and Percentages

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Current (x) | 0.70 | 0.75 | 0.73 |
| Current w/out PNB (x) | 4.20 | 4.29 | 3.44 |
| Debt to Equity (x) | 3.64 | 3.42 | 3.28 |
| Debt to Equity w/out PNB (x) | 0.15 | 0.13 | 0.18 |
| Return on Average Assets | 1.2% | 1.3% | 0.9% |
| Return on Average Equity | 7.1% | 5.2% | 3.6% |

## Per Share Data
*(In Php, except Pay-out rate)*

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Earnings per Share | 0.87 | 0.61 | 0.41 |
| Book Value (at year end) | 12.58 | 11.91 | 11.48 |
| Cash Dividend | 0.15 | 0.15 | 0.16 |
| Pay-Out Rate | 24.60% | 36.80% | 19.97% |

# OUR BUSINESSES AT A **GLANCE**

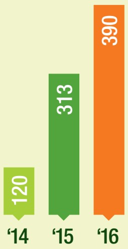
## Asia Brewery Incorporated


**Net Income**
*(in Php Millions)*

### 99.9% Ownership

Asia Brewery, Inc. started as a brewery in 1982. It offers non-alcoholic beverages as well as packaging materials. It is a market leader in the energy drinks and soymilk categories. It is ranked second in the bottled water segment. Its alcoholic beverages, namely beer and alcopop, were spun off into AB Heineken Philippines Inc. in 2016.

## Eton Properties Philippines, Inc.

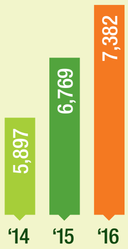



**Net Income**
*(in Php Millions)*

### 99.6% Ownership

Eton Properties Philippines, Inc. is the real estate arm of the group. It has a diversified portfolio of residential subdivisions, high-rise and mid-rise condominiums, BPO office buildings and commercial centers.

## PNB

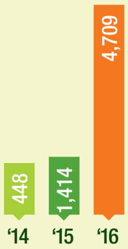



**Net Income**
*(in Php Millions)*

### 56.47% Ownership

Philippine National Bank is one of the largest private universal banks in the country.

## PMFTC

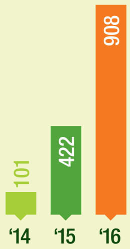



**Net Income**
*(in Php Millions)*

### 49.6% Ownership

PMFTC Inc. is the business combination of Philip Morris Philippines Manufacturing Inc. and Fortune Tobacco, Inc. It is the leading cigarette manufacturer in the Philippines.

## Tanduay Distillers, Inc.

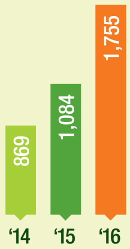



**Net Income**
*(in Php Millions)*

### 100% Ownership

Tanduay Distillers, Inc. has a 99% market share of rum in the Philippines and over 20% market share of the distilled spirits industry. In 2016, Tanduay started selling ethanol to fuel companies.

## Victorias Milling Company




**Net Income**
*(in Php Millions)*

### 30.17% Ownership

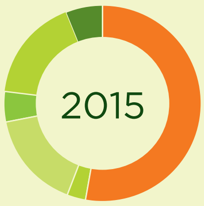
Victorias Milling Company, Inc. is one of the country's largest sugar refineries, based in Negros Occidental. In crop year 2015-2016, it milled 3.1 million tons of cane and produced 6.4 million 50-kilogram bags of refined sugar.

Note: For the crop years September to August

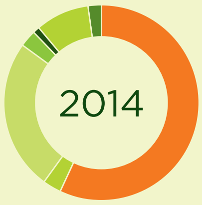
## Attributable Net Income Contribution to LTG

*(In Php Millions)*


| | | % to total |
|---|---|---|
| BANKING | 3,415 | 36% |
| TOBACCO | 2,582 | 27% |
| BEVERAGE | 1,753 | 19% |
| DISTILLED SPIRITS | 908 | 10% |
| PROPERTY DEVELOPMENT | 388 | 4% |
| VMC | 142 | 2% |
| OTHERS | 202 | 2% |
| TOTAL | 9,390 | 100% |




| | | % to total |
|---|---|---|
| BANKING | 3,508 | 53% |
| TOBACCO | 1,036 | 16% |
| BEVERAGE | 1,098 | 17% |
| DISTILLED SPIRITS | 422 | 6% |
| PROPERTY DEVELOPMENT | 312 | 5% |
| VMC | 214 | 3% |
| OTHERS | 9 | 0% |
| TOTAL | 6,599 | 100% |




| | | % to total |
|---|---|---|
| BANKING | 2,501 | 57% |
| TOBACCO | 147 | 3% |
| BEVERAGE | 1,121 | 25% |
| DISTILLED SPIRITS | 101 | 2% |
| PROPERTY DEVELOPMENT | 119 | 3% |
| VMC | 379 | 9% |
| OTHERS | 42 | 1% |
| TOTAL | 4,410 | 100% |

*Notes: Banking:*
*Attributable to LTG, net of inter-company transactions*
*VMC: 2014 includes Php 335 million gain from the purchase of VMC share and Php 44 million equity in net earnings*

### PMFTC Inc.

PMFTC Inc. is the business combination between Philip Morris Philippines Manufacturing Inc. and Fortune Tobacco Corporation, a 99.6%-owned subsidiary of LT Group, Inc. It is the leading cigarette manufacturer in the Philippines with a market share of 71% in 2016. PMFTC manufactures 9 out of the top 15 brands available in the market, led by Marlboro and Fortune. It operates plants in Batangas and Marikina, employs over 4,800 and directly contracts over 4,500 tobacco farmers from the provinces of Ilocos Norte, Ilocos Sur, Mindoro and Misamis Oriental.

After a two year trial stage of continuous operation (year-round tobacco growing, up to three cycles), PMFTC commenced commercial operations in Claveria, Misamis Oriental in January 2015. An investment of Php720 million was made to build our state of the art facility including curing barns with a capacity of four million kilos a year, a semi-float greenhouse with weekly capacity of seedlings to plant 45 hectares and biomass boilers to power the curing barns. We currently have around 400 active farmers per cycle, and recently started farm trials to expand our operations to other parts of Mindanao.


### Allianz-PNB Life Insurance, Inc.

Global insurance leader Allianz SE entered into a life insurance distribution partnership with PNB by acquiring 51% of PNB Life in 2016. An important aspect of the joint venture is a 15-year exclusive bancassurance agreement, opening up revenue generation opportunities not just in branch banking but across other banking units where life insurance can be offered. The joint venture aims to address the growing insurance needs of the increasing sophistication of the modern Filipino family. The new company, under the name Allianz PNB Life, shares the Insurance Commission's objective of increasing the Philippine life insurance penetration rate to 3 percent by 2019 from 1.8 percent in 2016. Leveraging on PNB's extensive nationwide network of 675 branches, Allianz PNB Life intends to make every PNB depositor an Allianz PNB Life policyholder. In support of PNB's continuing efforts to increase its deposits, cross-selling life insurance becomes an enabler of deposit generation. Allianz PNB Life will also take advantage of both PNB's and Allianz's global presence to address and serve the needs of overseas Filipino workers.

Meanwhile, the share of new business premiums generated as a percentage of total deposits is also expected to improve to as high as the industry average of 3% in 2020 from less than 1% in 2016. Aside from bancassurance with PNB, a pivotal strategy to widen its reach is to launch the agency channel, as well as to grow its institutional accounts through flexible product options. By focusing on regular-pay products and the introduction of new dollar and peso investment funds, it plans to regain its spot to be among the leading insurance companies in the country. Changing lifestyles also serves as an opportunity to offer health-related life products and services that maximizes access to Allianz's global resources, thereby attracting young and growing families, high net worth individuals, and millennials. Allianz PNB Life will also start offering microinsurance products targeting the emerging consumer market segment.


## ALI Eton Development Corporation

The Company is a 50%-50% joint venture between Ayala Land, Inc. and LT Group, Inc. It was formed to develop a 35-hectare property along the C5 corridor that spans portions of Pasig City and Quezon City.

The property will be developed into a township that has residential, office and retail components. The master plan is being completed, and is targeted to be introduced within 2017.

## AB Heineken Philippines, Inc.

AB Heineken Philippines, Inc. (ABHP) is a 50%-50% joint venture between Asia Brewery, Inc. and the Dutch company, Heineken International B.V. HEINEKEN is a globally-renowned brewer with a portfolio of more than 250 international, regional, local and specialty beers and ciders. It operates 167 breweries, malteries, cider plants and other production facilities in more than 70 countries.

This joint venture, which officially commenced operations in November 2016, adds premium brands such as HEINEKEN and TIGER into Asia Brewery's beer portfolio, and will be spearheading further premiumisation of the brand portfolio. The two breweries which Asia Brewery, Inc. owns in Cabuyao, Laguna and in El Salvador, Misamis Oriental are currently being upgraded to create capability for production of the Heineken and Tiger beer brands. Armed with Asia Brewery's local knowledge and distribution network as well as with Heineken's brewing and marketing expertise, ABHP promises to deliver quality beer brands and an exceptional experience for its consumers.

## ABI Pascual Holdings Pte. Ltd.

ABI Pascual Holdings Pte. Ltd.  is a 50%-50% joint venture between Asia Brewery, Inc. and Calidad Pascual of Spain.

Currently, the Company imports yogurt from Spain and distributes it in the Philippine market under the Pascual Creamy Delight brand. The aim is to eventually build a dairy plant in the Philippines.

Pascual Creamy Delight Yogurt has a long shelf life and does not require refrigeration. It is made with real fresh milk full of calcium, protein and zinc. It is a healthy product that is great for the whole family and gives a natural boost.

Filipinos lack dairy products in their daily intake. ABI Pascual aims to become the leader in providing consumers with the first affordable yogurt brand for all Filipinos.

"It took a whole community of employees and executives working in tandem to nurse our companies to better financial health."

***– Dr. Lucio C. Tan***

‘Tomorrow Together’ is the chosen theme for our 2016 Annual Report. It is a reflection of our Group’s twin mission of planning for tomorrow and working hand-in-hand to achieve our goals one day at a time.

Though we have our eyes set on the future, we could not get there without first looking back on what we have accomplished so far.

For 2016, our Group posted a net income of Php9.39 billion, 42% higher than 2015. While numbers are indicative of how our companies performed, it does not show the whole picture. The real story behind our growth is our employees’ dedication and hard work and the unwavering support of our shareholders. Every centavo earned comes from each stick of cigarette, bottle of beer, rum or beverage that we produce; every account opened or loan processed; every inch of residential or commercial space leased or sold.

It took a whole community of employees and executives working in tandem to nurse our companies to better financial health. As you know, the past few years, 2016 included, have not been easy. We continue to grapple with illicit trade in the tobacco sector which has been eating away market share and reducing profitability.

Your management continues to find ways to innovate and be more cost efficient in the face of stiff competition in all the sectors where we operate. With your support and cooperation, I am confident our growth will continue.

At the same time, our Group remains mindful of its social obligations especially in communities where we operate. We are leading private sector efforts to reduce our carbon footprint as we engage in renewable energy projects and an ambitious reforestation program, to name a few.

There will be challenges, for sure, but so long as we stand together – bound by a common purpose – there is no doubt we can reach whatever goals we set our hearts and minds to accomplish.

I wish to thank all our employees and company officers for doing a good job in 2016. My sincere gratitude as well to our shareholders for standing with us during our most difficult times. With your help, I know we can all do better tomorrow, together.

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

The Philippines remains as one of Asia's fastest growing economies, registering a Gross Domestic Product (GDP) growth of 6.8% in 2016, higher than the previous year's 5.8% GDP growth.

Private consumption grew 6.9%, spurred by OFW remittances that increased 5.0% to US$26.9 billion and the Information Technology-Business Process Outsourcing (IT-BPO) sector that generated US$22.9 billion in revenues, a 4.1% rise year-on-year (y-o-y).

For LT Group, Inc. (LTG), 2016 was a better year than 2015, although we continued to face challenges, especially the illicit trade in cigarettes and stiff competition in the other markets that we operate in. Improved sales across all segments boosted our earnings for 2016. As a result, LTG reported an attributable net income of Php9.39 billion, a 42% increase over the Php6.60 billion we reported for 2015.

**11%** growth in net interest income;

NIM flat at **3.1%**

***Philippine National Bank's (PNB) net interest income continues to grow, while its asset quality improves***

PNB reported a net income of Php7.38 billion for 2016, under the pooling method, a 9% growth from the Php6.77 billion reported in 2015.

Net Interest Income increased 11% y-o-y or Php1.92 billion to Php19.55 billion as loans and receivables grew 17% to Php428 billion, while Net Interest Margin was flat at 3.1%. Loans to Deposit Ratio (LDR) was at 73% as of end-December 2016, slightly lower than the 74% as of end-2015, as deposits grew at a slightly faster pace.

Net Service Fees and Commission Income dropped 26% to Php2.66 billion from Php3.60 billion. Service Fee Income was 17% lower largely due to lower deposit-related fees, while Service Fee Expenses were 28% higher.

Other Income grew 65% to Php9.29 billion from Php5.62 billion, mainly due to gains from the sale of a 51% stake in the life insurance business to the Allianz Group and the remeasurement of PNB's remaining stake, as well as gains from the sale of Real and Other Properties Acquired (ROPA). Trading and Foreign Exchange Gains were also 60% higher to Php2.87 billion.

PNB continued to dispose of its ROPAs, and sold properties with a book value of Php866 million and booked a gain of Php2.56 billion. This included a property sold to Eton in the first quarter of 2016 for Php1.9 billion, which enabled the Bank to book a gain of Php1.3 billion. ROPA as of end-2016 stood at Php10.1 billion, from Php11.8 billion as of end-2015.

Operating Expenses were 23% higher at Php23.22 billion from Php18.89 billion in 2015. These included the reversal of probable losses. In 2016, there was a Php234 million reversal for the Peace Bonds while 2015 included a reversal of Php974 million from the National Steel Corporation case. Without these reversals, Operating Expenses for 2016 would be 18% higher than 2015, due to expenses incurred for higher provisioning, marketing expenses, migration to a more secure EMV chip for the ATM and POS terminals, higher compensation, and debit and credit cards.

The Bank's asset quality continued to improve as Net Non-Performing Loans (NPL) ratio was at 0.2% while NPL cover stood at 133% as of end-2016, compared to 0.3% and 126%, respectively as of end-2015.

Marlboro at **40%** of sales volume

***PMFTC Inc.'s profit improved with mix skewed toward premium Marlboro***

The industry's total volume was estimated to have declined 12% y-o-y, while PMFTC's shipment volume was 15% lower y-o-y. The decrease in volume was due to the impact of price increases in the fourth quarter of 2015 and 2016. This brought our market share to 71% for full-year 2016, from 73% in 2015, based on Nielsen estimates.

From only Php0.50 per stick in 2012, the recommended retail price of cigarettes in the super-low segment increased to Php2 to Php2.25 by the end of 2016 which has caused volumes to drop significantly since the implementation of the Excise Tax Law starting 2013. We also raised the price of Marlboro in November 2016, the first time since January 2013. The recommended retail price per stick increased to Php3.50 from Php3.00.

Our equity in net earnings from PMFTC reached Php2.59 billion in 2016, significantly higher than 2015's Php975 million. The increase was mainly attributed to the change in the mix of PMFTC's sales, with Marlboro accounting for 40% of total volume, compared to 27% in 2015. The volume of premium Marlboro was 25% higher y-o-y, as customers continued to trade up with the narrowing of price gaps.

**15%** volume growth for bottled water; Still dominant in energy drinks and soymilk with over **70%** market share

***Asia Brewery, Inc.'s (ABI) earnings boosted by extraordinary gains related to the spin-off of the alcoholic beverage business, and consumer consumption continued to drive demand***

ABI's earnings amounted Php1.76 billion in 2016, Php656 million or 60% higher than the income disclosed in 2015. This is inclusive of the Php594 million extraordinary income arising from the gains from the revaluation of the beer assets. Excluding the extraordinary income, ABI's net income would have settled at Php1.16 billion, a 6% increase over 2015's net income of Php1.10 billion.

ABI formalized its joint venture (JV) with Heineken International B.V. (Heineken) in November, and the beer and alcopop businesses were transferred to AB Heineken Philippines, Inc. (ABHPI), the JV company.

ABI's revenues were 4% higher y-o-y in 2016, at Php11.85 billion from Php11.40 billion in 2015, excluding the beer and alcopop business which were transferred to ABHPI. While revenues from bottled water were higher, these were offset by lower revenues from the packaging business as some of the

Company's capacity for commercial glass bottles was utilized in producing bottles for the soymilk business. Revenues from the energy drinks business, which contributes the most to revenues, were flat.

Overall Gross Profit Margin (GPM) was at 34% from 35% the previous year as a result of product mix. Operating expenses were 12% higher than a year ago as more was spent on marketing expenses.

Cobra, our energy drink, continued to account for the largest portion of revenues at 42%. It remains the market leader with a market share of over 70%. Cobra's volume in 2016 was flat, as stiff competition and the price war in the carbonated beverage market impacted sales.

Absolute and Summit, our bottled water brands, continued to sustain strong sales with volume 15% higher y-o-y. The expansion in our Laguna plant was completed in June, and after commissioning, started commercial operations in mid-September. We have the second largest market share in this segment, at 25% as of end-December 2016. Water contributed 26% to ABI's revenues.

Vitamilk, the soymilk brand under an exclusive distributorship agreement with Green Spot, continued to post sales growth and enjoy a market share of over 80%. Our plant has been completed, and we started distributing the beverage in returnable glass bottles in the first quarter of 2017.

The packaging business accounted for 18% of revenues in 2016. Aside from supplying the glass bottle and packaging requirements of its beverage business and TDI, ABI also sells to third parties.

***Tanduay Distillers, Inc.'s (TDI) income boosted by contribution of ethanol***

TDI's earnings for full-year 2016 rose to Php908 million, more than double the Php422 million generated in 2015.

Revenues increased 24% to Php15.01 billion from Php12.12 billion in 2015 due to the start of ethanol's contribution in 2016. Revenues from liquor grew 4% y-o-y to Php12.33 billion.

**115%**
**Net income growth with contribution from ethanol**

TDI started selling ethanol to fuel companies in 2016. Revenues from the sale of ethanol amounted to Php2.24 billion for 2016. TDI has two distilleries, Absolut Distillers, Inc. and Asian Alcohol Corporation. These distilleries supply some of the alcohol requirements of TDI, aside from selling bioethanol.

The sales volume of liquor had a slight increase of 2%, with the growth coming from its flagship product, Tanduay Rhum Five Years. TDI's market share based on Nielsen's customer off-take on volume was at 23% as of the end of 2016, a slight decline from the 24% as of end-2015.

Most of Tanduay's sales are generated in the Visayas and Mindanao areas, where our market share stood at 59% and 62%, respectively, as of December 2016. We lost some market share in Visayas from 61% in December 2015, but we improved our share in Mindanao from 56%, thereby improving our Visayas-Mindanao share to 60% by December 2016 from 58% in end-2015.

**57K**
**square meters of leasable office and retail space in the pipeline**

TDI's GPM dropped to 18% in 2016 from 19% in 2015, due to lower margins for liquor. Higher prices of alcohol were not passed on by the price increase in December 2015 that primarily covered the increase in excise tax starting January 1, 2016.

***Eton Properties Philippines, Inc. (Eton) continues to enjoy strong take-up for BPO office buildings; expanding portfolio for future growth***

Eton reported a net income of Php390 million for 2016, 25% higher than the Php313 million reported a year ago.

Total revenues increased 14% to Php2.83 billion. Revenues from leasing operations increased 9% brought about by higher lease rates at the fully leased out BPO office buildings with a gross leasable area (GLA) of about 124,000 square meters. Revenues from the sale of residential units were 18% higher than 2015 primarily due to the percentage completion of previously sold units.

In the second quarter, Eton broke ground on Eton WestEnd Square, a mixed-use development along Pasong Tamo, Makati. It will have about 15,000 square meters of GLA for retail and office use, as well as a 44-storey residential component. The office and retail components are targeted to be completed by end-2019.

Eton broke ground on the fifth BPO office tower at Eton Centris in Quezon City in August. It will have a GLA of around 37,000 square meters and is expected to be completed by end-2018. Moreover, the 5,000 square meter expansion of the retail space at Centris Walk in Eton Centris which commenced in April 2016 is targeted to be completed by mid-2017.

**New partnerships, new investments in 2016**

In 2016, we saw the group investing for the future. We forged new partnerships, put up new facilities and expanded capacity. We planted the seeds for future growth. We will establish the roots, and make these strong. These will not produce instant results, but should contribute to our growth going forward. We will have to nurture these for our **Tomorrow, Together** with the other partnerships that we already have, with Philip Morris International (PMI) for tobacco and Calidad Pascual of Spain for yogurt.

In January, we signed a joint venture agreement with Ayala Land, Inc. for the development of a 35-hectare township project that spans areas of Pasig and Quezon Cities. In May, we announced a joint venture with Heineken for the beer and alcopop business of ABI. And in June, we finalized the acquisition of Allianz SE of a stake in the life insurance business of PNB, as well as an exclusive bancassurance agreement.

PNB invested in new technology with the EMV chip for its ATM and POS terminals, and the migration to the unified banking system. It opened new branches and added ATMs. ABI expanded its bottled water facilities and completed the soymilk plant. TDI started selling ethanol to utilize some of the capacity of our distillery. It continues to do research and product development for new products that are more appealing to the younger generation. Meanwhile, Eton broke ground on new projects to increase our office and retail portfolio, and to add another high-rise residential project.

**Prospects for 2017 remain bright**

We expect the business environment in 2017 to be better than the previous year, with the Duterte Administration's infrastructure plan to "Build, Build, Build," providing a boost. This will increase employment, especially in the countryside, which in turn will increase the purchasing power of consumers, resulting in continued demand for our products. We also see this translating to higher demand for loans as well as other banking services. This will provide another leg from which the economy can grow, aside from OFW remittances and the BPO-IT sectors that have been sustaining the growth in the past years. A lingering concern though is the stiff competition, and rising inflation, which will translate to higher costs.

PNB will be able to take advantage of the sustained demand for loans, while Allianz PNB Life Insurance should contribute another source of fee-based income. The Bank's migration to a unified, more modern IT system within 2017 should enable it to offer customers more products and services. However, the Bank will have to work harder to compensate for the one-time gains booked in 2016.

ABI will benefit from the increasing income of consumers, despite the stiff competition. It will enable us to develop a new market for our soymilk which was previously being sold only in the modern trade, while sustaining demand for our other products. Moreover, the joint venture with Heineken will enable us to develop a bigger market for our beer and alcopop. However, we will have to incur additional marketing expenses in developing and expanding our existing and additional brands, especially in the alcoholic beverage segment.

TDI will likewise benefit from the renewed demand for rhum, especially in Mindanao, which is our largest market, followed by Visayas. A more inclusive growth for our country will mean that consumers will have more discretionary funds to buy our products.

Eton will continue to enjoy high occupancy rates in the BPO office buildings, as well as the retail space that complement these and its residential developments.

We are hopeful that PMFTC's profitability will improve as the Government addresses the illicit trade and we move into a level playing field. In the past four years, prices have been kept artificially low at economically unsustainable levels.

Our **Tomorrow** looks bright as we work **Together** as a team to achieve our goals. It will not be easy, but with hard work and perseverance, we will be able to do it.

We are working for our **Tomorrow Together**. Your Board of Directors, officers and staff will work together to achieve new heights. We will also work closely with our partners to develop and expand these new areas for future growth. We remain committed to excellence and providing quality yet affordable products to our customers.

I would like to thank our stakeholders for the continued support and trust in your Company, especially during these challenging times, and our Board of Directors, management team and all our employees for their dedication and hard work.

**Michael G. Tan**
*President*

LT Group, Inc.'s (LTG) total revenues for the year 2016 reached Php57.80 billion, a 12.3% or Php6.33 billion increase over the Php51.47 billion revenues of 2015. The increase was across all business segments, but mainly from Tanduay Distillers, Inc. (TDI) and Philippine National Bank (PNB). The increase in TDI's revenues was due to the start of the contribution of ethanol sales in 2016, while the Bank booked higher interest income. Revenues of Asia Brewery, Inc. (ABI) grew on the back of higher bottled water sales while Eton Properties Philippines, Inc.'s (Eton) revenue growth came from both the sale of residential units and rental income from BPO office buildings.

LTG's attributable net income reached Php9.39 billion in 2016, 42.3% or Php2.79 billion more than the Php6.60 billion reported in 2015. There was improved profitability across all of LTG's business units, with the highest increase in contribution coming from tobacco, followed by ABI and TDI.

The tobacco's business contribution amounted to Php2.58 billion, Php1.54 billion or 149.2% higher than 2015's Php1.04 billion. Income from the tobacco business was primarily from the equity in net earnings from LTG's 49.6% stake in PMFTC Inc. In 2016, this amounted to Php2.59 billion, 165.9% higher than the Php975 million recognized in 2015. The higher income was mainly attributed to the bigger share of premium Marlboro in PMFTC's sales. While this is an improvement, the earnings are still substantially lower than what was realized in 2012 and 2013 as illicit trade in the industry continues to affect the overall profitability of the tobacco business.

ABI's contribution amounted to Php1.75 billion in 2016, Php655 million or 59.7% more than Php1.10 billion in 2015, boosted by the Php594 million extraordinary gain arising from the revaluation of the beer assets. TDI's contribution more than doubled to Php908 million in 2016 from Php422 million the previous year with the start of the contribution of ethanol sales in 2016. Eton's contribution rose by Php76 million or 24.4% to Php388 million in 2016 from Php312 million in 2015 on the back of higher leasing and residential development revenues.

Although LTG's share in PNB's income increased to Php4.14 billion in 2016 from Php3.72 billion in 2015, part of PNB's income in both years was from the sale of properties to Eton. LTG's share of these gains, at Php725 million in 2016 and Php208 million in 2015, were eliminated from LTG's attributable net income, bringing PNB's net contribution to Php3.42 billion in 2016, Php93 million lower than the net contribution of Php3.51 billion in 2015.

PNB's net contribution accounted for 36% of LTG's attributable income in 2016. The tobacco business contributed 27%, followed by ABI at 19%. TDI added 10%, and Eton generated 4%. Equity in net earnings from Victorias Milling Company, Inc. (VMC) amounted to Php142 million, or 2% of total.

The Company purchased 131.86 million additional shares of VMC on February 18, 2016 at Php5 per share or a total of Php659 million. This brought LTG's stake to 30.17% as of end-2016 from 22.54% as of end-2015. When the remaining convertible notes are converted to shares, LTG's stake in VMC will be at 30.91%.

In May, LTG paid a regular cash dividend of Php0.15 per share or a total of Php1.62 billion to shareholders on record as of April 28. This is equivalent to 24.6% of 2015's attributable income of Php6.60 billion, higher than the dividend policy of a 20% pay-out rate.

The capital expenditure of LTG's subsidiaries amounted to Php6.9 billion in 2016. Eton spent Php2.2 billion for land acquisition and construction of ongoing projects. ABI likewise spent Php2.2 billion, primarily on the soymilk plant and the expansion of its bottled water facilities. PNB invested Php2.0 billion, majority of which was for the new IT system. This IT system is targeted to be fully operational within 2017 and will integrate the different core banking systems of the former Allied Bank and PNB that were merged in 2013. TDI spent around Php500 million, mainly for plant upgrades.

LTG's balance sheet remains strong, with the parent company's cash balance at Php1.9 billion as of the end of 2016. Debt-to-Equity Ratio was at 3.64:1 with the Bank, and at 0.15:1 without the Bank.

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

**BEVERAGES**

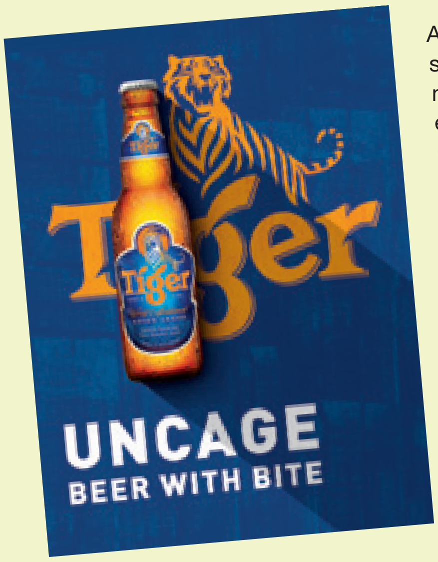
# ASIA BREWERY, INC.



## Launched Vitamilk in 200ml returnable glass bottles

*The year 2016 was marked by opportunities for building and strengthening partnerships for Asia Brewery, Inc. (ABI).*

In May 2016, ABI and Heineken International B.V. of the Netherlands formed a 50%-50% partnership, which was finalized in November under the corporate entity AB Heineken Philippines, Inc. The partnership is aimed at strengthening and expanding the Company's beer and alcopop brands in the Philippine market. The new Company initially launched Heineken and Tiger beers in the local market, the start of new offerings which will excite the Filipino drinker.




Also in 2016, ABI completed its soymilk plant in Laguna that will manufacture Vitamilk under an exclusive license with Thailand's Green Spot Company Ltd. The local production of Vitamilk will enable ABI to launch the existing offerings and other new variants at price points that will ensure a wider consumer base for ABI's first entry into the ready-to-drink (RTD) dairy market.

Excluding the beer and alcopop business which was transferred to AB Heineken Philippines, Inc., ABI's revenues were 4% higher year-on-year (y-o-y) in 2016, at Php11.85 billion from Php11.40 billion in 2015. Higher revenues from the bottled water business were partially offset by lower revenues from packaging, specifically commercial bottles, as some of the Company's capacity was utilized in producing returnable glass bottles (RGB) for the soymilk business.

Revenues from the energy drinks business, which contributes the most to revenues, were flat. Overall Gross Profit Margin (GPM) was at 34%, slightly lower than the 35% in 2015 as a result of product mix. Operating expenses were 12% higher y-o-y as the Company spent more on marketing expenses.

ABI's net income amounted to Php1.76 billion in 2016, Php656 million or 60% higher than the 2015 income. This is inclusive of the Php594 million extraordinary income arising from the revaluation of the beer assets. Excluding the extraordinary gain, ABI's net income stood at Php1.16 billion, a 6% increase over 2015's net income of Php1.10 billion.

Cobra upheld its market leadership in the energy drinks segment with over 70% market share. Cobra volumes remained stable despite the aggressive price-offs waged by indirect competitors in the carbonated soft drinks market. Under the tagline, "Tunay na Lakas," Cobra reinforces its position as the leading energy drink by maintaining its presence in various sporting events around the country. The TV Ad featuring the action primetime




## 50%-50% Partnership with Heineken

king and "Idol ng Masa," Coco Martin was launched with the tagline "Cobra, May Laban Ka," further strengthening its foothold in the mass market. With its sustained revenue base, Cobra remained as the Company's flagship product, accounting for more than 40% of revenues.

Bottled water, the second biggest contributor to revenues, continued its growth momentum with 15% volume growth in 2016. Absolute and Summit bottled water brands ranked second with around 25% market share. Backed by strong marketing and advertising support, Absolute and Summit continue to strengthen brand equity with the launch of nationwide thematic and trade programs. Summit's "Thirst for More" campaign and Absolute's "Pure water. Pure love." campaign of Judy Ann Santos reinforced their positions as the affordable and most trusted bottled water brands for the Filipino family and consumer.

Vitamilk continued to dominate the soymilk market with over 80% market share. With the "Pagud-tom, Fills Good" campaign, Vitamilk positions itself as the healthy and energizing drink for the youth market.

With commercial operations of the recently completed soymilk plant commencing in December 2016, the Company formally launched Vitamilk in the 200ml RGB in February 2017. This RGB format introduces Vitamilk to a wider market through sari-sari stores at an affordable price point. This innovation in the dairy RTD business has the potential to dramatically expand consumer demand for Vitamilk products.

In the packaging segment, the volume of commercial glass bottles sold to third party customers declined by 7% as more of the capacity was dedicated to internal requirements, including the RGB for Vitamilk, but this was partially offset by the 5% increase in the sales volume of corrugated carton boxes. The packaging division has aggressively pursued large commercial glass customers through the emphasis on excellence in quality and customer service. As a result, it is now the preferred supplier of major cola and condiment manufacturers, among others, for their glass container requirements.

Other emerging product lines continue to experience encouraging growth.

Under a joint venture with Calidad Pascual of Spain, Creamy Delight Yogurt for one, has achieved healthy market shares in consumer markets outside of Metro Manila where its expanded flavor line and long shelf life have distinct competitive advantages.

Continuous product innovations and improved distribution strategies have resulted in a 20% growth in yogurt volume for 2016.

On the other hand, Nestea RTD, under license from Nestle Philippines grew by 7% in 2016 in the midst of a highly competitive market.

In 2016, ABI set the foundations in two major areas of future growth. The partnership with Heineken, in spite of anticipated challenges against a dominant competitor in the early years, will provide the Company with the best opportunity to be a significant and profitable player in the beer and alcopop markets. At the same time, the commencement of commercial operations of the soymilk plant will open up new and bigger markets for what has already become a successful brand in the Philippine market. We are looking forward to building on these two new foundations, plus our partnership with Calidad Pascual, as well as strengthening our established brands in energy drinks and bottled water to achieve our objective to be the most diversified and innovative beverage company in the Philippines.

# ETON PROPERTIES PHILIPPINES, INC.

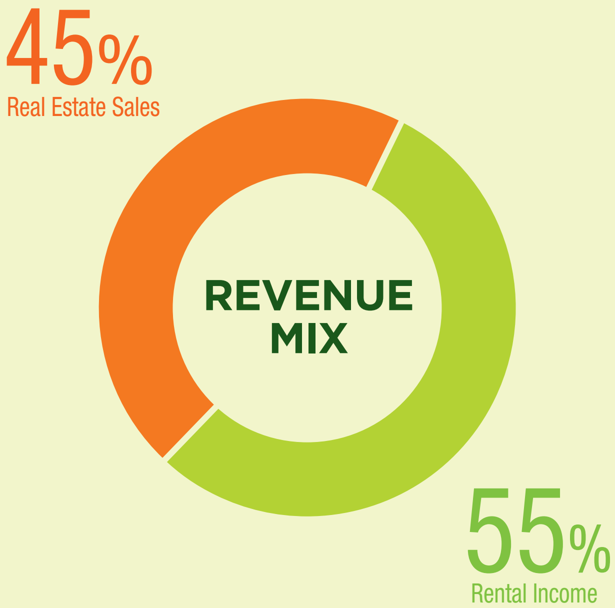
***Eton Properties Philippines, Inc. (Eton) reported its second year of stable growth in 2016, as it continued to expand its footprint and rebalance its portfolio.***

*Eton WestEnd Square*

Riding on the sustained demand for business spaces from the business process outsourcing (BPO) industry, coupled with the market's appetite for residential spaces, the Company reported gross revenues of Php2.83 billion in 2016, 14% higher than its 2015 revenues of Php2.48 billion. Net income stood at Php390 million, 25% higher compared to the previous year's Php313 million. Assets were reported at Php29.19 billion, a 12% increment from the 2015 level of Php26.10 billion.

Real estate sales and rental income contributed nearly equally to the Company's revenue stream in 2016.

Accounting for 55% of revenues, real estate sales hit Php1.55 billion, an 18% growth from the Php1.31 billion posted in 2015. Supported by a well-directed marketing program, the Company witnessed strong interest in its completed residential projects. These projects, located in prime locations across Metro Manila, include Eton Tower Makati in Legaspi Village, Makati; 8 Adriatico in Manila; 68 Roces along Don A. Roces Avenue in Quezon City; North Belton Communities in Quezon City; and West Wing Residences in Eton City.




Rental income continued to remain strong at Php1.28 billion, accounting for 45% of revenues and rising 9% from the previous year's Php1.17 billion. Demand stayed robust for the Company's BPO office buildings at Eton Centris in Quezon City and Eton Cyberpod Corinthian in Ortigas Center, Pasig City. Alongside this was the uptick in rental income from retail properties, such as the lifestyle and entertainment cluster Centris Walk, events venue Centris Elements, and commercial center Centris Station.

To date, Eton has seven fully leased out BPO buildings covering 124,000 square meters. Of this, four are in Eton Centris while three are at Eton Cyberpod Corinthian. Both areas are strategically located near transportation hubs and retail establishments, making these accessible to BPO employees and complementing the 24/7 operations of their locators.

Despite global uncertainty and headwinds, Eton is confident of the Philippines' strong economic

*Cyberpod Centris Five*

fundamentals. As such, it will remain focused on its plans to complete projects and further expand its presence in the office, commercial, and residential space markets.

Reflecting this optimism, the Company broke ground on its one-hectare, mixed-use project in West Makati, Eton WestEnd Square. This project will have about 15,000 square meters of retail and office space, as well as a 44-storey residential component.


Also in 2016, Eton began construction of the 25-storey Cyberpod Centris Five, the fifth BPO facility in Eton Centris, as well as of the three additional clusters of Centris Walk 2, with the objective of housing more retail and dining spaces for the thriving Quezon City market.

Further, the retail shops and restaurants located at Eton Tower Makati were launched in 2016, featuring sought-after tenants such as Dean and Deluca, Karada, Anytime Fitness, Sarabia Style Optics, Moshi Koshi, Bo's Coffee, Picnic, The Morning After, Empire Salon, and Fry and Bake.

Eton Properties also launched The Mini Suites, a 368-unit serviced apartment development in Makati. The Mini Suites is the first of Eton Properties' planned serviced residences and it answers the great demand for high-quality, affordable rooms in the city. The Company plans to expand its footprint beyond Luzon as it adds leisure and hospitality development to its portfolio.

Eton is optimistic that it can sustain its growth momentum in 2017, as it once again renews its commitment to remain a trusted, reliable, and responsive developer of value-laden projects.


# PMFTC Inc.

**Overview**

PMFTC Inc. (PMFTC), the business combination between Philip Morris Philippines Manufacturing Inc. (PMPMI) and Fortune Tobacco Corporation (FTC), continues to be the leading cigarette manufacturer in the Philippines. For the past six years, PMFTC has been providing the country's adult consumers with the best smoking experience through its diverse brand portfolio.

PMFTC manufactures 9 out of the top 15 brands available in the market today led by Marlboro, the world's number one cigarette brand, and Fortune, the largest heritage home-grown brand in the Philippines. PMFTC's market share remains strong at 71.3% (down 2.1 percentage points versus prior year) despite headwinds brought about by illicit trade, challenging excise and regulatory landscape, and pricing dynamics. Net income significantly increased, mainly brought about by excise-driven price increases in the fourth quarter of 2015 and most recently in the fourth quarter of 2016, coupled with improved mix from up-trading to the premium segment due to narrower price gaps. Marlboro and Fortune continue to be the most sold brands in the market, collectively contributing 73% of PMFTC's volume for the year (+6 percentage points versus the prior year).

PMFTC continues to employ over 4,800 employees and directly contracts over 4,500 tobacco farmers from four tobacco-growing areas in the country. The Company relies on its competent and diverse workforce supported by individual development and a merit-based career management program that recognizes potential and rewards achievements.

***Sales and Marketing***

Total industry volume in 2016 continued to weaken, driven by the decline of low and super low price segments following the fourth quarter 2015 price increases in these segments, along with challenges on competitors' discounting at the bottom of the market. However, pricing dynamics, complemented by key initiatives to maintain Marlboro's position at the forefront of innovation, made it possible to reach its highest share of the market since it was made available in the Philippines in 1955.

A key highlight for Marlboro in 2016 was the tipping design upgrade, and the introduction of the first ever Firm Filter® in the market, launched in June. Supported by extensive communication materials and adult (legal age 18+) consumer engagement efforts in Marlboro strongholds, the launch helped boost the brand's distribution and volume. In addition, Marlboro also launched the first and only double capsule offer with Marlboro Ruby Burst, introducing a new dimension in fresh taste, only available in modern trade.

Manufactures
**9** out of the top **15**
brands available in the market


These key innovations from Marlboro further reinforced the brand's leadership position, assuring quality superiority that can only be expected from the World's #1 cigarette brand.

Fortune continues on the path of innovation as well, with product and packaging upgrades to increase value proposition and maintain relevance in the market. Moreover, Fortune Tribal continued to leverage on the success of Fortune Mint Splash (launched in 2015) by further supporting its nationwide expansion. In order to further promote Fortune's interest among adult smokers, a nationwide raffle promotion, Fortune Tropa Premyo, was implemented, giving away a full range of items and cash prizes. All these initiatives were supported by distribution and awareness programs, delivering positive results for the brand.

***Operations***

Following innovation initiatives for Fortune such as pack upgrades and change in pack format from box to round corner box for Tribal, PMFTC successfully converted equipment on schedule, ensuring no interruption of market supply.

Various programs focused on ensuring safety of employees were implemented in 2016. In October, the Marikina plant marked a new milestone in Operations by achieving for the first time, Two Million Safe Man Hours without any injuries or breach of safety policies.

***Regulatory Environment and Illicit Trade***

The Implementing Rules and Regulations (IRR) of the Graphic Health Warnings (GHW) Law were approved by the GHW IRR Committee on February 9, 2016 and published last February 11, 2016.

The IRR affirmed the size requirements of the GHWs on cigarette packs, inserts, onserts and other tobacco product packaging at 50% of the principal display areas (front and back) and additional information covering 30% of one side panel.

As of March 3, 2016, tobacco products shall not be withdrawn from the manufacturing facilities or imported into the Philippine customs territory without the GHWs and must be compliant with the ban on certain descriptors. The illicit cigarette trade continues to be a major concern and returning illicit volumes to the legal market remains a business priority of PMFTC. In 2017, the Senate Ways and Means Committee noted a reduction in tobacco excise tax collection to Php91.6 billion in 2016 from Php99.5 billion in 2015, equivalent to a 7.9% decline.

The Bureau of Internal Revenue attributed the decline in tax collection to the proliferation of fake tax stamps and smuggled cigarettes, among others. Illicit cigarettes trade in the Philippines is principally driven by "domestic illicit" which


are locally manufactured cigarettes that are undeclared for tax purposes (Manila Times, February 6, 2017).

To fight illicit trade, PMFTC participated in various conferences to increase awareness about the problem and to propose solutions. PMFTC also provided technical trainings to various law enforcement agencies such as the Bureau of Customs, the Philippine National Police, the National Bureau of Investigation, the Intellectual Property Office of the Philippines and the Department of Trade and Industry to improve their capacity to conduct enforcement measures against illegal cigarettes.

These efforts were complemented by at least eight major enforcement operations highlighted by raids and the closure of two factories in Pampanga and Pangasinan that manufactured counterfeit cigarette products.

***Human Resources***

PMFTC continues to be a "talent exporter" – sending exceptional Filipino talents across Philip Morris International (PMI) affiliates globally. It has consistently provided overseas career opportunities in Asia, Europe and Latin America to its top mobile talents. International assignments provide maximum career acceleration and wider development of talents. It opens talents for an international PMI career or next level roles in the Philippines when they return.

In 2016, PMFTC continued key strategic talent acquisition initiatives to boost its talent pipeline and strengthen the PMFTC employer brand. PMFTC hired 408 employees nationwide across all functions, especially in Sales. INKOMPASS, now on its second year in the Philippines, is emerging as one of the most prized internship programs in the country and has doubled its applications from the previous year. Furthermore, PMFTC had the most number of interns that made it to the Global Inchallenge. The Sales Supervisor and Production Supervisor traineeship programs also bolstered talent pipeline in the mid-supervisory levels.

Internally, 79 employees nationwide went through Development Centers and local Pit Stops to assess their capabilities and build robust development plans to prepare them for next level jobs.

With the Company continuously working toward its goal of being a top employer in the Philippines, its Talent Management Programs on Employee Integration, Talent Development, and Talent Mobility have been recognized by the People Management Association of the Philippines as a Program of the Year Finalist.

In addition, PMFTC has successfully concluded a fresh five-year CBA with the PMFTC Labor Union. Also, PMFTC continued its focus on building a diverse and inclusive environment by facilitating a Management Team Strategy Workshop where four key focus areas have been prioritized.

***Public Affairs, Corporate Citizenship, and Recognitions***

PMFTC is committed to make a difference in the communities where it operates. Embrace, the Company's corporate social responsibility (CSR) program, has 15 projects currently running simultaneously that are aligned with the United Nations' Sustainable Development Goals (SDGs). The projects are on community health, poverty alleviation, livelihood, education, environment, disaster preparedness, and calamity relief and rehabilitation across the country.

The year 2016 saw the completion of 108 school buildings in areas devastated by Super Typhoon Yolanda (International name Haiyan) in Bohol, Cebu, Antique, Iloilo, Mindoro, Samar, and Leyte. The construction of school buildings valued at Php100 million was funded by Philip Morris International (PMI). The project implementation was done in consultation with responsible national government agencies and local government authorities after new hazard maps were drawn following the said disasters.

the Philippine Art Awards (PAA), also organized by PMFTC, successfully held its 22nd awarding ceremonies, naming its five national winners from Luzon, Visayas, and Mindanao.

PMFTC supports the arts through the PAA to recognize the excellence of Filipino artists. After more than two decades, almost fifteen thousand competition entries, and 10 ASEAN wins, the PAA has maintained its stature as the Philippines' preeminent contemporary art competition and exhibition today.


To further help the province of Leyte become resilient to climate change, PMFTC organized the first Climate Change and Agriculture Summit in the Municipality of Palo, in partnership with the provincial government. Participants in the workshop included town and city mayors, Local Government Units (LGU) representatives, farmer leaders, and representatives from the provincial and municipal agriculture and planning offices. The summit's objective was to provide Filipino farmers, LGUs, and other stakeholders with information on available technology and best practices that they can input into their plans for the agricultural sector to be prepared for the changes that come with climate change.

Still on agriculture, PMFTC held the 10th Bright Leaf Agriculture Journalism Awards (Bright Leaf) with the mission to promote the writing and production of outstanding and relevant agriculture stories in print, radio, and television by giving them due recognition. It also honors the most compelling photos that capture the essence of the agriculture industry. After nearly a decade, the program has become one of the most renowned journalism awards. On the other hand,

Finally, PMFTC is one of five recipients of the 2016 CSR World Leader Award given by a UK-based international network of corporate social responsibility (CSR) professionals, at the Westminster Palace in London. The five CSR World Leaders were selected from the winners of the CSR Excellence Awards in early 2016, which included PMFTC—the only Asian company in the roster. Dubbed as "companies with a heart," the CSR World Leaders are described as "caring companies that use their privileged position to help their colleagues, communities, customers, the environment and the less fortunate."

# PHILIPPINE NATIONAL BANK

The Philippine National Bank (PNB) is a private universal bank providing a full range of banking and other financial services to its highly diverse clientele comprised of retail customers, small and medium enterprises (SMEs), domestic and international corporations, government institutions, and overseas Filipinos. PNB is one of the country's largest private universal banks in terms of assets.

PNB sustained its profitability in 2016 with its consolidated net income reaching Php7.4 billion under the pooling method, 9% higher compared to earnings of Php6.8 billion in 2015. The improvement in the Bank's bottomline is a result of relentless efforts to strengthen revenue streams, improve cost efficiency, and further enhance the quality of the balance sheet.

Leveraging on its solid franchise, PNB's net interest income continued to grow, increasing by 11% to Php19.5 billion, comprising nearly two-thirds of total operating income. The increase in net interest income was driven by the 15% rise in interest income on loans to Php19.7 billion.


Behind this strong growth was the 17% hike in the loan book, notably corporate and commercial/SME loans.

At the same time, a proactive management of liabilities contained the growth in interest expense. PNB redeemed its Php6.5 billion Lower Tier 2 Unsecured Subordinated Notes in June 2016 which were replaced by new Long-Term Negotiable Certificates of Time Deposit (LTNCDs) with lower interest rate toward the end of 2016.

Aside from substantially growing its lending business, PNB also harnessed other revenue streams. Fixed income securities trading and foreign exchange gains registered a 60% increase year-on-year (y-o-y), as PNB benefited from favorable market conditions and growth in transaction volumes, the latter brought about by further harnessing the distribution strength of Treasury products by the branches.

The Bank also achieved significant increase in net gains from sale of foreclosed assets, highlighting continued efforts to reduce non-earning assets. Higher miscellaneous income augmented the Bank's revenues primarily from a one-time gain from the sale of the Bank's 51% stake in its life insurance subsidiary.

On the other hand, operating expenses were 23% higher, with additional expenses necessary for the migration to the more secure EMV technology for its ATM and POS terminals, debit and credit cards, and the successful thematic marketing campaign. Moreover, the 2015 and 2016 operating expenses included reversals for previous provisioning amounting to Php974 million and Php234 million, respectively. Without the reversals, operating expenses would have been 18% higher y-o-y.

By end-2016, PNB's total consolidated resources stood at Php740.9 billion, up Php74.4 billion or 11% from year-ago level.

PNB's branch banking business continued to provide a stable source of low-cost funds, which accounted for 56% of deposits.

Deposit level rose by 17% y-o-y to reach Php570.5 billion. Given the Banks' double-digit loan growth, the loan to deposit ratio stood at 73% as of end-2016. Despite the upsurge in lending activities, PNB's asset quality steadily improved as the non-performing loan ratios further declined to 0.18% (net of valuation reserves) and 2.31% (at gross) from 0.25% and 2.61%, respectively in December 2015.

**17%** loan growth; LDR at **73%**

NPL coverage reached 133% from 126% a year ago. The Bank's consolidated risk-based Capital Adequacy Ratio (CAR) has consistently exceeded the minimum regulatory requirement of 10% with a CAR at 16.7% and Common Equity Tier (CET) 1 ratio at 15.8% by end-2016. With its robust capital base, PNB is well positioned to take advantage of the opportunities arising from the country's sustained economic growth.

## BANKING


Last July 22, 2016, PNB celebrated its centennial, a milestone for an institution that has served generations of Filipinos locally and internationally. The anniversary theme, "A Century of Excellence," depicted PNB's remarkable performance as a bank that customers can lean on, offering services that are uniquely Filipino to address clients' diverse banking needs. The centennial was highlighted by a series of initiatives that further cemented PNB's legacy of excellence.

In 2016, PNB launched its new tagline, "You First," which reflects the Bank's renewed brand promise to be more customer-centric. The tagline lays the foundation for the next chapter of PNB's growth story as it continues to pioneer a series of banking "firsts" in the industry. Having pioneered many industry innovations in its 100 years of service, PNB plans to introduce more banking "firsts" to benefit its existing and potential customers. Last year, the Bank launched yet another first in the industry with the Unit Investment Trust Fund (UITF) ATM facility. This new service enables clients to invest their money easily through PNB ATMs nationwide.

To bolster its insurance business, PNB forged a strategic partnership with Allianz SE, one of the leading global financial services companies. In June 2016, PNB concluded the sale of its 51% ownership of its life insurance subsidiary, PNB Life Insurance, Inc., to Allianz SE. A key component of this joint venture is a 15-year bancassurance agreement, which will provide Allianz SE exclusive access to more than four million customers in PNB and PNB Savings Bank (PNBSB) branches. The new entity is known as Allianz PNB Life Insurance, Inc.

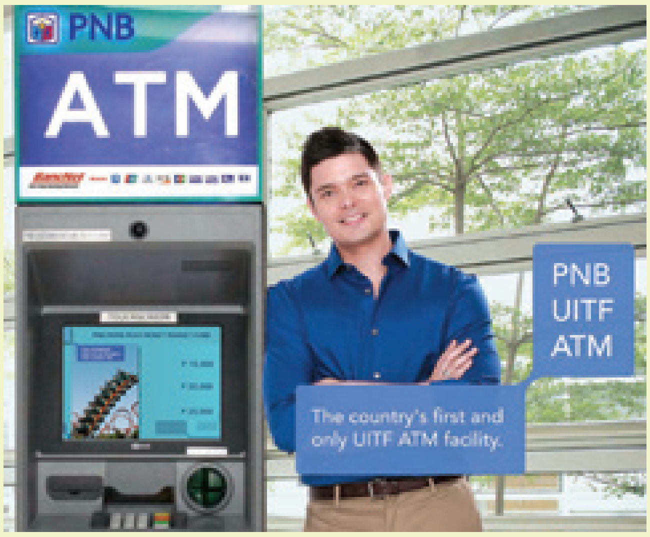
During the year, Fitch upgraded PNB's credit rating to one notch below investment grade on expectations that the Bank will maintain broadly steady asset quality, adequate capital buffers, and stable funding and liquidity profiles as it grows and potentially gains market share amidst continued economic improvement and proactive regulatory oversight. The rating agency raised PNB's Long Term Issuer Default Rating to BB+ from BB and its Viability Rating to 'bb+' from 'bb' and maintained its stable outlook.

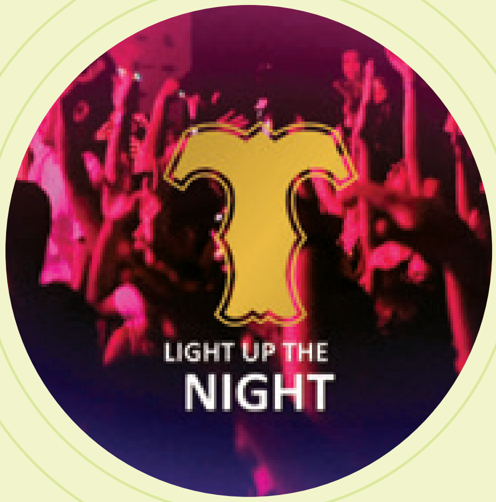
PNB continued to garner awards for its products and service innovation. Its Bank on Wheels was recognized by three international award-giving bodies: a) the "Most Innovative Banking Service - Philippines 2016" award from the Global Business Outlook Awards; b) the "Most Innovative Bank, Philippines 2016" award from International Finance Magazine (IFM) Awards; and c) the "Most Innovative Banking Product Philippines 2016" from the Global Banking and Finance Review Awards. PNB relaunched the Bank on Wheels in December 2015 to meet the evolving needs of its customers and provide them with banking services when and where they need it most.

PNBSB also received the “New Consumer Lending Product of the Year Award” for its SSS Pension Loan Program in the Asian Banking and Finance Retail Banking Awards 2016, held in Singapore. During the SSS Balikat ng Bayan Award Ceremonies, PNB was recognized as “Best OFW Collecting Partner.” At the same time, PNBSB was awarded as “Best Collecting Partner” in the thrift bank category. The Best Collection Partner distinction is awarded to financial institutions that are consistently among the top with the highest collections, have the biggest volume of transactions, and widest coverage.

As of December 31, 2016, PNB had a total of 675 branches and 1,051 ATMs strategically located nationwide. In addition, PNB boasts of having the most extensive international footprint among Philippine banks with 73 overseas branches and offices across Asia, Europe, Middle East, and North America.

Backed by a hundred years of stability and excellence, PNB looks forward to another hundred years of serving its customers first.




# TANDUAY DISTILLERS, INC.


The Year 2016 marked a major transformation in Tanduay Distillers, Inc.'s (Tanduay) operations as its ethanol business, through subsidiary Absolut Distillers, Inc., became fully operational and provided a major boost to the Company's revenue generating capacity.

Tanduay's consolidated net income increased by 115% to Php908 million in 2016 from Php422 million in 2015, propelled by the additional contribution from the ethanol business. Ethanol sales reached 38.5 million liters in 2016 accounting for 8% of the total domestic ethanol consumption and a 15% share among local ethanol producers.

Meanwhile, the liquor business posted a 4% increase in revenues on the back of a 2% improvement in volume and 2% increase in average selling prices. Liquor gross margin however fell by 4 percentage points on account of higher excise taxes and packaging materials costs.

The total domestic liquor market continued to recover as it grew by 3% in 2016 after years of decline starting in 2013 when the new excise tax law was implemented. The increase in demand is much evident in Luzon which grew by 8%, offsetting the 5% decline in the Visayas-Mindanao area. The market share of imported alcohol also improved to 4% in 2016 from 3% a year ago.



On the marketing front, Tanduay received its second consecutive "Brand of The Year" award from the World Branding Forum, a non-profit organization dedicated to promoting brand standards. Tanduay Asian Rum continued to gain international prominence as it won another gold medal from the Madrid International Rum Conference, two gold medals from the Beverage Testing Institute in Chicago and superior ratings from the International Taste and Quality Institute in Belgium. Tanduay Asian Rum is now sold in Florida, California, Illinois, New York, Massachusetts, and Rhode Island in the United States.

Tanduay continued its marketing campaign anchored on the theme "**Tibay ng Loob, Tibay Tanduay**" that describes the perseverance and resilience of the Filipino as it applies as well to the Tanduay brand which had withstood the test of time. This campaign was focused heavily in the Visayas and Mindanao area to counter competitor moves to penetrate these markets. Apart from Tanduay Five Years, the year-round tri-media campaign and below-the-line promotions also covered Tanduay Light and Tanduay Select which are slowly gaining the patronage of the younger drinking market. Dealers Nights were also held in various key cities in the South to recognize the support and loyalty of Tanduay's major dealers in the region.

The key successes in 2016 has emboldened the Tanduay Group to seek for greater achievements as it set its sights in the larger Luzon market in 2017 and to firm up its status as a major player in the emerging renewable energy business.

**115%**

Net income growth with contribution from ethanol

Diversity in the Board was evident with the election of three women directors out of thirteen seats that comprised the Board. This is also strongly observed in the appointment of some female directors as Chairman and members of various Board Committees.

Ms. Florencia G. Tarriela, an Independent Director who is likewise the Chairperson of Philippine National Bank is the Chairperson of the Corporate Governance Committee of the Company. She is also a member of the Audit and Risk Management Committee and the powerful Executive Committee.

Ms. Juanita Tan Lee is the Treasurer of the Company. She likewise sits in the Executive Committee, the Audit and Risk Management Committee and the Nomination and Compensation Committee.

There are three other Independent Directors in the Board with diverse backgrounds and experiences, which are all valuable in the performance of their responsibilities as directors of the Company.

Independent Director Antonino L. Alindogan, Jr. was formerly a member of the Monetary Board of the Bangko Sentral ng Pilipinas and formerly Chairman of the Development Bank of the Philippines. His work experience provides invaluable insights to the bank and other subsidiaries of the Company.

Independent Director Wilfrido E. Sanchez was formerly with the auditing firm of SyCip Gorres Velayo & Company and continuous to be a Tax Counsel of a leading law firm. His training and experiences are invaluable source of counsel, which he shares with the Company and its subsidiaries.

Independent Director Robin C.Sy is a respected member, and an Honorary President of the Federation of Filipino-Chinese Chamber of Commerce and Industry, Inc., and President of Asian Shipping Corporation. His wide range of businesses involving logistics gives wide support to the subsidiaries of the Company.

The Board continues to provide oversight functions over the performances of the subsidiaries. At the start of the year, the subsidiaries were required to present their respective Business Plans and Budgets for the year. During the monthly Board Meetings, each of the subsidiaries presents its financial statements and results of operations, which were compared and measured against the submitted budgets.

The Board has faithfully complied with the circulars of the Securities and Exchange Commission, which requires members of the Board and Senior Officers of the Company to attend qualified corporate governance seminars conducted by accredited providers. In the conduct of the annual self-performance appraisal by the Directors, compliance with and attendance in the seminars, as well as participation in the meetings are taken into consideration in the evaluation of their respective performances.

Hereunder are the details of the participations by the Directors in the meetings of the Company throughout the year.

Board of Directors' Meetings

| Board | Name | Date of Election | No. of Meetings Held during the year (2016) | No. of Meetings Attended | % |
|---|---|---|---|---|---|
| Chairman | Lucio C. Tan | 06/21/2016 | 13 | 13 | 100 |
| Member | Carmen K. Tan | 06/21/2016 | 13 | 10 | 77 |
| Member | Harry C. Tan | 06/21/2016 | 13 | 9 | 69 |
| Member | Michael G. Tan | 06/21/2016 | 13 | 13 | 100 |
| Member | Lucio K. Tan, Jr. | 06/21/2016 | 13 | 12 | 92 |
| Member | Joseph T. Chua | 06/21/2016 | 13 | 10 | 77 |
| Member | Juanita Tan Lee | 06/21/2016 | 13 | 13 | 100 |
| Member | Washington Z. Sycip | 06/21/2016 | 13 | 8 | 62 |
| Member | Peter Y. Ong | 06/21/2016 | 13 | 13 | 100 |
| Independent | Robin C. Sy | 06/21/2016 | 13 | 12 | 92 |
| Independent | Florencia G. Tarriela | 06/21/2016 | 13 | 12 | 92 |
| Independent | Antonino Alindogan, Jr. | 06/21/2016 | 13 | 12 | 92 |
| Independent | Wilfrido E. Sanchez | 06/21/2016 | 13 | 13 | 100 |

Audit and Risk Management Committee Meetings

| Office | Name | Date of Appointment | No. of Meetings Held | No. of Meetings Attended | % | Length of Service in the Committee |
|---|---|---|---|---|---|---|
| Chairman (ID) | Antonino L. Alindogan, Jr. | 06/21/2016 | 5 | 4 | 80 | 3 yrs |
| Member (NED) | Washington Z. SyCip | 06/21/2016 | 5 | 4 | 80 | 2 yrs |
| Member (NED) | Lucio K. Tan, Jr. | 06/21/2016 | 5 | 1 | 20 | 11 yrs |
| Member (ID) | Wilfrido E. Sanchez | 06/21/2016 | 5 | 5 | 100 | 3 yrs |
| Member (ID) | Florencia G. Tarriela | 06/21/2016 | 5 | 4 | 80 | 2 yrs |
| Member (ED) | Juanita Tan Lee | 06/21/2016 | 5 | 5 | 100 | 11 yrs |

Nomination and Compensation Committee Meetings

| Office | Name | Date of Appointment | No. of Meetings Held | No. of Meetings Attended | % | Length of Service in the Committee |
|---|---|---|---|---|---|---|
| Chairman | Lucio C. Tan | 06/21/2016 | 1 | 1 | 100 | 2 yrs |
| Member (ED) | Harry C. Tan | 06/21/2016 | 1 | 1 | 100 | 2 yrs |
| Member (NED) | Lucio K. Tan, Jr. | 06/21/2016 | 1 | 1 | 100 | 2 yrs |
| Member (ED) | Michael G. Tan | 06/21/2016 | 1 | 1 | 100 | 2 yrs |
| Member (ID) | Wilfrido E. Sanchez | 06/21/2016 | 1 | 1 | 100 | 2 yrs |
| Member (ED) | Juanita Tan Lee | 06/21/2016 | 1 | 1 | 100 | 10 yrs |

Corporate Governance Committee Meetings

| Office | Name | Date of Appointment | No. of Meetings Held | No. of Meetings Attended | % | Length of Service in the Committee* |
|---|---|---|---|---|---|---|
| Chairman | Florencia G. Tarriela | 06/21/2016 | 3 | 3 | 100 | 3 yrs |
| Member (NED) | Lucio K. Tan, Jr. | 06/21/2016 | 3 | 2 | 67 | 3 yrs |
| Member (ED) | Michael G. Tan | 06/21/2016 | 3 | 3 | 100 | 3 yrs |
| Member (ID) | Antonino L. Alindogan, Jr. | 06/21/2016 | 3 | 3 | 100 | 3 yrs |
| Member (NED) | Joseph T. Chua | 06/21/2016 | 3 | 3 | 100 | 2 yrs |

The Company has been faithfully complying with SEC Memorandum Circular No. 20 Series of 2013. During the year, the directors and officers attended the following seminars on Corporate Governance.

Board of Directors:

| Name of Director | Date of Seminar Attended | Program | Name of Training Institution |
|---|---|---|---|
| Lucio C. Tan | August 3, 2016 | Securities and Exchange Commission: Corporate Governance Forum | Securities and Exchange Commission (SEC) |
| Carmen K. Tan | August 3, 2016 | Securities and Exchange Commission: Corporate Governance Forum | Securities and Exchange Commission (SEC) |
| Harry C. Tan | August 3, 2016 | Securities and Exchange Commission: Corporate Governance Forum | Securities and Exchange Commission (SEC) |
| Lucio K. Tan, Jr. | October 19, 2016 | Best Parliamentary Procedures for Board Directors and Top Management | Center for Global Best Practices |
| Michael G. Tan | August 3, 2016 | Securities and Exchange Commission: Corporate Governance Forum | Securities and Exchange Commission (SEC) |
| Juanita Tan Lee | June 9, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Joseph T. Chua | December 20, 2016 | Corporate Governance & AMLA Seminar | Philippine Corporate Enhancement and Governance, Inc. (Formerly: Philippine Securities Consultancy Cooperation) |
| Washington Z. Sycip | Exempted | | |
| Peter Y. Ong | June 9, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Antonino L. Alindogan, Jr. | October 7, 2016 | Seminar on Corporate Governance | Sycip Gorres Velayo & Co. |
| Wilfrido E. Sanchez | October 7, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Florencia G. Tarriela | August 3, 2016 | Securities and Exchange Commission: Corporate Governance Forum | Securities and Exchange Commission (SEC) |
| Robin C. Sy | November 16, 2016 | Corporate Governance Orientation Program | The Institute of Corporate Directors |

Board of Advisors:

| Name | Date of Seminar Attended | Program | Name of Training Institution |
|---|---|---|---|
| Johnip G. Cua | June 9, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |

Officers:

| Name | Position | Date of Seminar attended | Program | Name of Training Institution |
|---|---|---|---|---|
| Ma. Cecilia L. Pesayco | Corporate Secretary | Oct. 7, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Marivic T. Moya | Asst. Corp. Secretary | Oct. 19, 2016 | Best Parliamentary Procedures for Board Directors and Top Management | Center for Global Best Practices |
| Erwin C. Go | Chief Legal Officer | Jun. 9, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Nestor C. Mendones | Deputy Chief Finance Officer | Oct. 7, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |
| Jose Gabriel D. Olives | Chief Finance Officer | Oct. 7, 2016 | Distinguished Corporate Governance Speaker Series | The Institute of Corporate Directors |

The Board of Directors is composed of the following:

***Dr. Lucio C. Tan,*** 82. Chairman & CEO
First elected: July 2, 1999
He is the Chairman of Philippine Airlines Inc., Asia Brewery Inc., Eton Properties Philippines Inc., **MacroAsia Corp.**, Fortune Tobacco Corp., PMFTC Inc., Grandspan Development Corp., Himmel Industries Inc., Lucky Travel Corp., **PAL Holdings Inc.**, Air Philippines Corporation, Tanduay Distillers Inc., The Charter House Inc., AlliedBankers Insurance Corp., Absolut Distillers Inc., Progressive Farms Inc., Foremost Farms Inc. and Basic Holdings Corp. He is also a Director of **Philippine National Bank**. He holds a Bachelor of Science degree in Chemical Engineering from Far Eastern University. He was awarded the degree of Doctor of Philosophy, major in Commerce, by the University of Santo Tomas in 2003 and is an awardee of several other honorary Doctorate degrees.

***Carmen K. Tan***, 75. Director
First elected: May 5, 2010
She is a Director of Asia Brewery Inc., The Charter House Inc., Foremost Farms Inc., Philippine Airlines Inc., **PAL Holdings Inc.**, Air Philippines Corporation, Fortune Tobacco Corp., Tanduay Distillers Inc., Himmel Industries Inc., Lucky Travel Corp., Progressive Farms Inc., **MacroAsia Corp.**, **Philippine National Bank**, and PMFTC Inc.

***Harry C. Tan*** ,70. Director
First elected: May 28, 2008.
He is a Director of Eton Properties Philippines 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., Absolut Distillers Inc., Basic Holdings Corp., Foremost Farms Inc., Himmel Industries Inc., PMFTC Inc., **Philippine National Bank**, Progressive Farms Inc., Grandspan Development Corp. and Tanduay Distillers Inc. He holds a Bachelor of Science degree in Chemical Engineering from the Mapua Institute of Technology.

***Michael G. Tan***, 50. President & COO
First elected: February 21, 2003.
Mr. Tan is a Director and the Chief Operating Officer of Asia Brewery Inc. (ABI). He joined ABI in 1991, and held various positions until his appointment to his current position in 2000. He is also a Director of Tanduay Distillers Inc., Eton Properties Philippines Inc., **Philippine National Bank**, PMFTC Inc., **Victorias Milling Company Inc.**, Abacus Distribution Systems Philippines Inc., AlliedBankers Insurance Corp., Grandway Konstruct Inc., Lucky Travel Corp., Maranaw Hotel (Century Park Hotel), Pan Asia Securities Inc., Philippine Airlines Inc., and Shareholdings Inc. He is a Director and the Treasurer of **PAL Holdings Inc**. and Air Philippines Corporation. He graduated 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.***, 50. Director
First elected: February 21, 2003.
He is a Director/President of Tanduay Distillers Inc. and Eton Properties Philippines Inc.; Director/EVP of Fortune

Tobacco Corp.; Director of AlliedBankers Insurance Corp., Philippine Airlines Inc., **Philippine National Bank**, **PAL Holdings Inc.**, **MacroAsia Corp.**, **Victorias Milling Company Inc.**, PMFTC Inc., Lucky Travel Corp., Air Philippines Corp., Absolut Distillers Inc., Asia Brewery Inc., Foremost Farms Inc., Himmel Industries Inc., Progressive Farms Inc., The Charter House Inc., Grandspan Development Corporation 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.

***Joseph T. Chua***, 60. Director
First elected: June 9, 2014.
He is Chairman of J.F. Rubber Philippines, Watergy Business Solutions Inc., and Cavite Business Resources Inc.; Director/President and Chief Operating Officer of **MacroAsia Corp.**; Managing Director of Goodwind Development Corporation (Guam); Director/President of MacroAsia Airport Services Corporation, MacroAsia Air Taxi Services, MacroAsia Catering Services Inc., MacroAsia Properties Development Corp. and MacroAsia Mining Corporation; Director/OIC of Eton Properties Philippines Inc.; Director of Lufthansa Technik Philippines Inc., Bulawan Mining, Air Philippines Corporation, **PAL Holdings Inc.**, Philippine Airlines Inc.; Member of the Board of Advisors of Asia Brewery, Inc., Tanduay Distillers Inc., and **Philippine National Bank**. Mr. Chua has a double degree in AB Economics and BS Management from De La Salle University.

***Juanita Tan Lee***, 74. Director & Treasurer
First elected: May 2, 2012.
She is also Director of Eton Properties Philippines Inc., Asia Brewery, Inc., and Tanduay Distillers Inc.; Director/Corporate Secretary of Fortune Tobacco Corp., Corporate Secretary of Absolut Distillers Inc., The Charter House Inc., Foremost Farms Inc., Grandspan Development Corp., Himmel Industries Inc., Landcom Realty Corp., Lucky Travel Corp., PMFTC Inc., and Progressive Farms 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***, 95; Director
First elected: July 9, 2013.
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 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., **MacroAsia Corp.**, **PAL Holdings Inc.** and **Philippine National Bank**. Mr. Sycip holds BS and MS degrees from the University of Santo Tomas, which later conferred him a Doctor of Accounting Education, honoris causa degree in 1984. He also obtained a Master of Science in Commerce from Columbia Business School.

***Peter Y. Ong***, 69. Director
First elected: June 9, 2014.
He is a Director and the Treasurer of Merit Holdings & Equities Corporation; Director of Fortune Tobacco Corporation, AlliedBankers Insurance Corporation, Allied Leasing and Finance Corporation and Solar Holdings Corporation; Former President of Air Philippines Corporation, Former Senior Vice President for Production of Fortune Tobacco Corporation and Former Director of Allied Savings Bank. Mr. Ong graduated from the Mapua Institute of Technology with a degree in Chemical Engineering.

***Antonino L Alindogan Jr.***, 78. Independent Director
First elected: July 31, 2012.
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., **PAL Holdings Inc.**, Asia Brewery Inc., and Tanduay Distillers 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 the Bangko Sentral ng Pilipinas (BSP) 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***, 79. Independent Director
First elected: July 31, 2012.
He is the Tax Counsel of Quiason Makalintal Barot Torres Ibarra & Sison Law Offices; Vice Chairman of The 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., Asia Brewery Inc., and Tanduay Distillers Inc. He holds a Bachelor of Arts degree from the Ateneo de Manila University and has a Post-Graduate degree in Bachelor of Laws from the Ateneo De Manila University and Masters of Law from Yale Law School.

***Florencia G. Tarriela***, 69. Independent Director
First elected: August 9, 2012.
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 Pag-unlad 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 of the Philippines (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 Holdings 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.

***Robin C. Sy***, 81. Independent Director
First elected: June 9, 2014.
He is the President of Asian Shipping Corporation, Independent Non-executive Director of Dynamic Holdings Limited, Honorary President of the Federation of Filipino-Chinese Chamber of Commerce and Industry Inc., Former Director of Air Philippines Corporation and Former Director of Zuma Holdings and Management Corporation. His companies are engaged in shipbuilding and repairing business as well as heavy construction equipment trading field in the Philippines.

## BOARD COMMITTEES

The role of the Board Committees is to institute good corporate governance.

With their oversight functions, the Audit and Risk Management Committee reviews and institutes controls in the operations of the subsidiaries. The Corporate Governance Committee is the venue to discuss Board and Management issues. The Committees have been invaluable in sorting out issues and recommending solutions to the Board for consideration and approval.

| Name | Nomination and Compensation | Audit and Risk Management | Executive | Corporate Governance |
|---|---|---|---|---|
| Lucio C. Tan | C | | C | |
| Carmen K. Tan | | | | |
| Harry C. Tan | √ | | √ | |
| Michael G. Tan | √ | | √ | √ |
| Lucio K. Tan, Jr. | √ | √ | √ | √ |
| Joseph T. Chua | | | √ | √ |
| Juanita Tan Lee | √ | √ | √ | |
| Washington Z. Sycip | | √ | | |
| Peter Y. Ong | | | | |
| Antonino L. Alindogan, Jr. | | C | √ | √ |
| Wilfrido E. Sanchez | √ | √ | | |
| Florencia G. Tarriela | | √ | √ | C |
| Robin C. Sy | | | | |

### Executive Committee

The Executive Committee is provided for in the By-Laws and is constituted by eight (8) directors. The Executive Committee is vested with the powers of the Board within the limits set by Board policy and the By-Laws, in the management of the business. It is specifically called to convene where there are important urgent matters to discuss and decide upon between the regular meetings of the Board.

Matters that are normally brought to the Executive Committee before they are presented to the Board are:

1. Any request by a subsidiary of capital funding from the Company
2. Any undertaking by a subsidiary of new business ventures, corporate mergers and acquisitions, joint ventures, divestment of existing businesses and key assets, and corporate debts with a term of at least five years or will require some form of corporate guarantee. Further, capital investments, outside regular capex projects, subject to a certain threshold, are also presented to the Committee.

### Nomination and Compensation Committee

The Committee meets at least once a year, ensuring a formal and transparent Board nomination process. It selects, compensates, monitors and, when necessary, replaces key executives and oversees succession planning.


The Committee had convened once in 2016 to pass upon qualifications of candidates nominated for Board and key positions in the Company.

### Audit and Risk Management Committee

The Audit Committee has the arduous task of overseeing the financial and operational performance of the Company. It reviews the financial reports of the subsidiaries, the system of internal control and management of financial risk, the audit process, and the Company's process for monitoring compliance with laws and regulations and its own code of corporate governance.

The Committee is composed of non-executive directors and is headed by an Independent Director, as Chairman and who was formerly a member of the Monetary Board of the Bangko Sentral ng Pilipinas (Central Bank), formerly a Chairman of a state-owned bank and other financial institutions. He is a Certified Public Accountant and holds a Bachelor of Science in Commerce degree major in Accounting from De La Salle University, Cum Laude.

There were five meetings of the Committee in 2016, which took up among others, the quarterly financial reports and the Audited Financial Statements for the period ending December 31, 2016 for the Company and its subsidiaries. The Committee likewise reviews and assesses related party transactions to ensure that minority shareholders and stakeholders are not unduly prejudiced in any of the transactions. Lastly, the Committee reviews the performance of the External Auditors and makes the corresponding recommendation to the Board.

The Audit and Risk Management Committee also oversees the performance of the internal and external auditors of the Company and the subsidiaries. The external auditors presents to the Audit and Risk Committee their findings and recommendations resulting from the examinations of the Company and its subsidiaries, together with the Audit Plan.

### Corporate Governance Committee

The Committee meets on issues relating to the faithful observance of the principles of good corporate governance. Its powers include the authority to require any or all members of the Board of Directors, Executive Management or such other person to attend the Committee meetings as it may deem necessary; and the authority to require the Board of Directors, Management, Board Committees, and all Departments to submit reports to the Committee pertaining to the evaluation of the Company's compliance with corporate governance principles and guidelines.

The Committee is ably headed by a female Independent Director, who is currently the Chairperson of a bank. She was formerly the Undersecretary of Finance of the Philippine Government, an alternate member of the Monetary Board of the Bangko Sentral ng Pilipinas

(Central Bank) and worked with one of the biggest international banks in the country. She obtained her Bachelor of Science in Business Administration major in Economics from the University of the Philippines and Masters in Economics from the University of California, Los Angeles. The Company, and its Board of Directors and Management, guided by its Corporate Governance Committee, have fully complied with the requirements of the Revised Corporate Governance Manual for 2014.

## MANAGEMENT

Management is headed by Dr. Lucio C. Tan as the Chairman and CEO and Mr. Michael G. Tan as President and COO. On critical or sensitive issues, the President coordinates closely with the Chairman/CEO for directions and confirmation of decision on the matter at hand. The President, with the cooperation and support from the subsidiaries has steered the Company to continuous growth.

The President/COO, members of the Board and Members of Management Committees attended the Annual Stockholders' Meeting. There were eleven (11) out of thirteen (13) Directors who attended the Annual Stockholders' Meeting held on June 21, 2016:

| Name of the Director | Present | Absent |
|---|---|---|
| Lucio C. Tan | √ | |
| Carmen K. Tan | √ | |
| Lucio K. Tan, Jr. | √ | |
| Harry C. Tan | | √ |
| Michael G. Tan | √ | |
| Joseph T. Chua | | √ |
| Juanita Tan Lee | √ | |
| Washington Z. Sycip | √ | |
| Peter Y. Ong | √ | |
| Florencia G. Tarriela | √ | |
| Wilfrido E. Sanchez | √ | |
| Antonino L. Alindogan, Jr. | √ | |
| Robin C. Sy | √ | |

## DISCLOSURE AND TRANSPARENCY

### *UNSTRUCTURED DISLCOSURES*

The Company, has among other things, disclosed the following in 2016.

- The disclosure on the joint venture project with Ayala Land, Inc.

- The acquisition of 131,863,677 shares in the total outstanding and issued shares of Victorias Milling Company, Inc.

- The declaration on April 12, 2016 of regular Cash Dividend of Php0.15 per share to all stockholders of record as of April 28, 2016 with payment date of May 6, 2016.

- The election of Directors and Officers for 2016-2017 and the appointment of the members for each Board Committee.

- Asia Brewery Inc., a subsidiary of the LT Group, Inc. entered into a joint venture agreement with Heineken on May 26, 2016. A new joint venture company, AB Heineken Philippines, Inc., was formed.

## DISCLOSURE AND TIMING

The Company ensures that material information relating to the actions or decisions of the Board affecting the Company are disclosed to the investing public. The financial information and comprehensive disclosures are filed with SEC and PSE. These disclosures may be accessed through the Company's website: www.ltg.com.ph.

The Company has been faithfully reporting on any major and market sensitive information such as dividend declaration, and other information that may affect the decision of the investing public immediately after its approval or confirmation by the Board.

The Minutes of the Stockholders' Meeting is uploaded in the Company website within five days from the date of the meeting and the Audited Financial Statements (SEC Form 17-A) for the year 2015 were submitted to the SEC and PSE on April 14, 2016, more than two months before the Annual Stockholders' Meeting of June 21, 2016.

The interim or quarterly financial statements and results of operations are submitted to the regulators in accordance with the prescribed period or within 45 days from the end of the financial period. The financial statements are likewise submitted or made available to the stock market through the analysts' briefings held regularly or as soon as the financial results are submitted to the regulators. In the said briefings, members of Management are present to answer questions posed by the analysts. The financial statements may also be accessed through the Company's website.

### Ownership Structure

The Company's outstanding common shares held by record owners of more than 5% are as follows:

| Title of Class | Name of Record Owner | Citizenship | No. of Shares | Percent of Class |
|---|---|---|---|---|
| Common | Tangent Holdings Corporation | Filipino | 8,046,318,193 | 74.36% |
| Common | PCD Nominee Corporation | Non-Filipino | 1,882,780,236 | 17.40% |

## COMPENSATIONS OF DIRECTORS AND EXECUTIVE OFFICERS

The Directors of the Company receive an allowance of Php30,000 a month and a per diem of Php25,000 for every Board meeting and Php15,000 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.

### SUMMARY COMPENSATIONS TABLE: ANNUAL COMPENSATION

| | Year | Salary | Bonus | Others* |
|---|---|---|---|---|
| Four (4) most highly compensated executive officers (see below) | 2017 (Estimate) | 7,854,000 | 654,500 | 3,162,500 |
| | 2016 | 7,140,000 | 595,000 | 2,875,000 |
| | 2015 | 6,980,000 | 595,000 | 2,805,000 |
| All other officers and directors as a group unnamed | 2017 (Estimate) | 2,640,000 | 220,000 | 8,244,500 |
| | 2016 | 2,400,000 | 200,000 | 7,495,000 |
| | 2015 | 2,619,150 | 218,263 | 7,695,000 |

*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 is the Chairman of the Board of Directors and Chief Executive Officer (CEO)
2. Mr. Michael G. Tan is the President
3. Atty. Ma. Cecilia Pesayco is the Corporate Secretary
4. Ms. Juanita Tan Lee is the Treasurer

### EXTERNAL AUDITOR

The auditing firm of SyCip Gorres Velayo & Co. (SGV) is the External Auditor of the Company with Martin C. Guantes as the partner-in-charge for the year 2016 onwards. The SGV has been consistently providing the Company with updates on latest circulars, rulings or revenue regulations from the Bureau of Internal Revenue, as well as updates on Philippine Reporting Standards for the entire group of companies.

AUDIT and AUDIT RELATED FEES:

2014 – Php 1,500,000.00
2015 – Php 1,500,000.00
2016 - Php 1,500,000.00

There were non-audit fees of Php1.2million for the year 2016.

### DEALINGS IN SECURITIES

The Company has adopted and strictly enforces the policy against insider trading on stock transactions. It ensures compliance with rules on disclosures to prevent violations of the government rules on insider trading, and toward this end, undertakes to report to the PSE and SEC within three (3) trading days any acquisition or disposal of Company shares by, or any change in the shareholdings therein, of its directors and principal officers.

| Name of Director | Direct shares As of end-2015 | Direct shares As of end-2016 | Indirect shares / Through (name of record owner) | % of Capital Stock |
|---|---|---|---|---|
| Lucio C. Tan | 2,200 | 2,200 | NIL | - |
| Carmen K. Tan | 2,200 | 2,200 | NIL | - |
| Harry C. Tan | 3,300 | 3,300 | NIL | - |
| Michael G. Tan | 1,100 | 1,100 | NIL | - |
| Lucio K. Tan, Jr. | 1,100 | 1,100 | NIL | - |
| Joseph T. Chua | 2,200 | 2,200 | NIL | - |
| Juanita Tan Lee | 1,100 | 1,100 | NIL | - |
| Peter Y. Ong | 1,100 | 1,100 | NIL | - |
| Washington Z. SyCip | 1,000 | 1,000 | NIL | - |
| Antonino L. Alindogan, Jr. | 1,000 | 1,000 | NIL | - |
| Wilfrido E. Sanchez | 1,000 | 1,000 | NIL | - |
| Robin C. Sy | 1,000 | 1,000 | NIL | - |
| Florencia G. Tarriela | 1,000 | 1,000 | NIL | - |
| **TOTAL** | **19,300** | **19,300** | **NIL** | **-** |

### Trading Blackouts

The Company has adopted a policy on trading blackouts, which covers directors, officers, advisers, consultants and employees who may have knowledge of material facts regarding matters that may affect the shares of the Company.

The Company observes the following blackout period before the financials are disclosed to the public: (1) two weeks before disclosure, for quarterly reports; and (2) one month or thirty (30) days before disclosure, for the year end financials. There were no instances of trading by insiders for the year 2016.

### STAKEHOLDERS RELATIONS

Consistent with its Vision/Mission statements, the Company seeks to ensure that its stockholders, employees, customers and trade partners shall correspondingly benefit from the growth of the Company. The Company believes in the time-honored principles of fairness and integrity as the foundation of any long-term relationship and has continuously and consciously exercised the same in its dealings with its stakeholders.

### SHAREHOLDERS' MEETING AND VOTING PROCEDURES

The Company provides notices of the Stockholders' Meetings at least 28 days prior to the date of the meeting. In 2016, Management sent the Notices beginning May 22, 2016 or 28 days prior to the Stockholders' Meeting.

The Notice to the Stockholders' Meeting contains the Agenda of the meeting and if it is an annual stockholders' meeting, the Definitive Information Statement accompanies said Notice in order to afford all stockholders the opportunity to review the performances of the Board and Management during the prior year and ask the questions if any, in regard thereto. The Definitive Information Statement indicates the major actions taken by the Board during the year, which are

*Analysts' Briefing at LTG's office*

subject of confirmation of the Stockholders. The Company encourages the Shareholders to ask questions during the Annual Stockholders' Meeting. The Notice also indicates the requirement of a Proxy if the Stockholder cannot be personally present, and the date that it is expected to be submitted to the Office of the Corporate Secretary, which is at least five 5 days prior to the date of the meeting in order to accord the Office of the Corporate Secretary time to validate the proxies. Each outstanding common share entitles the registered shareholder to one vote.

The stockholders are also encouraged to send their proposed nominees to the Board through the Office of the Corporate Secretary for proper consideration by the Nomination Committee during its meeting held not later than the end of April.

## DIVIDENDS

Over the past years, the Company has consistently declared Dividends in accordance with the policy set by the Board, of at least 20% of the of the previous year's attributable net income of the Company. On April 12, 2016, the Company declared a cash dividend of Php0.15 per share, or a total of Php1.623 billion, equivalent to 25% of the previous year's attributable net income. The Dividends declared benefitted all stockholders of record as of April 28, 2016 and the same were paid on May 6, 2016, 24 days after it was approved and disclosed. The Company adheres strictly to the guidance of good corporate governance to distribute the Dividends within 30 days from the time it is approved and declared.

## EMPLOYEE RELATIONS

The Company is committed to the safety and well-being of its employees and keeps open the lines of communications. The Company and its subsidiaries have provided company wide health insurance to its employees, scholarship benefits to the children and beneficiaries of the employees and further training and learning opportunities for those who aspire and are determined to undertake it. There are numerous scholarship programs and study grants that employees can apply for and qualify in the group.

Moreover, an Employee Code of Conduct or Personnel Policies are in place in all subsidiaries, which are observed and implemented all throughout the Company. It likewise subscribes to the "Whistle Blowing Policy" which has been adopted in the operating companies.

## INVESTOR RELATIONS

LTG maintains open communications with the investing community to promote greater understanding of the Company. Reports to the SEC and PSE are disclosed on time, and are available for viewing and downloading in the Company's website, www.ltg.com.ph. There is also a dedicated Investor Relations Officer.

The Company conducts meetings regularly with investors and analysts to keep them updated on developments with LTG and its subsidiaries. LTG arranges teleconferences and plant visits, and participates in non-deal roadshows and conferences in various locations arranged by several stockbrokerages. The Company also communicates through emails and telephone calls.

In 2016, LTG attended 8 conferences with different brokers in Manila (3), Singapore (3) and Hong Kong (2). During these conferences, LTG met 112 times with representatives of different funds in one-on-one or group meetings. The Company also had 31 one-on-one meetings as well as 18 conference calls with different funds in its office, as well as conducted two visits to Asia Brewery's and Tanduay's production facilities with groups of sell-side and buy-side analysts.

LTG conducted four (4) Analysts' Briefings during the 2016 calendar year, for Full Year 2015 Results, First Quarter 2016 Results, First Half 2016 Results and Nine Months 2016 Results. The briefing for Full Year 2016 Results was held on March 17, 2017. LTG disclosed the schedule of these briefings to the PSE at least a week before the briefing date. These were attended by analysts from different brokerages and local funds.

Regular press releases are disclosed to the PSE and SEC and distributed to the media, on quarterly earnings results as well as events that may have a significant impact on the operations of the Company and its subsidiaries. After the Annual Stockholders' Meeting, a press briefing was conducted where members of the media had access to Senior Management.

# TAN YAN KEE FOUNDATION, INC.

*The companies under LT Group, Inc. and other companies majority-owned by the Tan family conduct most of their Corporate Social Responsibility (CSR) activities under the Tan Yan Kee Foundation, Inc. (TYKFI).*

*Dr. Lucio C. Tan and his siblings established TYKFI in 1986. The Foundation is named in honor of the late Tan patriarch and is governed by a 15-member Board.*

*In 2016, TYKFI donated Php116 million to various social causes and philanthropic activities, bringing the total to over Php1.6 billion since its inception.*

*The Foundation and its partners pursue projects that focus on four advocacies: Education, Health Services, Social Welfare, and the Environment.*

## Education

Scholars at the University of the East's Caloocan campus

Scholars at the University of the East's Manila campus

### Top-Up Assistance for the K to 12 Basic Education Program

For school year 2016-2017, the Philippine educational system started implementing the K to 12 Program, which requires an additional two years of basic education, Senior High School (SHS) or Grades 11 and 12.

In support of this program, TYKFI granted financial assistance to 192 scholars from public junior high schools to enable them to enrol at the SHS of the University of the East, in its Caloocan and Manila campuses.

### 100 Scholars for Saint Teresita's Academy in Nueva Vizcaya

TYKFI granted scholarships to 100 students in grades 7 to 10 for Saint Teresita's Academy (STA), a Catholic secondary school in Poblacion Aritao, Nueva Vizcaya. The scholars, many of whom belong to indigenous groups, came from the towns of Kayapa, Macdu, Caretas, Aritao, and Santa Fe. Their scholarships include tuition, miscellaneous fees, books, uniforms, and school supplies.

Scholars at the Saint Teresita's Academy in Nueva Vizcaya

### Training for a Better Living

TYKFI in partnership with Ang-Hortaleza Foundation and the local government unit of Sta. Cruz, Ilocos Sur conducted the ***Ganda Mo, Hanapbuhay Ko*** livelihood training program in May.

There were 31 participants who were given training on basic cosmetology which included haircutting, hair coloring, manicures, and pedicures. These skills will enable the women to help support their families.

### *Donation for Law Scholarships*

TYKFI donated Php2 million to the Foundation for Liberty and Prosperity (FLP) to fund its law scholarship program. FLP gives four-year scholarships to deserving students who will uphold its core values of integrity, independence, industry, and intelligence. Scholars are currently enrolled in Ateneo de Davao University, Ateneo de Manila University, San Beda College, Far Eastern University, University of San Carlos, University of Santo Tomas, University of the East, and University of the Philippines. The scholarships include tuition, book allowance, and a yearly stipend amounting to Php200,000 for each scholar.

FLP was established in 2012 and is headed by former Chief Justice Artemio V. Panganiban.

*Former Chief Justice Artemio V. Panganiban receives the check from TYKFI Chairman and President Dr. Lucio C. Tan, and Trustees Mr. Washington Z. Sycip and Mrs. Carmen K. Tan*

### *Supplies for School Children in Ilocos Sur*

The Foundation distributed school uniforms and supplies to 767 students of four elementary schools in Ilocos Sur, namely Baybayon Elementary School, Nagtenga Elementary School, Sidaoen Elementary School, and San Julian Elementary School.

### *Livelihood Training for Electrical Installation and Maintenance*

The Foundation, in partnership with Christ's Commission Fellowship (CCF) sponsored the training of 10 individuals at the Meralco Foundation for Electrical Installation and Maintenance. This is TYKFI's second batch of scholars under this program, and they were given a set of electrical tools after graduation.

## Health Services

### *TYKFI-ABI Medical Specialty Scholarship Program*

Four doctors completed their training abroad under the TYKFI and Asia Brewery, Inc. Medical Specialty Scholarship Program. They are:

Dr. Jeremy James C. Munji, for Anthoscopic and Reconstructive Shoulder Surgery in Clinique General Annecy in France and Clinique General Beaulieu Geneva in Switzerland

Dr. Maria Blanca de Guzman, for Cardiac Pacing and Electrophysiology at the National Heart Centre in Singapore

Dr. Maria Benita Gatmaitan-Arcangel in the Trauma and Acute Care Surgery Department of the Tan Tock Seng Hospital in Singapore

Dr. Emmeline Elaine L. Cua for Intensive General Surgery Laparoscopic Course Training at the Asian Institute for Telesurgery in Taichung in Taiwan.


### *Medical Mission in Lian, Batangas*

TYKFI and Absolut Distillers, Inc., a subsidiary of Tanduay Distillers, Inc., conducted a medical mission in Barangay Malaruhatan in Lian, Batangas. Around 500 residents were given check-ups as well as vitamins and medicines.

The University of the East Ramon Magsaysay Memorial Medical Center also sends volunteers to TYKFI's medical missions. Nine doctors specializing in pediatrics, general medicine, and obstetrics-gynecology participated in this particular activity.

### *Monthly Medical Forum*

TYKFI continues to hold the monthly Asia Brewery Medical Forum in cooperation with the Association of Asia Brewery Medical Specialty Scholars. These forums provide laymen with better health information and the latest medical options. Some of the topics discussed in 2016 include colon cancer, prostate cancer, common rheumatic disorders, alopecia and anti-aging, coronary artery disease, diabetes, gallbladder disease, plastic surgery, movement disorders in the elderly, the aging eye, dengue and other viral infections from mosquito bites, and basic life support for lay rescuers.

## Social Welfare

### *Bridging the Gap*

TYKFI built and inaugurated in May 2016 the hanging bridge in Balete, Santa Fe, Nueva Vizcaya. Previously, residents had to walk a few kilometres and cross the river between the national highway and the barangay. The bridge now provides a shorter route and helps residents get to their schools, transport their agricultural goods to the market and bring their purchases home.

### *Typhoon Victims in Casiguran, Aurora Receive Housing Materials*

TYKFI distributed food and school supplies in Barangay Bianoan in Casiguran, Aurora in the aftermath of Typhoon Lando in 2015. In early 2016, the Foundation returned and distributed galvanized iron sheets and other roofing materials to residents whose homes were totally damaged. The residents also received grocery items.

### *Sharing Our Blessings*

More than 700 students and teachers from four schools in Ilocos Sur received food packages in mid-December 2016 under the annual food packs distribution activity of the Foundation. These were

the same schools whose students were given uniforms and supplies earlier in the year.

## Environment

### *Dr. Lucio C. Tan Legacy Forest Project*

Launched in 2014, the Dr. Lucio D. Tan Legacy Forest Project has a goal of planting 15 million trees. As of 2016, over 725,000 seedlings have been planted covering around 500 hectares in the provinces of Nueva Ecija, Quezon, and Laguna. A new seedling nursery has also been set up in Nueva Vizcaya.

Aside from providing local residents work opportunities in the seedling nurseries, the Foundation also gives them the opportunity to be employed as forest caretakers.

The Legacy project team also oversees the protection of 285 hectares of a natural bio-diverse forest which is home to a variety of rare plants and wildlife.

## ASIA BREWERY, INC.


*LT Group Chairman Dr. Lucio C. Tan (3rd from left) presents a Php2 Million check from Cobra Energy Drink to the HERO Foundation through its president Bernard Vincent Dy (4th from left). The donation is in support of the HERO Foundation's educational assistance program for orphaned children and siblings of soldiers killed in action or incapacitated in the line of duty. Also in photo are (from left) HERO Foundation trustee Aniceto Bisnar Jr., executive director ret. Maj. Gen. Victor Bayani, Basic Holdings president ret. Lt. Gen. Salvador Mison and Asia Brewery Inc. chief operating officer and HERO Foundation trustee Michael G. Tan.*

Asia Brewery, Inc. (ABI) implemented a number of corporate social responsibility initiatives in 2016 including social and environmental projects.

### *Blood Donation Drive*

In October 2016, ABI, in cooperation with the Philippine Red Cross, conducted a blood donation drive in its office in Cabuyao, Laguna. Of the 117 volunteers, 87 qualified as donors. The blood donation drive is a semi-annual commitment of ABI employees.

### *On-the-Job Training*

In September 2016, the Company commenced an 18-month Dualtech On-the-Job Trainee Tie-Up that enables participants to acquire skills that will help them get employed. The program covers basic training on electrical, electronics, and mechanical technology, followed by the Dualtech Training System.

This enables the scholars to undergo actual hands-on training across the diverse technical fields within ABI's plants and workshops. The Company is committed to providing training supervision, financial subsidies, and employment or referrals for the program's graduates. At present, ABI employs 20 graduates of the program across its various business units.


### *A Clean Environment is Clean Business*

Throughout 2016, ABI participated in various environmental clean-up drives.

On March 23, the Pampanga plant of ABI subsidiary, Interbev Philippines, Incorporated (IPI) launched the Adopt-an-Estero Program for Sapang Matua Creek in San Fernando.

Together with local residents and the Department of Environment and Natural Resources - Environmental Management Bureau (DENR-EMB), IPI Pampanga monitors the cleanliness of the area as well as the water quality of the creek that serves as the discharge point of the plant's water treatment facility.

On August 2, ABI, together with the local government of the City of Cabuyao, conducted a coastal clean-up of the Mamatid Lakeshore.

In October, another ABI subsidiary, Waterich Resources Corporation (WRC) introduced a monthly clean-up drive for ABI's Cabuyao complex.

***Tree Planting***

To celebrate the plant's anniversary, ABI subsidiary Interbev Philippines, Incorporated (IPI) sponsored a tree planting activity, IPInunla, at Eton Tierra Bella on May 30, 2016. This is part of ABI and its subsidiaries' annual participation in tree planting.

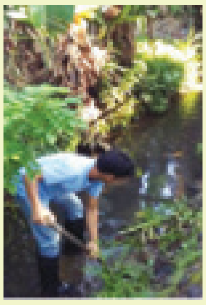
## TANDUAY DISTILLERS, INC.


***Multi-Sectoral Lakeshore Clean-up***

Tanduay Distillers, Inc. (TDI) employees from the Cabuyao, Laguna plant participated in the Multi-Sectoral Lakeshore Clean-Up of the Laguna Lake on August 2, 2016 as part of the 4th anniversary of the Cityhood of Cabuyao. TDI provided empty sacks for the collection of garbage along the lakeshore in Barangay Mamatid.

***Tree-Planting Project at Casile National High School***

On August 3, 2016, TDI employees participated in the tree planting activity at Casile National High School in Cabuyao, Laguna. Other participants were from the local government and the academe.



***National Clean-Up Day or "Bayan ko, Linis ko" at the Cabungan-an Creek***

TDI employees from Negros province joined the National Clean-up Day on September 18, 2016. They cleaned the Cabungan-an Creek as part of TDI's Adopt-an-Estero Project. Employees cleaned up the creek near the perimeter fence of the plant.

***Donation of Garbage Cans to DENR-NIR***

In March 2016, TDI donated twelve color-coded garbage cans from recycled drums to the Department of Environment and Natural Resources (DENR) in the Negros Island Region (NIR).

In March, TDI participated in the observance of the Fire Prevention Month with the donation of 15 empty plastic drums to the Philippine National Police (PNP) -Firearms and Explosives Section at Camp Alagar, Cagayan de Oro City, Misamis Oriental

## PMFTC INC.

***School Supplies for Indigenous Community in Dingalan, Aurora***

PMFTC, together with the Rotary Club of Downtown Olongapo and the Jaime V. Ongpin Foundation, Inc. provided school supplies and personal hygiene kits to 137 school children of Singawan Elementary School in Barangay Umiray, Dingalan, Aurora. Sitio Singawan is the farthest coastal village nestled within the Sierra Madre mountain range that separates Dingalan, Aurora and General Nakar, Quezon.

***Habitat for Humanity***

Armed with buckets of paint, brushes, and plenty of energy, around 100 PMFTC volunteers trooped to Barangay Pinagbuhatan in Pasig City to help some 60 indigent families repaint their units at a four-story residential building project of the Habitat for Humanity.

The activity was part of PMFTC's celebration of the International Women's Month in March. Donning their purple shirts as a sign of support to the global campaign on women empowerment, employees joined the residents and painted the homes to enliven them with colors. "In our culture, homes are usually entrusted to mothers. PMFTC believes that by making homes beautiful and our communities clean, it will allow mothers to radiate their light to their families even more. We pay tribute to the mothers by brightening up the community," said External Affairs Director Bayen Elero-Tinga, who is also the head of PMFTC's Diversity and Inclusion (D&I) program. "In the long term, when families see themselves living in clean and bright homes, it will uplift their spirits. That is definitely going to have a positive impact in the society," Bayen added.

***PMFTC Leadership Camp***

The Leadership Camp is a distinct PMFTC program that provides a blended learning experience for the Company's "leaders." There were 26 participants from different departments in the Company for the third annual Leadership Camp.

Activities for the leadership camp included refurbishing classrooms of Ane-I Elementary School in Claveria, Misamis Oriental. Aside from working on the classrooms, participants were given the opportunity to interact with the kids and the rest of the local community in activities such as reading, public speaking and a mini sports clinic.

## PHILIPPINE NATIONAL BANK

### *Education: Creating Shared Value through Youth Empowerment*

The Philippine National Bank (PNB) and ABS-CBN Lingkod Kapamilya Foundation, Inc. (ALKFI) have joined hands for a financial literacy program titled "Young and Empowered Students for the Philippines" or YESPh.

The move is in line with the Bangko Sentral ng Pilipinas' (BSP) aim to promote financial discipline and to involve the banking industry in instilling basic financial knowledge especially among the Filipino youth.

The program seeks to educate Filipino students on the importance of savings, budgeting, and money management.

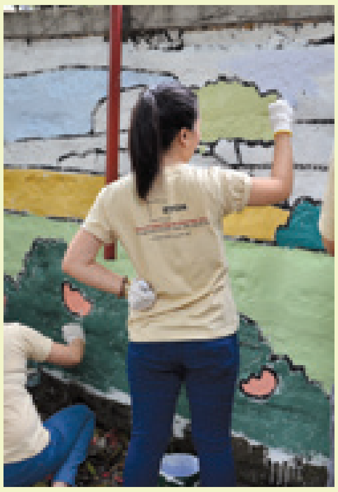
PNB and ALKFI officially launched YESPh in a three-day financial literacy training program, held from November 26 to 28, 2015. The participants were 40 student leaders, 42 teachers, and 24 PNB branch managers from different parts of the country. It was held at the Hive Hotel in Quezon City. The participants engaged in leadership workshops and learned tips and strategies on good money management.

YESPh widens its reach as the students, in close collaboration with the participating PNB branches, are encouraged to share what they have learned with their schoolmates and members of their communities.

As a pilot project, YESPh was cascaded to at least 10 schools nationwide from December 2015 to March

2016. Through the collaborative efforts of PNB and the BSP, YESPh was able to reach over 10,800 students. Through YESPh, PNB aspires to develop future leaders and influencers to help achieve a financially literate population.

## ETON PROPERTIES PHILIPPINES, INC.



### *Eton Brings Smiles to Asilo Kids*

Eton, in partnership with Hands on Manila, mobilized its employees for an outreach program in Asilo de San Vicente de Paul, an orphanage. Volunteers from the Company painted wall murals and refurbished the compound's umbrella sheds used by the children as study areas.

Afterwards, employees handed over gift bags to the children in a simple turnover ceremony.

A meaningful segment of the activity involved quality time spent with the children as volunteers partnered with the kids to talk and bond with them.

The outreach activity was fruitful and rewarding for both the volunteers and the children. For the volunteers, it was a great opportunity to share their energy and talent to the community and their time with the children. For the children, it was evident in their smiles and laughter that they truly appreciated this endeavour.

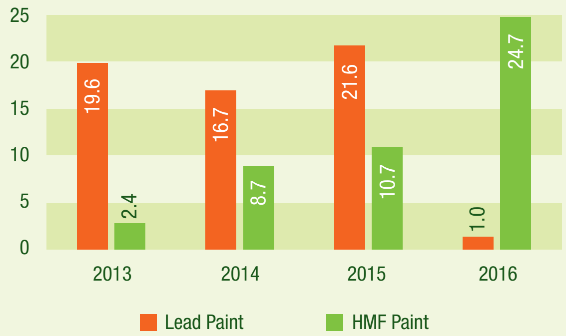
## ASIA BREWERY, INC.

### *Glass Plant Shifts to Heavy Metal Free Applied Color Label Paints*

Asia Brewery, Inc.'s (ABI) glass plant shifted to Heavy Metal Free (HMF) Applied Color Label (ACL) paints in 2014, with the target of fully eliminating leaded paints by 2019. ABI, however, was able to eliminate lead paints by May 2016, more than three years ahead of schedule.

ABI initially used the non-leaded paint for Cobra bottles. Currently, all bottles are painted with HMF ACL paints, including Vitamilk bottles and those for external customers.

**Lead and HMF Paint Usage**
(in Thousand Kilograms)




### *Improvements in Waste Water Treatment*

With its environmental programs, ABI shares with the interconnected global community its commitment of creating a sustainable world as it replaces wasteful methods with more efficient ones in its wastewater treatment operations.

From 2009, the acid dosing step in ABI's treatment plant was already replaced with neutralization via the mixing of low and high pH wastewater streams, saving more than 30 tons of hydrochloric acid (HCl) usage per year, and eliminating the hazard of corrosive chemicals to facility personnel.

Similarly, from October 2015 to present, the annual diammonium phosphate (DAP) consumption was cut down by more than 40% (versus the rest of 2015), resulting in faster sludge settling and minimal algal growth.

Unwanted algal bloom, triggered by uncontrollably high levels of DAP in bodies of water, proves suffocating to the fishes as it steals oxygen from water. Thus, ABI's initiative in minimizing DAP usage significantly contributes to the drop in algal bloom occurrence, and in turn, saves aquatic life.

In addition to these initiatives, through the first half of 2016, ABI's exploration on lessening the number of operated aerators and their working time gave birth to a new aeration scheme which led to the reduction in the monthly power consumption of the treatment facilities by more than 20% compared to 2015.

For 2017, the Company is looking into further optimizations of the treatment process – water recycling, methane gas collection, and reengineering aerators into bubble diffusers.

Besides generating savings, these optimizations have reduced the chemical and carbon footprints of the wastewater treatment process without compromising the compliance of the Company's effluent discharge with the standards of the Department of Environment and Natural Resources (DENR). These process optimizations are concrete examples ~~on~~ of how ABI seriously stands by the global community in its efforts to bring the environment toward a future of sustainable development.

## TANDUAY DISTILLERS, INC.

### *Solar Farm*

Tanduay Distillers, Inc. (TDI) subsidiary, Absolut Distillers, Inc., inaugurated its two megawatt solar generating facility in 2015. It sold 1.99 million kilowatt hours to the National Transmission Corporation in 2016.

### *Bioethanol Fuel*

In 2016, TDI started producing ethenol which was sold to major oil companies as a component of the gasoline sold to the public. It sold 38 million liters of ethanol during the year.

Republic Act 9367 or the Biofuels Act of 2006 requires oil companies to use locally-sourced biofuels from Department of Energy accredited producers as a component of the liquid fuels for motors and engines sold in the Philippines. In 2011, the mandated blend went up to 10%.

### *Wastewater Treatment*

TDI's aim is to operate a "zero wastewater" scheme by providing alternative and productive uses of its wastewater, and eliminating the need to dispose this in bodies of water. This also involves the reduction of greenhouse gases with the reduction in the emissions emanating from the existing water treatment facility.

The Company partnered with University of the Philippines' National Institute of Molecular Biology and Biotechnology (BIOTECH) to determine whether distillery effluent could be used as organic fertilizer for sugarcane. The study proved that distillery effluent contains high levels of nutrients that improve soil conditions and subsequently increase sugarcane yield.

In 2000, TDI was the first distillery to be recognized, registered and licensed by the Fertilizer and Pesticide Authority to use slops as fertilizer. In 2016, it produced 332 thousand metric tons of fertilizer that was given for free to farmers in the municipalities of Lian, Nasugbu, Calatagan, Tuy and Balayan in Batangas.

## SUSTAINABILITY

### PMFTC INC.

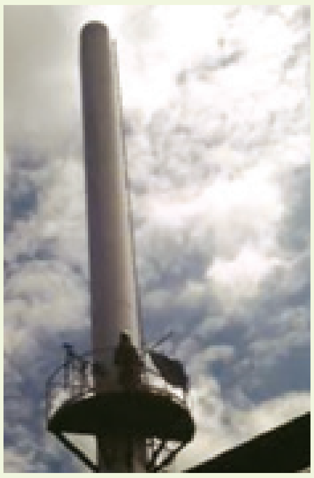
PMFTC has embarked on a number of sustainability initiatives to reduce carbon footprint as part of its commitment to promote sustainability and reduce the environmental impact of day-to-day activities.

The Company focuses on reducing its energy usage and CO2 emissions through lighting automation, installation of solar heaters and air-conditioning units, replacement of metal halide lamps with light-emitting diode (LED) lights, rehabilitation of cooling systems, replacement of disposal plastic bags with recyclable bags, composting of waste and sludge and coffee grinds, and energy recovery from waste instead of disposing in landfills.

To support environmentally responsible tobacco production and energy conservation, PMFTC provides tobacco farmers with self-sufficient and sustainably-sourced wood fuel for tobacco curing.

***Reducing CO2 Emission of Broilers***

In 2016, the Company achieved an 11.3% reduction in the consumption of coal in the its Vigan facility by mixing dust to with the fuel used by the broilers.



***Lighting Automation***

Lighting Height Adjustment and Replacement with compact fluorescent lamp (CFL) and LED lights.

***Solar Tubes***

In 2016, PMFTC reduced its electricity consumption in Vigan by 1.3% with the replacement of 408 units of conventional fluorescent bulb with solar tubes or tubes that use natural light from the sun.

***Upgrade of Curing Barns***

PMFTC converted old furnaces to the Venturi design, replaced heating pipes, and provided farmers with better insulation materials, making these curing barns at least 20% more efficient in terms of wood fuel consumption.

***Energy Recovery from Waste***
Bureau of Internal Revenue (BIR) regulated waste used as fuel in cement kilns instead of disposing at the landfill.

***Good Agricultural Practices Roadshow: Bringing Learning Closer to Farmers***
PMFTC's Leaf Operations Division kicked off the Good Agricultural Practices (GAP) Roadshow in the town of Claveria, Misamis Oriental.

The roadshow aims to reach tobacco growers in the most far-flung areas and share with them farm practices geared toward improving the yield and quality of their crop.

The learning takes place at the village level. The farmers' capacity and agronomic skills are built by giving them specific examples and experiential learning.

As the United Nations' Food and Agriculture Organization stated, dramatic changes are taking place in farming communities worldwide as a result of globalization and liberalization. Because of these rapid changes, technical know-how is no longer enough. Farmers increasingly have to adapt to market changes to improve efficiency, profitability and income.

PMFTC is committed to help farmers achieve sustainable farming by helping them access these practical learnings.

The GAP Roadshow consists of two parts. The first part is a lecture on basic guidelines on tobacco growing: fertilization, field practices, integrated pest management, and achieving crop quality. The second part is sustainable and responsible farming through open forums on key concepts related to Agricultural Labor Practices (ALP) which include the prevention of child labor, ensuring fair and safe working conditions for farm workers, farmers and everyone else in the farm.

LT GROUP, INC.

# 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 including the schedules attached therein, for each of the three years ended December 31, 2016, in accordance with the prescribed financial reporting framework indicated therein, and for such internal control as management determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

The Board of Directors is responsible for overseeing the Company's financial reporting process.

The Board of Directors reviews and approves the consolidated financial statements including the schedules attached therein, and submits the same to the stockholders or members.

SyCip Gorres Velayo & Co., the independent auditor appointed by the stockholders, has audited the consolidated financial statements of the company in accordance with Philippine Standards on Auditing, and in its report to the stockholders or members, has expressed its opinion on the fairness of presentation upon completion of such audit.

Signed under oath by the following:

Lucio C. Tan
Chairman and Chief Executive Officer

Michael G. Tan
President

Jose Gabriel D. Olives
Chief Financial Officer

Signed this 14th day of March 2017

# INDEPENDENT AUDITOR'S REPORT

SGV
Building a better working world

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

Tel: (632) 891 0307
Fax: (632) 819 0872
ey.com/ph

BOA/PRC Reg. No. 0001,
December 14, 2015, valid until December 31, 2018
SEC Accreditation No. 0012-FR-4 (Group A),
November 10, 2015, valid until November 9, 2018

The Board of Directors and Stockholders
LT Group, Inc.

**Opinion**

We have audited the consolidated financial statements of LT Group, Inc. (a subsidiary of Tangent Holdings Corporation) and its subsidiaries (the Group), which comprise the consolidated balance sheets as at December 31, 2016 and 2015, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2016, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2016 and 2015, and its consolidated financial performance and its consolidated cash flows for each of the three years in the period ended December 31, 2016 in accordance with Philippine Financial Reporting Standards (PFRSs).

**Basis for Opinion**

We conducted our audits in accordance with Philippine Standards on Auditing (PSAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the Code of Ethics for Professional Accountants in the Philippines (Code of Ethics) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Philippines, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

***Accounting for the disposal of Allianz-PNB Life Insurance, Inc. (APLII) and the remaining interest in APLII***

In 2016, the Group's subsidiary, Philippine National Bank (PNB), completed the sale of its 51% ownership interest in APLII for a consideration amounting to US$66.0 million (P3.1 billion). Pursuant to the sale of APLII, PNB also entered into a distribution agreement with APLII where PNB will allow APLII to have exclusive access to the distribution network of PNB and its subsidiary, PNB Savings Bank, for over a period of 15 years (the Exclusive Distribution Rights). Both the share purchase agreement and the distribution agreement have provisions referring to one another, making the distribution agreement an integral component of the sale transaction. Accordingly, the purchase consideration of US$66.0 million (P3.1 billion) was allocated between the 51% ownership interest in APLII and the Exclusive Distribution Rights. The sale of the 51% ownership interest in APLII resulted in the loss of control of PNB. Under PFRSs, PNB is required to remeasure the remaining interest in APLII to its fair value at date of disposal. The accounting for the disposal of 51% ownership interest in APLII and the remaining interest in APLII is significant to our audit because of the amounts involved in the transaction and the significant judgment of the management for the valuation of the 51% interest in APLII, the Exclusive Distribution Rights and the remaining interest in APLII. PNB engaged a third party valuer in determining the fair values of the shares of APLII and the Exclusive Distribution Rights. The disclosures related to the disposal of APLII are included in Notes 11 and 37 to the consolidated financial statements.

*Audit Response*

We read the key agreements related to the disposal of APLII, that is, the share purchase agreement and the distribution agreement. Likewise, we also reviewed the accounting for the consideration received and the allocation made between the 51% interest in APLII and the Exclusive Distribution Rights. We considered the competence, capabilities and objectivity of the valuer engaged by PNB to perform the valuation. We performed an understanding of the valuation techniques used by the valuer. We involved our internal specialist to assist us in evaluating the valuation methodology and the data and valuation multiples used by the third party valuer. For key assumptions related to the valuation of the 51% ownership interest in APLII, we compared the data and the valuation multiples used to available market or industry data. We also compared the discount rate and growth rate used on future cash flows to publicly available data on market participants that are comparable to the business of APLII. For key assumptions related to the valuation of the Exclusive Distribution Rights, we compared the data and valuation multiples, that is, number of customers and number of branches used in the valuation to available market or industry data and to the internal data of PNB.

***Adequacy of allowance for credit losses of loans and receivables***

The Group's loans and receivables from PNB are significant as they represent 24% of the total assets of the Group. The Group determines the allowance for credit losses on individual basis for individually significant loans and receivables, and collectively, for loans and receivables that are not individually significant such as consumer loans and credit card receivables. We considered the impairment of loans and receivables as a key audit matter because it involves significant management judgment in determining the allowance for credit losses. The determination of the recoverable amount of loans and receivables involves various assumptions and factors including the financial condition of the borrower, timing of expected future cash flows, probability of collections, observable market prices and expected net selling prices of the collateral. The disclosures related to allowance for credit losses on loans and receivables are included in Notes 3 and 8 to the consolidated financial statements.

*Audit Response*

We obtained an understanding of the specific and collective impairment process and tested the related controls over impairment data and calculations. For loans and receivables subjected to specific impairment test, we obtained an understanding of the basis for measuring the impairment. We selected samples of individually impaired loans and inquired of the latest developments about the borrowers. We tested the key inputs to the impairment calculation by assessing whether the forecasted cash flows are based on the borrower's current financial condition; inspecting recent appraisal reports to determine the fair value of collateral held; and checking whether the discount rates used are based on the original effective interest rate or the last repriced rate. For loans and receivables subjected to collective impairment test, we tested inputs in the historical loss and net flow rate models, such as, for consumer loans, agreeing the past due aging reports per consumer loan product type while for business loans, agreeing the groupings of business loans based on their internal credit risk ratings to the Group's records and subsidiary ledgers. We examined whether the assumptions and parameters in the collective impairment calculation, such as historical losses of default and recovery rate, are based on historical data. We also reperformed the calculation of historical loss rates.

***Valuation of net retirement benefits liability***

The Group has defined benefit retirement plans covering all of its permanent employees. We consider this as a key audit matter because the valuation of the benefits liability involves a significant level of management judgment. The valuation also requires the assistance of an external actuary whose calculation involves the use of certain assumptions, such as prospective salary increases, employee turnover rates, and discount rates that could have a material impact on the valuation of the benefits expense and liability. The relevant disclosures are included in Note 23 to the consolidated financial statements.

*Audit Response*

We involved our internal specialist in the review of the scope, bases, methodology and results of the work by PNB's external actuary. We also considered the internal specialist's professional qualifications and objectivity. We evaluated the key assumptions used by comparing the employee demographics and attrition rate against PNB's human resources data, and the discount rate and mortality rate against available market data. We inquired from PNB's management about the basis of the salary rate increase and compared it against PNB's forecast and available market data. Further, we compared the fair value of the retirement plan assets to market price information.

**Other Information**

Management is responsible for the other information. The other information comprises the information included in the SEC Form 20-IS (Definitive Information Statement), SEC Form 17-A and Annual Report for the year ended December 31, 2016, but does not include the consolidated financial statements and our auditor's report thereon. The SEC Form 20-IS (Definitive Information Statement), SEC Form 17-A and Annual Report for the year ended December 31, 2016 are expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audits of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audits, or otherwise appears to be materially misstated.

**Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with PFRSs, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with PSAs will always detect a material misstatement when it exists.
Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with PSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern.

  If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Martin C. Guantes.

**SYCIP GORRES VELAYO & CO.**

Martin C. Guantes
Partner
CPA Certificate No. 88494
SEC Accreditation No. 0325-AR-3 (Group A),
August 25, 2015, valid until August 24, 2018
Tax Identification No. 152-884-272
BIR Accreditation No. 08-001998-52-2015,
February 27, 2015, valid until February 26, 2018
PTR No. 5908704, January 3, 2017, Makati City

March 14, 2017

**LT GROUP, INC.**
(A Subsidiary of Tangent Holdings Corporation)
**AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
(Amounts in Thousands)

| | December 31 | |
|---|---|---|
| | **2016** | 2015 |
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents (Note 5) | **P174,676,789** | P137,556,341 |
| Financial assets at fair value through profit or loss (Notes 6 and 21) | **6,441,511** | 9,663,734 |
| Available-for-sale investments (Notes 7 and 17) | **8,473,221** | 2,915,170 |
| Loans and receivables (Notes 8 and 17) | **189,812,938** | 172,140,625 |
| Due from related parties (Note 22) | **1,922,467** | 1,593,034 |
| Inventories (Note 9) | **12,849,799** | 14,024,047 |
| Other current assets (Note 10) | **10,600,399** | 8,841,923 |
| | **404,777,124** | 346,734,874 |
| Assets of disposal group classified as held for sale (Note 37) | **–** | 23,526,757 |
| **Total Current Assets** | **404,777,124** | 370,261,631 |
| **Noncurrent Assets** | | |
| Loans and receivables - net of current portion (Notes 8 and 17) | **248,621,351** | 206,782,709 |
| AFS investments (Notes 7 and 17) | **60,128,678** | 66,649,517 |
| Held-to-maturity investments (Notes 7 and 10) | **24,102,594** | 23,096,473 |
| Investments in associates and joint ventures (Note 11) | **16,817,351** | 11,761,290 |
| Property, plant and equipment (Note 12): | | |
| At appraised values | **36,104,048** | 39,538,145 |
| At cost | **5,170,574** | 5,299,731 |
| Investment properties (Note 13) | **28,217,373** | 22,231,525 |
| Deferred income tax assets - net (Note 29) | **1,424,159** | 551,237 |
| Other noncurrent assets (Note 14) | **3,727,772** | 3,380,244 |
| **Total Noncurrent Assets** | **424,313,900** | 379,290,871 |
| **TOTAL ASSETS** | **P829,091,024** | P749,552,502 |

| | | |
|---|---|---|
| **LIABILITIES AND EQUITY** | | |
| **Current Liabilities** | | |
| Deposit liabilities (Note 15) | **P515,554,099** | P436,362,854 |
| Financial liabilities at fair value through profit or loss (Notes 16 and 21) | **232,832** | 126,075 |
| Bills and acceptances payable (Note 17) | **25,068,268** | 5,836,839 |
| Accounts payable and accrued expenses (Note 18) | **17,291,277** | 17,079,820 |
| Income tax payable | **282,025** | 294,581 |
| Short-term debts (Note 19) | **1,750,000** | 1,400,000 |
| Current portion of long-term debts (Note 19) | **466,946** | 476,015 |
| Due to related parties (Note 22) | **57,054** | 46,770 |
| Other current liabilities (Notes 20 and 38) | **17,364,001** | 13,249,643 |
| | **578,066,502** | 474,872,597 |
| Liabilities of disposal group classified as held for sale (Note 37) | **–** | 21,452,621 |
| **Total Current Liabilities (Carried Forward)** | **578,066,502** | 496,325,218 |

| | December 31 | |
|---|---|---|
| | **2016** | 2015 |
| **Total Current Liabilities (Brought Forward)** | **P578,066,502** | P496,325,218 |
| **Noncurrent Liabilities** | | |
| Deposit liabilities - net of current portion (Note 15) | **45,866,133** | 39,793,338 |
| Financial liabilities at fair value through profit or loss (Notes 16 and 21) | **–** | 9,118 |
| Bills and acceptances payable (Note 17) | **10,817,679** | 19,915,383 |
| Long-term debts - net of current portion (Note 19) | **5,101,801** | 10,706,431 |
| Net retirement benefits liability (Note 23) | **3,899,342** | 3,900,926 |
| Deferred income tax liabilities-net (Note 29) | **1,323,121** | 1,182,976 |
| Other noncurrent liabilities (Note 20) | **5,411,870** | 7,961,017 |
| **Total Noncurrent Liabilities** | **72,419,946** | 83,469,189 |
| **Total Liabilities** | **650,486,448** | 579,794,407 |
| **Equity** | | |
| Attributable to equity holders of the Company (Notes 1, 7, 12, 23, 24, 30 and 36): | | |
| Capital stock | **10,821,389** | 10,821,389 |
| Capital in excess of par | **35,906,231** | 35,906,231 |
| Preferred shares of subsidiaries issued to Parent Company | **18,060,000** | 18,060,000 |
| Other equity reserves | **804,095** | 804,095 |
| Reserves of disposal group classified as held for sale (Note 37) | **–** | 335,000 |
| Other comprehensive income, net of deferred income tax effect | **1,878,006** | 3,116,572 |
| Retained earnings | **68,640,783** | 59,855,195 |
| Shares of stock of the Company held by subsidiaries | **(12,519)** | (22,464) |
| | **136,097,985** | 128,876,018 |
| Non-controlling interests (Notes 1, 7, 12 and 30) | **42,506,591** | 40,882,077 |
| **Total Equity** | **178,604,576** | 169,758,095 |
| **TOTAL LIABILITIES AND EQUITY** | **P829,091,024** | P749,552,502 |

*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 | | |
|---|---|---|---|
| | **2016** | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
| **REVENUE** (Note 24) | | | |
| Banking | **P29,111,818** | P26,600,160 | P24,210,181 |
| Beverage | **10,932,326** | 10,386,308 | 9,877,681 |
| Distilled spirits | **14,904,343** | 12,002,266 | 11,919,131 |
| Property development | **2,851,514** | 2,484,453 | 2,278,600 |
| | **57,800,001** | 51,473,187 | 48,285,593 |
| **COST OF SALES AND SERVICES** (Note 24) | **26,126,881** | 22,002,882 | 21,632,083 |
| **GROSS INCOME** | **31,673,120** | 29,470,305 | 26,653,510 |
| **EQUITY IN NET EARNINGS OF ASSOCIATES** (Note 11) | **2,711,540** | 1,188,974 | 894,555 |
| | **34,384,660** | 30,659,279 | 27,548,065 |
| **OPERATING EXPENSES** | | | |
| Selling expenses (Note 25) | **2,351,522** | 2,202,441 | 2,398,394 |
| General and administrative expenses (Note 26) | **25,563,084** | 21,156,533 | 20,994,127 |
| | **27,914,606** | 23,358,974 | 23,392,521 |
| **OPERATING INCOME** | **6,470,054** | 7,300,305 | 4,155,544 |
| **OTHER INCOME (CHARGES) - Net** | | | |
| Foreign exchange gains - net | **1,535,217** | 1,322,400 | 1,347,704 |
| Finance costs (Note 27) | **(202,490)** | (202,518) | (454,855) |
| Finance income (Note 27) | **106,426** | 110,376 | 119,041 |
| Others - net (Note 28) | **5,026,447** | 3,686,974 | 3,789,575 |
| | **6,465,600** | 4,917,232 | 4,801,465 |
| **INCOME BEFORE INCOME TAX** | **12,935,654** | 12,217,537 | 8,957,009 |
| **PROVISION FOR INCOME TAX** (Note 29) | | | |
| Current | **2,535,861** | 2,490,527 | 2,266,825 |
| Deferred | **(361,393)** | 238,292 | 409,818 |
| | **2,174,468** | 2,728,819 | 2,676,643 |
| **NET INCOME FROM CONTINUING OPERATIONS** | **10,761,186** | 9,488,718 | 6,280,366 |
| **NET INCOME FROM DISCONTINUED OPERATIONS** (Note 37) | **1,327,970** | 7,936 | 191,840 |
| **NET INCOME** | **P12,089,156** | P9,496,654 | P6,472,206 |
| **NET INCOME ATTRIBUTABLE TO:** | | | |
| Equity holders of the Company | **P9,390,407** | P6,599,035 | P4,410,230 |
| Non-controlling interests | **2,698,749** | 2,897,619 | 2,061,976 |
| | **P12,089,156** | P9,496,654 | P6,472,206 |
| **Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Company** (Note 31) | **P0.87** | P0.61 | P0.41 |
| **Basic/Diluted Earnings Per Share Attributable to Equity Holders of the Company from Continuing Operations** (Note 31) | **P0.86** | P0.58 | P0.39 |

*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 | | |
|---|---|---|---|
| | **2016** | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
| **NET INCOME** | **P12,089,156** | P9,496,654 | P6,472,206 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | | |
| *Other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods:* | | | |
| Net changes in fair value of AFS investments (Note 7) | **(723,853)** | (1,098,424) | 551,055 |
| Income tax effect | **8,686** | 3,311 | 1,383 |
| | **(715,167)** | (1,095,113) | 552,438 |
| Translation adjustments | **302,754** | 662,775 | (275,448) |
| Net other comprehensive income (loss) to be reclassified to profit or loss in subsequent periods | **(412,413)** | (432,338) | 276,990 |
| *Other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods:* | | | |
| Re-measurement gains on defined benefit plans (Note 23) | **(423,766)** | (50,010) | (1,047,515) |
| Income tax effect | **20,179** | 7,679 | (53,628) |
| | **(403,587)** | (42,331) | (1,101,143) |
| Share in re-measurement gain on defined benefit plans of an associate (Note 11) | **63,642** | – | – |
| Revaluation increment (decrement) on property, plant and equipment (Note 12) | **390,727** | (518,611) | – |
| Income tax effect | **(117,218)** | 158,448 | – |
| | **273,509** | (360,163) | – |
| Net other comprehensive income (loss) not to be reclassified to profit or loss in subsequent periods | **(66,436)** | (402,494) | (1,101,143) |
| **OTHER COMPREHENSIVE LOSS, NET OF TAX** | **(478,849)** | (834,832) | (824,153) |
| **TOTAL COMPREHENSIVE INCOME** | **P11,610,307** | P8,661,822 | P5,648,053 |
| **TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO:** | | | |
| Equity holders of the Company | **P9,170,228** | P6,266,724 | P3,816,532 |
| Non-controlling interests | **2,440,079** | 2,395,098 | 1,831,521 |
| | **P11,610,307** | P8,661,822 | P5,648,053 |

*See accompanying Notes to Consolidated Financial Statements.*

**LT GROUP, INC.**
(A Subsidiary of Tangent Holdings Corporation)
**AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

**FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 and 2014**
(Amounts in Thousands)

| | Attributable to Equity Holders of the Company (Notes 1, 7, 12, 24, 30 and 36) | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Other Comprehensive Income (Loss) | | | | | | | | | | | |
| | Capital Stock | Capital in Excess of Par | Deposit for Future Stock Subscription | Preferred Shares of Subsidiaries Issued to Parent Company | Other Equity Reserves | Reserves of Disposal Group Classified as Held for Sale | Cumulative Translation Adjustments | Net Changes in AFS Investments (Note 7) | Re-Measurement Gains (Losses) on Defined Benefit Plans (Note 23) | Revaluation Increment on Property Plant and Equipment (Note 12) | Revaluation Increment on Property Plant and Equipment Transferred to Associate (Notes 2, 11 and 12) | Re-measurement Gains on Defined Benefit Plans of an Associate (Note 11) | Total Other Comprehensive Income (Loss), Net of Deferred Income Tax Effect | Retained Earnings | Shares of Stock of the Company Held by Subsidiaries | Total | Non-controlling Interests (Notes 1, 7, 12 and 30) | Total |
| **BALANCES AT DECEMBER 31, 2013** | **P10,821,389** | **P35,906,231** | **P6,048,534** | **P7,405,000** | **P790,136** | **P–** | **P299,243** | **(P875,973)** | **(P823,855)** | **P6,378,188** | **P1,065,858** | **P27,338** | **P6,070,799** | **P50,505,944** | **(P12,518)** | **P117,535,515** | **P32,235,085** | **P149,770,600** |
| Net income for the year | – | – | – | – | – | – | – | – | – | – | – | – | – | 4,410,230 | – | 4,410,230 | 2,061,976 | 6,472,206 |
| Other comprehensive income (loss) | – | – | – | – | – | – | (155,545) | 125,559 | (563,712) | – | – | – | (593,698) | – | – | (593,698) | (230,455) | (824,153) |
| Total comprehensive income (loss) for the year | – | – | – | – | – | – | (155,545) | 125,559 | (563,712) | – | – | – | (593,698) | 4,410,230 | – | 3,816,532 | 1,831,521 | 5,648,053 |
| Issuance of preferred shares of subsidiaries | – | – | (6,048,534) | 10,655,000 | – | – | – | – | – | – | – | – | – | – | – | 4,606,466 | – | 4,606,466 |
| Capital contribution of non-controlling interest | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – | – | 4,427,697 | 4,427,697 |
| Cash dividends declared | – | – | – | – | – | – | – | – | – | – | – | – | – | (1,730,622) | – | (1,730,622) | – | (1,730,622) |
| Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal | – | – | – | – | – | – | – | – | – | (596,649) | (297,785) | – | (894,434) | 894,434 | – | – | – | – |
| **BALANCES AT DECEMBER 31, 2014** | **10,821,389** | **35,906,231** | **–** | **18,060,000** | **790,136** | **–** | **143,698** | **(750,414)** | **(1,387,567)** | **5,781,539** | **768,073** | **27,338** | **4,582,667** | **54,079,986** | **(12,518)** | **124,227,891** | **38,494,303** | **162,722,194** |
| Net income for the year | – | – | – | – | – | – | – | – | – | – | – | – | – | 6,599,035 | – | 6,599,035 | 2,897,619 | 9,496,654 |
| Other comprehensive income (loss) | – | – | – | – | – | – | 379,660 | (348,779) | (3,029) | (360,163) | – | – | (332,311) | – | – | (332,311) | (502,521) | (834,832) |
| Total comprehensive income (loss) for the year | – | – | – | – | – | – | 379,660 | (348,779) | (3,029) | (360,163) | – | – | (332,311) | 6,599,035 | – | 6,266,724 | 2,395,098 | 8,661,822 |
| Stock issue cost | – | – | – | – | – | – | – | – | – | – | – | – | – | (213) | – | (213) | – | (213) |
| Acquisition of shares of subsidiaries from the Controlling Shareholders | – | – | – | – | 14,502 | – | – | – | – | – | – | – | – | – | – | 14,502 | – | 14,502 |
| Acquisition of non-controlling interest | – | – | – | – | (543) | – | – | – | – | – | – | – | – | – | – | (543) | – | (543) |
| Acquisition of shares by subsidiary | – | – | – | – | – | – | – | – | – | – | – | – | – | – | (9,946) | (9,946) | – | (9,946) |
| Cash dividends declared | – | – | – | – | – | – | – | – | – | – | – | – | – | (1,622,397) | – | (1,622,397) | (7,324) | (1,629,721) |
| Reserves disposal group classified as held for sale | – | – | – | – | – | 335,000 | – | (348,786) | 13,786 | – | – | – | (335,000) | – | – | – | – | – |
| Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal | – | – | – | – | – | – | – | – | – | (501,001) | (297,783) | – | (798,784) | 798,784 | – | – | – | – |
| **BALANCES AT DECEMBER 31, 2015 (CARRIED FORWARD)** | **10,821,389** | **35,906,231** | **–** | **18,060,000** | **804,095** | **335,000** | **523,358** | **(1,447,979)** | **(1,376,810)** | **4,920,375** | **470,290** | **P27,338** | **3,116,572** | **59,855,195** | **(22,464)** | **128,876,018** | **40,882,077** | **169,758,095** |

| | Capital Stock | Capital in Excess of Par | Deposits for Future Stock Subscription | Preferred Shares of Subsidiaries Issued to Parent Company | Other Equity Reserves | Reserves of Disposal Group Classified as Held for Sale | Cumulative Translation Adjustments | Net Changes in AFS Investments (Note 7) | Re-Measurement Gains (Losses) on Defined Benefit Plans (Note 23) | Revaluation Increment on Property Plant and Equipment (Note 12) | Revaluation Increment on Property Plant and Equipment Transferred to Associate (Notes 2, 11 and 12) | Re-measurement Gains on Defined Benefit Plans of an Associate (Note 11) | Total Other Comprehensive Income (Loss), Net of Deferred Income Tax Effect | Retained Earnings | Shares of stock of the Company Held by Subsidiaries | Total | Non-controlling Interests (Notes 1, 7, 12 and 30) | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Attributable to Equity Holders of the Company (Notes 1, 7, 12, 24, 30 and 36) | | | | | | | | | | | | | | | | | |
| | | | | | | | Other Comprehensive Income (Loss) | | | | | | | | | | | |
| **BALANCES AT DECEMBER 31, 2015 (BROUGHT FORWARD)** | **P10,821,389** | **P35,906,231** | **P–** | **P18,060,000** | **P804,095** | **P335,000** | **P523,358** | **(P1,447,979)** | **(P1,376,810)** | **P4,920,375** | **P470,290** | **P27,338** | **P3,116,572** | **P59,855,195** | **(P22,464)** | **P128,876,018** | **P40,882,077** | **P169,758,095** |
| Net income for the year | – | – | – | – | – | – | – | – | – | – | – | – | – | 9,390,407 | – | 9,390,407 | 2,698,749 | 12,089,156 |
| Other comprehensive income (loss) | – | – | – | – | – | – | 170,965 | (523,918) | (204,377) | 273,509 | – | 63,642 | (220,179) | – | – | (220,179) | (258,670) | (478,849) |
| Total comprehensive income (loss) for the year | – | – | – | – | – | – | 170,965 | (523,918) | (204,377) | 273,509 | – | 63,642 | (220,179) | 9,390,407 | – | 9,170,228 | 2,440,079 | 11,610,307 |
| Sale of disposal group | – | – | – | – | – | (335,000) | – | – | – | – | – | – | – | – | 9,945 | (325,055) | (271,814) | (596,869) |
| Cash dividends declared | – | – | – | – | – | – | – | – | – | – | – | – | – | (1,623,206) | – | (1,623,206) | (543,751) | (2,166,957) |
| Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal | – | – | – | – | – | – | – | – | – | (720,604) | (297,783) | – | (1,018,387) | 1,018,387 | – | – | – | – |
| **BALANCES AT DECEMBER 31, 2016** | **P10,821,389** | **P35,906,231** | **P–** | **P18,060,000** | **P804,095** | **P–** | **P694,323** | **(P1,971,897)** | **(P1,581,187)** | **P4,473,280** | **P172,507** | **P90,980** | **P1,878,006** | **P68,640,783** | **(P12,519)** | **P136,097,985** | **P42,506,591** | **P178,604,576** |

*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)

| | Years Ended December 31 | | |
|---|---|---|---|
| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37 |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Income before income tax from continuing operations | P12,935,654 | P12,217,537 | P8,957,009 |
| Income (loss) before income tax from discontinued operations (Note 37) | 1,385,397 | (97,757) | 204,015 |
| Income before income tax | 14,321,051 | 12,119,780 | 9,161,024 |
| Adjustments for: | | | |
| Depreciation and amortization (Notes 12, 13 and 14) | 3,657,358 | 3,452,518 | 3,554,992 |
| Provision for losses (Note 8) | 3,218,905 | 865,889 | 2,207,864 |
| Gain on disposal of: | | | |
| Other noncurrent assets (Notes 12, 13 and 28) | (1,823,200) | (1,562,020) | (1,889,744) |
| AFS investments (Notes 7 and 28) | – | (2,928) | (245,216) |
| Equity in net earnings of associates (Note 11) | (2,711,540) | (1,188,974) | (894,555) |
| Share in losses of joint venture (Notes 10 and 28) | 438,961 | 2,067 | 46,043 |
| Mark-to-market gain on financial assets at fair value through profit or loss (Note 28) | (62,955) | 42,383 | 32,351 |
| Gain on remeasurement of retained interest (Note 28) | (1,644,339) | – | – |
| Gain on sale of disposal group (Note 37) | (834,535) | – | – |
| Gain on investment in an associate arising from contribution of non-monetary assets (Note 28) | (1,056,240) | – | – |
| Gain on sale of brands (Note 37) | (46,300) | – | – |
| Finance costs (Note 27) | 202,490 | 202,518 | 454,855 |
| Finance income (Note 27) | (106,426) | (110,376) | (119,041) |
| Dividend income (Note 28) | (53,729) | (22,464) | (10,912) |
| Movement in accrued retirement benefits (Note 23) | (362,683) | 83,058 | 2,081,913 |
| Operating income before changes in working capital | 13,136,818 | 13,881,451 | 14,379,574 |
| Decrease (increase) in: | | | |
| Financial assets at fair value through profit or loss | 3,284,668 | (1,019,884) | (10,255,769) |
| Receivables | (64,624,296) | (49,118,548) | (44,955,219) |
| Inventories | 1,174,248 | (2,299,582) | (2,656,906) |
| Other current assets | (1,781,349) | (125,447) | (2,247,938) |
| Increase (decrease) in: | | | |
| Deposit liabilities | 85,264,040 | 41,296,083 | 8,718,031 |
| Financial liabilities at fair value through profit or loss | 97,639 | 2,956,106 | 2,787,130 |
| Accounts payable and accrued expenses | 211,457 | 1,515,018 | (4,285,023) |
| Other current and noncurrent liabilities | 2,984,382 | (2,337,872) | 3,752,493 |
| Cash generated from (used in) operations | 39,747,607 | 4,747,325 | (34,763,627) |
| Dividends received (Notes 11, 22 and 28) | 53,729 | 1,718,432 | 3,371,564 |
| Interest received | 106,426 | 94,872 | 143,541 |
| Interest paid | (202,490) | (202,518) | (454,855) |
| Income taxes paid, including creditable withholding and final taxes | (2,244,451) | (2,903,245) | (3,160,488) |
| Net cash from (used in) operating activities | 37,460,821 | 3,454,866 | (34,863,865) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Acquisition of: | | | |
| Held to maturity investments | (P937,948) | (P1,470,378) ) | (P571,602) |
| Investment properties (Note 13) | (6,246,875) | (540,417) | (2,608,825) |
| Property, plant and equipment (Note 12) | (2,028,339) | (5,036,289) | (2,534,580) |
| Software (Note 14) | (426,881) | (124,176) | (419,809) |
| AFS investments (Note 7) | – | (15,078,720) | (65,693,182) |
| Shares and convertible notes of an associate (Note 11) | – | – | (772,864) |
| Investment in a joint venture | 112,746 | – | – |
| Return of investment from a joint venture (Note 11) | – | 27,157 | – |
| Proceeds from sale of: | | | |
| Disposal group classified as held for sale (Note 37) | 3,050,850 | – | – |
| AFS investments (Note 7) | 247,621 | 1,502,928 | 63,499,326 |
| Other assets (Notes 12 and 13) | 3,504,533 | 8,320,764 | 2,434,543 |
| Advances extended to affiliates | (329,433) | – | – |
| Net cash from (used in) investing activities | (3,053,726) | (12,399,131) | (6,666,993) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from availment of: | | | |
| Short-term debts (Note 19) | 350,000 | 1,100,000 | – |
| Bill and acceptance payable (Note 17) | 10,133,725 | 6,702,164 | 2,000,841 |
| Long-term debts (Note 19) | 1,500,000 | – | 500,000 |
| Payments of: | | | |
| Long-term debts (Note 19) | (6,775,520) | (5,000,000) | (1,623,537) |
| Finance cost | (338,179) | (802,545) | (402,750) |
| Due to related parties (Note 22) | – | (3,089) | (2,684,943) |
| Proceeds from sale of non-controlling interest (Note 30) | – | 102,623 | – |
| Dividends paid (Note 30) | (2,166,957) | (1,629,721) | (1,730,622) |
| Advances from affiliates (Note 22) | 10,284 | – | – |
| Capital contribution of noncontrolling interest (Note 30) | – | – | 4,427,697 |
| Acquisition of non-controlling interest (Note 30) | – | (601,772) | – |
| Net cash from (used in) financing activities | 2,713,353 | (132,340) | 486,686 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 37,120,448 | (9,076,605) | (41,044,172) |
| CASH FROM DISPOSAL GROUP RECLASSIFIED AS HELD FOR SALE (Note 37) | – | (642,544) | – |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 137,556,341 | 147,275,490 | 188,319,662 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 5) | P174,676,789 | P137,556,341 | P147,275,490 |

See accompanying Notes to Consolidated Financial Statements.

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

Corporate Information

LT Group, Inc. ("LTG" or the "Company") is a stock corporation incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on May 25, 1937 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 the Company's 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%. 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, 2016 and 2015, LTG is 74.36%-owned by its ultimate parent company, Tangent, which is also incorporated in the Philippines.

The official business address of the Head Office is 11th Floor, Unit 3 Bench Tower, 30th 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 two-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 in 2011 was 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 Philippine 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 two-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 of LTG 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 1,840,000,000 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%.

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.

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, the Philippine 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.

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 shares 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, 2012 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 the Philippine 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 96.03% 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 99.25%.

On September 30, 2015, upon approval by the Philippine SEC of the increase in authorized capital stock of Eton from 5,000,000,000 common shares to 8,000,000,000 common shares with a par value of 1.00 per share, at least 25% of the increase in authorized capital stock or 750,000,000 common shares have been subscribed by Saturn and Paramount resulting in the increase of ownership interest to 56.9% and 42.7%, respectively, thus LTG's effective ownership interest in Eton increased from 99.25% to 99.6% in 2015.

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, the merger was effected via a share-for-share exchange with PNB as the surviving entity. PNB issued to ABC shareholders 130 PNB common shares for every ABC common share and 22,763 PNB common shares for every ABC preferred share. As of January 17, 2013, PNB received all the necessary approvals from the Philippine 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 is 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.

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 was 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 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 Philippine SEC for the increase in authorized capital stock of certain Bank Holding Companies, LTG 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, 2016 and 2015, 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 the pooling-of-interests method. Accordingly, LTG recognized the net assets of the acquired subsidiaries equivalent to their carrying values.

Authorization for Issue of the Consolidated Financial Statements
The consolidated financial statements as at December 31, 2016 and 2015 and for each of the three years in the period ended December 31, 2016 were authorized for issue by the BOD on March 14, 2017.

## 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), available-for-sale (AFS) investments, 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 and presentation currency of LTG. All values are rounded to the nearest Peso, except when otherwise indicated.

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

**Basis of Consolidation**

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

| | Percentage of Ownership | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2016** | | 2015 | | 2014 | | Country of |
| | **Direct** | **Indirect** | Direct | Indirect | Direct | Indirect | Incorporation |
| **Distilled Spirits** | | | | | | | Philippines |
| TDI and subsidiaries | **100.0** | **–** | 100.00 | – | 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)[1] | **–** | **100.0** | 100.0 | – | 100.0 | – | Philippines |
| **Beverages** | | | | | | | 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 |
| AB Nutribev Corp.[2] | **–** | **99.9** | – | 99.9 | – | 99.9 | Philippines |
| Asia Pacific Beverage Pte Ltd [3] | **–** | **99.9** | – | 99.9 | – | 99.9 | Singapore |
| **Tobacco** | | | | | | | |
| Shareholdings | **97.7** | **–** | 97.7 | – | 97.7 | – | Philippines |
| FTC | **82.7** | **16.9** | 82.7 | 16.9 | 82.7 | 16.9 | Philippines |
| **Property Development** | | | | | | | |
| Saturn | **100.0** | **–** | 100.0 | – | 100.0 | – | Philippines |
| Paramount and subsidiaries | **100.0** | **–** | 100.0 | – | 100.0 | – | Philippines |
| Eton | **–** | **99.6** | – | 99.6 | – | 99.3 | Philippines |
| Belton Communities, Inc. (BCI) | **–** | **99.6** | – | 99.6 | – | 99.3 | Philippines |
| Eton City, Inc. (ECI) | **–** | **99.6** | – | 99.6 | – | 99.3 | Philippines |
| FirstHomes, Inc. (FHI) | **–** | **99.6** | – | 99.6 | – | 99.3 | Philippines |
| Eton Properties Management Corporation (EPMC) | **–** | **99.6** | – | 99.6 | – | 99.3 | Philippines |
| **Banking** | | | | | | | |
| Bank Holding Companies (Note 23) [4] | **80.0-100.0** | **–** | **80.0-100.0** | – | 80.0-100.0 | – | Various |
| PNB and Subsidiaries[5] | **–** | **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 |
| 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 (PNB 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. (PNB RCI) | **–** | **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 (PISpA) [6] | **–** | **–** | – | – | – | 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 |
| PNB Savings Bank | **–** | **56.5** | – | 56.5 | – | 56.5 | Philippines |
| Allied Bank Philippines (UK) Plc (ABUK) | **–** | **56.5** | – | 56.5 | – | 56.5 | United Kingdom |
| Allied Commercial Bank | **–** | **55.9** | – | 55.9 | – | 50.8 | People's Republic of China |
| Allianz-PNB Life Insurance, Inc. (APLII) (formerly PNB LII) (7) | **–** | **24.8** | | 45.2 | – | 45.2 | Philippines |
| Allied Leasing and Finance Corporation (ALFC) | **–** | **32.3** | – | 32.3 | – | 32.3 | Philippines |
| Allied Banking Corporation (Hong Kong) Limited (ABCHKL) | **–** | **28.8** | – | 28.8 | – | 28.8 | Hong Kong |
| ACR Nominees Limited | **–** | **28.8** | – | 28.8 | – | 28.8 | Hong Kong |
| Oceanic Holdings (BVI) Ltd. (OHBVI) | **–** | **15.7** | – | 15.7 | – | 15.7 | USA |

*[1] Incorporated on May 6, 2003 to handle the marketing of TDI's products in the export market, TBI has not yet started commercial operations. On December 20, 2016, the Parent Company sold its 100% ownership interest in TBI to TDI through an execution of a Deed of Sale.*
*[2] On February 3, 2014, the Beverage segment's BOD approved the subscription of the 124,999,995 shares of AB Nutribev Corp. at P1.00 per value per share.*
*[3] On August 4, 2014, the Beverage segment's BOD approved the subscription of one (1) ordinary share of Asia Pacific Bev PTE at $1 per value per share.*
*[4] As of December 31, 2016 and 2015, 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 22).*
*[5] 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.*
*[6] On November 19, 2014, PISpA was liquidated.*
*[7] Beginning December 18, 2015, assets and liabilities of APLII as of December 31, 2015 have been reclassified as disposal group classified as held for sale and the results of its operations for each of the three years ended December 31, 2016 have been reclassified as discontinued operations, following the approval of PNB's BOD disposing 51.00% of its ownership interest in APLII to Allianz SE (see Note 37).*

Subsidiaries are entities over which the Company has control. 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, the fair value of 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 (OCI) to profit or loss or retained earnings, as appropriate.

<u>Business Combination and Goodwill</u>
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 consolidated 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 Philippine Accounting Standards (PAS) 39, *Financial Instruments: Recognition and Measurement* 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 for 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 the pooling of interest method.

In applying the pooling-of-interests 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 are consistent with those of the previous financial year, except that the Group has adopted the following new accounting pronouncements starting January 1, 2016. Adoption of these pronouncements did not have any significant impact on the Group's financial position or performance, unless as otherwise indicated.

- Amendments to PFRS 10, *Consolidated Financial Statements*, PFRS 12, *Disclosure of Interests in Other Entities*, and PAS 28, *Investments in Associates and Joint Ventures, Investment Entities: Applying the Consolidation Exception*, clarify that the exemption in PFRS 10 from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity that measures all of its subsidiaries at fair value. They also clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity parent is consolidated. The amendments also allow an investor (that is not an investment entity and has an investment entity associate or joint venture) to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries when applying the equity method.

- Amendments to PAS 27, *Separate Financial Statements, Equity Method in Separate Financial Statements*, allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying PFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively.

- Amendments to PFRS 11, *Joint Arrangements, Accounting for Acquisitions of Interests in Joint Operations*, require a joint operator that is accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business (as defined by PFRS 3), to apply the relevant PFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to PFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party. The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation.

- PFRS 14, *Regulatory Deferral Accounts*, is an optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of PFRS. Entities that adopt PFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of income and other comprehensive income. The standard requires disclosures on the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements. Since the Group is an existing PFRS preparer, this standard would not apply.

- Amendments to PAS 1, *Presentation of Financial Statements, Disclosure Initiative*, are intended to assist entities in applying judgment when meeting the presentation and disclosure requirements in PFRSs. They clarify the following:

  a. That entities shall not reduce the understandability of their financial statements by either obscuring material information with immaterial information; or aggregating material items that have different natures or functions
  b. That specific line items in the statement of income and other comprehensive income and the statement of financial position may be disaggregated
  c. That entities have flexibility as to the order in which they present the notes to financial statements
  d. That the share of other comprehensive income of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

- Amendments to PAS 16, *Property, Plant and Equipment* and PAS 38, *Intangible Assets, Clarification of Acceptable Methods of Depreciation and Amortization*, clarify the principle in PAS 16 and PAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets.

- Amendments to PAS 16 and PAS 41, *Agriculture: Bearer Plants*, change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of PAS 41. Instead, PAS 16 will apply. After initial recognition, bearer plants will be measured under PAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of PAS 41 measured at fair value less costs to sell. For government grants related to bearer plants, PAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, will apply.

*Annual Improvements to PFRS (2012 - 2014 cycle)* are effective for annual periods beginning on or after January 1, 2016. Except as otherwise stated, the Group does not expect these amendments to have a significant impact on the Group's consolidated financial statements.

- Amendment to PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations, Changes in Methods of Disposal*, is applied prospectively and clarifies that changing from a disposal through sale to a disposal through distribution to owners and vice-versa should not be considered to be a new plan of disposal, rather it is a continuation of the original plan. There is, therefore, no interruption of the application of the requirements in PFRS 5. The amendment also clarifies that changing the disposal method does not change the date of classification.

- Amendment to PFRS 7, *Financial Instruments: Disclosures, Servicing Contracts*, requires an entity to provide disclosures for any continuing involvement in a transferred asset that is derecognized in its entirety. The amendment clarifies that a servicing contract that includes a fee can constitute continuing involvement in a financial asset. An entity must assess the nature of the fee and arrangement against the guidance for continuing involvement in PFRS 7 in order to assess whether the disclosures are required. The amendment is to be applied such that the assessment of which servicing contracts constitute continuing involvement will need to be done retrospectively. However, comparative disclosures are not required to be provided for any period beginning before the annual period in which the entity first applies the amendments.

- Amendment to PFRS 7, *Applicability of the Amendments to PFRS 7 to Condensed Interim Financial Statements*, is applied retrospectively and clarifies that the disclosures on offsetting of financial assets and financial liabilities are not required in the condensed interim financial report unless they provide a significant update to the information reported in the most recent annual report.

- Amendment to PAS 19, *Employee Benefits, Discount Rate: Regional Market Issue*, is applied prospectively and clarifies that market depth of high quality corporate bonds is assessed based on the currency in which the obligation is denominated, rather than the country where the obligation is located. When there is no deep market for high quality corporate bonds in that currency, government bond rates must be used.

- Amendment to PAS 34, *Interim Financial Reporting, Disclosure of Information 'Elsewhere in the Interim Financial Report'*, is applied retrospectively and clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the greater interim financial report (e.g., in the management commentary or risk report).

<u>New Accounting Standards, Amendments to Existing Standards and Interpretation Effective Subsequent to December 31, 2016</u>
The standards, amendments and interpretation which have been issued but not yet effective as at December 31, 2016 are disclosed below. The Group intends to adopt these standards, amendments and interpretation, if applicable, when they become effective.

*Effective in 2017*

- Amendment to PFRS 12, *Clarification of the Scope of the Standard (Part of Annual Improvements to PFRS 2014 - 2016 Cycle)*, clarify that the disclosure requirements in PFRS 12, other than those relating to summarized financial information, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. The Group will consider these amendments.

- Amendments to PAS 7, *Statement of Cash Flows, Disclosure Initiative*, require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendments, entities are not required to provide comparative information for preceding periods. Early application of the amendments is permitted. The Group is assessing the potential effect of the amendments on its consolidated financial statements.

- Amendments to PAS 12, *Income Taxes, Recognition of Deferred Tax Assets for Unrealized Losses*, clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

  Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognized in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact. Early application of the amendments is permitted. The Group is currently assessing the effect of these amendments on its consolidated financial statements.

*Effective in 2018*

- Amendments to PFRS 2, *Share-based Payment, Classification and Measurement of Share-based Payment Transactions*, address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and the accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

  On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and if other criteria are met. Early application of the amendments is permitted. The amendments are not applicable to the Group as it does not have any share-based compensation plan for its officers and employees.

- Amendments to PFRS 4, *Insurance Contracts, Applying PFRS 9, Financial Instruments, with PFRS 4*, address concerns arising from implementing PFRS 9, the new financial instruments standard before implementing the forthcoming insurance contracts standard. They allow entities to choose between the overlay approach and the deferral approach to deal with the transitional challenges. The overlay approach gives all entities that issue insurance contracts the option to recognize in other comprehensive income, rather than profit or loss, the volatility that could arise when PFRS 9 is applied before the new insurance contracts standard is issued. On the other hand, the deferral approach gives entities whose activities are predominantly connected with insurance an optional temporary exemption from applying PFRS 9 until the earlier of application of the forthcoming insurance contracts standard or January 1, 2021.

  The overlay approach and the deferral approach will only be available to an entity if it has not previously applied PFRS 9. The amendments are not applicable to the Group since it does not have activities that are predominantly connected with insurance or issue insurance contracts.

- PFRS 9, *Financial Instruments*, reflects all phases of the financial instruments project and replaces PAS 39, *Financial Instruments: Recognition and Measurement*, and all previous versions of PFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. PFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early application permitted. Retrospective application is required, but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The Group is currently assessing the impact of adopting this standard.

- PFRS 15, *Revenue from Contracts with Customers*, establishes a new five-step model that will apply to revenue arising from contracts with customers. Under PFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in PFRS 15 provide a more structured approach to measuring and recognizing revenue.

  The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under PFRS. Either a full or modified retrospective application is required for annual periods beginning on or after January 1, 2018. The Group is currently assessing the impact of the new revenue standard.

- Amendments to PAS 28, *Measuring an Associate or Joint Venture at Fair Value (Part of Annual Improvements to PFRS 2014 - 2016 Cycle)*, clarify that an entity that is a venture capital organization, or other qualifying entity, may elect, at initial recognition on an investment-by-investment basis, to measure its investments in associates and joint ventures at fair value through profit or loss. They also clarify that if an entity that is not itself an investment entity has an interest in an associate or joint venture that is an investment entity, the entity may, when applying the equity method, elect to retain the fair value measurement applied by that investment entity associate or joint venture to the investment entity associate's or joint venture's interests in subsidiaries. This election is made separately for each investment entity associate or joint venture, at the later of the date on which (a) the investment entity associate or joint venture is initially recognized; (b) the associate or joint venture becomes an investment entity; and (c) the investment entity associate or joint venture first becomes a parent. The amendments should be applied retrospectively, with earlier application permitted. The Group is currently assessing the impact of the new revenue standard.

- Amendments to PAS 40, *Investment Property, Transfers of Investment Property*, clarify when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments should be applied prospectively to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is only permitted if this is possible without the use of hindsight.

- Philippine Interpretation based on International Financial Reporting Interpretations Committee (IFRIC) 22, *Foreign Currency Transactions and Advance Consideration* clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the nonmonetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The interpretation may be applied on a fully retrospective basis. Entities may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognized on or after the beginning of the reporting period in which the entity first applies the interpretation or the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

*Effective in 2019*

- PFRS 16, *Leases*, will no longer require lessees to classify their leases as either operating or finance leases in accordance with PAS 17, *Leases*. Rather, lessees will apply the single-asset model. Under this model, lessees will recognize the assets and related liabilities for most leases on their balance sheets, and subsequently, will depreciate the lease assets and recognize interest on the lease liabilities in their profit or loss. Leases with a term of 12 months or less or for which the underlying asset is of low value are exempted from these requirements.

  The accounting by lessors is substantially unchanged as the new standard carries forward the principles of lessor accounting under PAS 17. Lessors, however, will be required to disclose more information in their financial statements, particularly on the risk exposure to residual value.

  Entities may early adopt PFRS 16 but only if they have also adopted PFRS 15. When adopting PFRS 16, an entity is permitted to use either a full retrospective or a modified retrospective approach, with options to use certain transition reliefs. The Group is currently assessing the impact of PFRS 16 and plans to adopt the new standard on the required effectivity date.

*Deferred effectivity*

Amendments to PFRS 10 and PAS 28 - *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*, address the conflict between PFRS 10 and PAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that a full gain or loss is recognized when a transfer to an associate or joint venture involves a business as defined in PFRS 3, Business Combinations. Any gain or loss resulting from the sale or contribution of assets that does not constitute a business, however, is recognized only to the extent of unrelated investors' interests in the associate or joint venture.

The Group continues to assess the impact of the above new and amended accounting standards and interpretations effective subsequent to 2016 on the Group's consolidated financial statements in the period of initial application. Additional disclosures required by these amendments will be included in the consolidated financial statements when these amendments are adopted.

**Significant Accounting Policies Applicable to the Group**

<u>Current versus Non-Current Classification</u>
The Group presents assets and liabilities in the consolidated balance sheet based on current/non-current classification. An asset as current when it is:

- expected to be realized or intended to be sold or consumed in normal operating cycle
- held primarily for the purpose of trading
- expected to be realized within 12 months after the reporting period, or
- cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

All other assets are classified as non-current.

A liability is current when:
- it is expected to be settled in normal operating cycle
- it is held primarily for the purpose of trading
- it is due to be settled within 12 months after the reporting period, or
- there is no unconditional right to defer the settlement of the liability for at least 12 months after the reporting period.

Deferred income tax assets and liabilities are classified as non-current assets and liabilities.

<u>Investments in Associates and Joint Ventures</u>
Investment in associates pertains to entities over which the Group has significant influence but not control. Investment in joint ventures pertains to the Group's interest in joint ventures, which are jointly controlled entities, whereby the venturers have a contractual arrangement that establishes joint control over the economic activities of the entities. The joint venture arrangements requires unanimous agreement for financial and operating decisions among the venturers. The Group recognizes its investments in associates and joint ventures using the equity method.

Under the equity method, the investments in associates and joint ventures are carried in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the associates and joint ventures. The Group's share in the associates' and joint ventures' post-acquisition profits or losses is recognized in the consolidated statement of income, and its share of post-acquisition movements in the associates' and joint ventures' 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 legal or constructive obligations or made payments on behalf of the associate and joint venture. Profits and losses resulting from transactions between the Group and the associates and joint ventures are eliminated to the extent of the interest in the associates and joint ventures.

Where necessary, adjustments are made to the financial statements of the associates and joint ventures 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 goodwill which is retained in the carrying value of the investment or a gain in consolidated net income under "Equity in net earnings of associates".

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 associates and joint ventures 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.

Non-current Assets and Disposal Group Classified as Held for Sale and Discontinued Operations
The Group classifies non-current assets and disposal group as held for sale if their carrying amounts will be recovered principally through a sale transaction. Such non-current assets and disposal groups are measured at the lower of their carrying amount and fair value less costs to sell. Costs to sell are the incremental costs directly attributable to the sale, excluding the finance costs and income tax expense.

The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the sale will be made or that the decision to sell will be withdrawn. Management must be committed to the sale expected within one year from the date of the classification.

Assets and liabilities of disposal group classified as held for sale are presented separately in the consolidated balance sheet.

The Group accounts for any investment to be retained over the disposal group at cost and presents it as part of 'Investment in subsidiaries' in the consolidated balance sheets.

A disposal group qualifies as discontinued operation if it is a component of an entity that either has been disposed of, or is classified as held for sale, and:

- represents a separate major line of business or geographical area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or
- is a subsidiary acquired exclusively with a view to resale

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the consolidated statement of 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 34.

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 participants' 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 consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest Level of 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 of input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 - Valuation techniques for which the lowest Level of input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognized in the consolidated 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 of 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 investments. 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.

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 fair value hierarchy, as explained above.

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.

*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" 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" under "Revenue - banking" account. 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". 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" under "Revenue - banking" account. Interest earned or incurred is recorded in "Interest income" or "Interest expense", respectively, while dividend income is recorded in "Others" 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 Special-purpose vehicle (SPV) (included under "Other noncurrent assets").

These are non-derivative 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 and Allied Leasing and Finance Corporation (ALFC). 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 receivable", "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 changes in fair value of 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" under the "Banking revenue" while recognized in profit or loss for the other operating segments 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 "Others" 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. Once tainted, the Group is prohibited from classifying investments under HTM for at least the following two financial years. 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.

<u>Derecognition of Financial Assets and Liabilities</u>
*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.

<u>Impairment of Financial Assets</u>
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 risk 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 in the consolidated statement of comprehensive income.

In the case of debt instruments classified as AFS investments, impairment is assessed based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss on that investment previously recognized in profit or loss. 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.

Offsetting of 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. The Group assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the Group and all of the counterparties.

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, accredited and 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.

Returnable 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 comprehensive income.

Deposit value for the containers loaned to customer is included as part of "Trade 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 or lease term, whichever is shorter |
| Transportation equipment | 2 - 5 |
| Returnable containers | 5 - 7 |
| Furniture, fixtures and other equipment | 3 - 20 |

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 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 "Net gains on sale or exchange of assets" and presented in the "Others" account in the consolidated statement of income. Foreclosed properties are classified under "Investment properties" upon:

a. entry of judgment in case of judicial foreclosure;
b. execution of the Sheriff's Certificate of Sale in case of extra-judicial foreclosure; or
c. 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 five 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" 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, other properties, investments in associates and joint ventures, 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.

<u>Revenue</u>
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. Refer to the significant accounting policies generally applicable to the consumer products, banking and property development for the specific recognition criteria that must also be met before revenue is recognized.

<u>Costs and Expenses</u>
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.

*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.

<u>Retirement Benefits</u>
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.

<u>Borrowing Costs</u>
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.

<u>Debt Issue Costs</u>
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:

a. there is a change in contractual terms, other than a renewal or extension of the arrangement;
b. a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;
c. there is a change in the determination of whether fulfillment is dependent on a specified asset; or
d. 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 balance sheet 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, plant 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.

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 Group, 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 income 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.

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.

Equity
*Capital stock* is measured at par value for all shares issued by the Group. When the Group 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.

*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).

*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.

*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 associates.

*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.

*Treasury shares* are owned equity instruments that are reacquired. Where any member of the Group purchases the Company's capital stock (presented as "Shares of the Company held by subsidiaries"), 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 Group.

*Deposit for stock subscription* represents the amount received which will be applied as payment in exchange for a fixed number of the Company's own equity instruments. It is classified as an equity item if there is sufficient unissued authorized capital stock, or if in case the unissued authorized capital stock is insufficient to cover the amount of the deposit, (1) the BOD and stockholders have approved a proposed increase in authorized capital stock for which a deposit was received, and (2) the proposed increase was filed with the Philippine SEC. Otherwise, the deposit is classified as a liability.

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.

**Significant Accounting Policies Generally Applicable to Banking**

Banking Revenue
*Interest income*
For all financial instruments measured at amortized cost and interest-bearing financial instruments classified as FVPL 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 three 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, 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.

- *Bancassurance fees*
  Non-refundable access fees are recognized on a straight-line basis over the term of the period of the provision of the access.

  Milestone fees or variable and fixed earn-out fees are recognized in reference to the stage of achievement of the milestones.

- *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 consolidated 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 revenue from rewards redeemed*
'Interchange fees' are taken up as income under 'Service fees and commission 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 redeemed. 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. The deferred balance is included under "Other liabilities" in the consolidated balance sheet.

*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 period.

*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.

<u>Insurance Product Classification</u>
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.

Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of price or rates, a credit rating or credit index or other variable. Investment contracts mainly transfer financial risk but can also transfer insignificant insurance 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.

For financial options and guarantees which are not closely related to the host insurance contract, bifurcation is required to measure these embedded financial derivatives separately as FVPL. Bifurcation is not required if the embedded derivative is itself an insurance contract or when the host insurance contract itself is measured as financial assets or liabilities at FVPL. The options and guarantees within the insurance contracts issued by the Group are treated as derivative financial instruments which are closely related to the host insurance and therefore not bifurcated subsequently. As such, the Group does not separately measure options to surrender insurance contracts for a fixed amount (or an amount based on a fixed amount and an interest rate). Likewise, the embedded derivative in unit-linked insurance contracts linking the payment on the contract to units of internal investment funds meets the definition of an insurance contract and is therefore not accounted for separately from the host insurance contract.

Based on the Group guidelines, all products in its portfolio meet the definition of insurance contracts, including unit-linked products, which contain features that make use of funds specifically segregated for the benefit of unit-linked policyholders.

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.

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. When claims are paid, such reinsurance assets are reclassified to "Accounts receivable".

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.

When the Group enters into a proportional treaty reinsurance agreement for ceding out its insurance business, the Group initially recognizes a liability at transaction price. Subsequent to initial recognition, the portion of the amount initially recognized as a liability which is presented as "Other liabilities" in the consolidated balance sheet will be withheld and recognized as Funds held for reinsurers and included as part of the "Other liabilities" in the consolidated balance sheet. The amount withheld is generally released after a year.

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. 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.

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.

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. 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 (IBNR) 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.

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.

**Significant Accounting Policies Generally Applicable to Consumer Products**

Sale of Consumer 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).

Cost of Consumer Goods Sold
Cost of consumer goods sold is recognized as expense where the related goods are sold.

Consumer Goods 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:

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 |
|---|---|---|---|
| Finished goods | Moving-average | Weighted-average | Moving-average |
| Work in process | Moving-average | Weighted-average | First-in first-out |
| Raw materials and materials and supplies | 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 and materials and supplies, NRV is current replacement cost.

**Significant Accounting Policies Generally Applicable to Property Development**

Property Development Revenue and Cost Recognition
*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.
*Cost of Real Estate Sales*
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.

*Cost of Rental Income*
Cost of rental income is recognized in relation to the leasing activities of the Group. This includes general, administrative and selling expenses allocated to the leasing activities, rental expense on the property leased to tenants and depreciation of the investment properties.

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 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.

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.

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.

## 3. 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:

*Disposal of APLII*
In 2016, the Bank completed the sale of its 51% ownership interest in APLII for a consideration amounting to US$66.0 million (P3.1 billion). Pursuant to the sale of APLII, the Bank also entered into a distribution agreement with APLII where the Bank will allow APLII to have exclusive access to the distribution network of the Bank over a period of 15 years [the Exclusive Distribution Rights (EDR)].

The Group has determined based on its evaluation that the share purchase agreement and distribution agreement have provisions referring to one another, making the distribution agreement an integral component of the sale transaction. Accordingly, the consideration received by the Bank was allocated between the sale of its 51% ownership interest in APLII and the EDR (see Notes 11 and 37).

*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 Peso except for the following entities with functional currency other than the Peso:

| Subsidiary | Functional Currency |
|---|---|
| PNB Guam | United States Dollar |
| PNB IIC | -do- |
| PNB RCI | -do- |
| Nevada | -do- |
| PNB RCI Holding Co. Ltd. | -do- |
| ACB | -do- |
| OHBVI | -do- |
| ABUK | Great Britain Pound |
| PNB Europe PLC | -do- |
| Canada | Canadian Dollar |
| PNB GRF | Hongkong Dollar |
| ABCHKL | -do- |
| ACR Nominees Limited | -do- |

*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, through PNB, holds less than 50.00% of OHBVI's issued share capital. Management concluded that the Group has the ability to control the relevant activities and to affect its returns in OHBVI on the basis of PNB's combined voting rights of 70.56% arising from its direct ownership of 27.78% and assigned voting rights of 42.78% by certain stockholders to the Group.

*Classification of Investment in AB Heineken Philippines, Inc (AB HPI) as Investment in an Associate*
The Group and Heineken International B.V. (Heineken) established AB HPI, a 50%-owned associate, through a joint venture agreement. The Group has determined that it has significant influence, but no control or joint control, over the operating and financial activities of AB HPI. Accordingly, the Group classified its investment in AB HPI as an investment in an associate.

*Classification of transfer of beer segment as discontinued operations*
The Group classified the transfer of its beer segment as discontinued operations in accordance with PFRS 5, effective November 15, 2016, based on the joint venture agreement signed on May 27, 2016 in respect of the establishment of AB HPI to manage its beer segment. The beer segment met the criteria of a component of an entity that has been disposed of to be classified as discontinued operations as of December 31, 2016 since it represents a separate major line of business or geographical area of operations (see Note 37).

*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 sheet.

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 P18.1 billion as equity as of December 31, 2016 and 2015 (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 2016, 2015 and 2014.

*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 38).

*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 38).

*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, 2016 and 2015, 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, 2016 and 2015, investment in unquoted shares of stock amounted to P1.3 billion and P1.2 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.

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:

*Determination of fair value of shares of APLII and EDR*
The Group determined the fair value of the shares of APLII using a combination of the Income Approach and the Market Approach. The Income Approach was based on the present value of the future cash flows over a three-year period, adjusted for the control premium and the lack of marketability discount. Significant management judgment is required to determine the expected future cash flows. The valuation under the Income Approach is most sensitive to discount rate and growth rate used to project cash flows.

The Market Approach involved determining the price to book value of selected publicly traded companies that have been identified to be comparable to APLII such as those with similar business activities and product offerings. The price to book value are then subjected to a control premium and lack of marketability discount.

The fair value of the EDR was determined using the Market Approach where it involved identifying recent bancassurance agreements with upfront payments from publicly available data of comparable companies. Using the amount of upfront payment fee, the number of branches and customers, a value per branch and value per customer multiple were determined. The relevant fair values of the shares of APLII and EDR are disclosed in Note 37 to the consolidated financial statements.

*Estimation of allowance for credit losses on loans and receivables*
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. The Group determines the allowance for credit losses on individual basis for individually significant loans and receivables, and collectively, for loans and receivables that are not individually significant such as consumer loans and credit card receivables. The determination of the recoverable amount of loans and receivables involves various assumptions and factors including the financial condition of the borrower, timing of expected future cash flows, probability of collections, observable market prices and expected net selling prices of the collateral. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Refer to Notes 8 and 14 for the carrying values of loans and receivables and receivables from SPV, respectively.

*Estimation of retirement benefits costs and liability*
The Group's retirement benefits costs and liability is actuarially computed. This entails using certain assumptions with respect to prospective salary increases, employee turnover rates and discount rates per annum.

Net retirement plan assets as of December 31, 2016 and 2015 amounted to P276.9 million and P255.7 million, respectively. Net retirement benefits liability amounted to P3.9 billion as of December 31, 2016 and 2015 (see Notes 14 and 23).

*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 P1.6 billion, P1.3 billion and P1.5 billion and cost of real estate sales amounting to P1.1 billion, P1.0 billion and P1.3 billion in 2016, 2015 and 2014, respectively (see Note 24).

*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, 2016 and 2015, the carrying value of the Group's AFS financial assets amounted to P68.6 billion and P69.6 billion, respectively, net of allowance for impairment losses on AFS equity investments amounting to P944.1 million and P998.7 million, respectively (see Note 7).

*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 34 for information on the fair values of these instruments.

*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, the Group adjusts the 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, 2016 and 2015 amounted to P12.3 billion and P13.4 billion, respectively. Certain materials and supplies amounting to P0.5 billion and P0.6 billion as of December 31, 2016 and 2015, 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 P36.1 billion and P39.5 billion as of December 31, 2016 and 2015, 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 2016 and 2015, 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).

The total carrying amount of depreciable property, plant and equipment as of December 31, 2016 and 2015 amounted to P25.2 billion and P24.9 billion, respectively (see Note 12). The carrying amount of depreciable investment properties as of December 31, 2016 and 2015 amounted to P7.4 billion and P6.6 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 PFRSs.

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:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Other current assets (except miscellaneous cash and other cash items and held to maturity investments) (Note 10) | **P10,344,336** | P8,670,082 |
| Investments in associates and joint ventures (Note 11) | **16,817,351** | 11,761,290 |
| Property, plant and equipment (Note 12) | **41,274,622** | 44,837,876 |
| Investment properties (Note 13) | **28,217,373** | 22,231,525 |
| Other noncurrent assets (except refundable and security deposits, goodwill and net retirement plan assets) (Note 14) | **3,014,149** | 2,800,283 |

*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 P163.7 million as of December 31, 2016 and 2015 is not impaired (see Note 14).

*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 counsels 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 P1.3 billion and P898.7 million as of December 31, 2016 and 2015, respectively (see Note 38).

*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 over 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 over RCIT 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 over RCIT and other deductible temporary differences totaling to P5.8 billion and P4.7 billion as of December 31, 2016 and 2015, 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 and other insurance 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, liquor and bioethanol 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 and metal closures production facility, to support the requirements of its brewing, bottled water and non-beer products operations. The Group conducts its beverage business through ABI and its consolidated subsidiaries.

- 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, Shareholdings, and Bank Holding Companies) that provide financing for working capital and capital expenditure requirements of the operating businesses of the Group.

The BOD of LTG 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 PFRSs. 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 the USA, Canada, Western Europe, Middle East and Asia. The distribution of assets and revenues of the banking segment outside the Philippines constitute 10.5% and 3.6% as of December 31, 2016, respectively, and 8.0% and 3.8% as of December 31, 2015 of the Group's consolidated assets and revenues, respectively.

Further, the measurement of the segments is the same as those described in the summary of significant accounting and financial reporting policies. TDI's investment property is adjusted at the consolidated level to carry it at cost in accordance with the Group's policy. Certain assets and liabilities of PNB are also adjusted at the consolidated level of LTG to reflect the original carrying values prior to the merger of PNB and ABC.

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 revenue from two major distributors which averaged 84%, 90% and 89% of the segment's total revenue in 2016, 2015 and 2014, respectively. 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, 2016:

| | Banking | Distilled Spirits | Beverage | Tobacco | Property Development | Eliminations, Adjustments and Others | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(In Thousands)* | | | |
| Segment revenue: | | | | | | | |
| External customers | P29,111,818 | P14,904,343 | P10,932,326 | P– | P2,851,514 | P– | P57,800,001 |
| Inter-segment | 190,274 | 109,385 | 917,651 | – | – | (1,217,310) | – |
| | 29,302,092 | 15,013,728 | 11,849,977 | – | 2,851,514 | (1,217,310) | 57,800,001 |
| Cost of sales and services | 5,722,739 | 12,293,366 | 7,818,988 | – | 1,342,857 | (1,051,069) | 26,126,881 |
| Gross profit | 23,579,353 | 2,720,362 | 4,030,989 | – | 1,508,657 | (166,241) | 31,673,120 |
| Equity in net earnings of associates | – | – | – | 2,593,261 | – | 118,279 | 2,711,540 |
| | 23,579,353 | 2,720,362 | 4,030,989 | 2,593,261 | 1,508,657 | (47,962) | 34,384,660 |
| Selling expenses | – | 999,866 | 1,310,612 | – | 52,848 | (11,804) | 2,351,522 |
| General and administrative expenses | 23,215,141 | 551,755 | 907,564 | 152,630 | 628,773 | 107,221 | 25,563,084 |
| Operating income | 364,212 | 1,168,741 | 1,812,813 | 2,440,631 | 827,036 | (143,379) | 6,470,054 |
| Foreign exchange gains - net | 1,487,740 | 364 | – | 27,417 | 4,251 | 15,445 | 1,535,217 |
| Finance costs | – | (10,967) | (48,789) | – | (357,700) | 214,966 | (202,490) |
| Finance income | – | 159 | 20,807 | 70,136 | 55,871 | (40,547) | 106,426 |
| Others - net | 6,427,747 | 14,664 | (189,206) | 50,537 | 71,811 | (1,349,106) | 5,026,447 |
| Income before income tax | 8,279,699 | 1,172,961 | 1,595,625 | 2,588,721 | 601,269 | (1,302,621) | 12,935,654 |
| Provision for income tax | 1,517,029 | 265,459 | 548,815 | (3,579) | 211,760 | (365,016) | 2,174,468 |
| Segment profit (loss) from: | | | | | | | |
| Continuing operations | 6,762,670 | 907,502 | 1,046,810 | 2,592,300 | 389,509 | (937,605) | 10,761,186 |
| Discontinued operations | 619,563 | – | 708,407 | – | – | – | 1,327,970 |
| | P7,382,233 | P907,502 | P1,755,217 | P2,592,300 | P389,509 | (P937,605) | P12,089,156 |
| Segment profit attributable to: | | | | | | | |
| Equity holders of the Company | P7,344,112 | P898,192 | P1,755,217 | P2,581,412 | P388,029 | (P3,576,555) | P9,390,407 |
| Non-controlling interests | 38,121 | 9,310 | – | 10,888 | 1,480 | 2,638,950 | 2,698,749 |
| Depreciation and amortization expense | 1,393,334 | 529,743 | 1,538,972 | 11,477 | 163,644 | 20,188 | 3,657,358 |

Other financial information of the operating segments as of December 31, 2016 is as follows:

| | Banking | Distilled Spirits | Beverage | Tobacco | Property Development | Eliminations, Adjustments and Others | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(In Thousands)* | | | |
| Assets: | | | | | | | |
| Current assets | P376,639,685 | P11,281,760 | P11,899,140 | P10,107,420 | P12,774,195 | (P17,925,076) | P404,777,124 |
| Noncurrent assets | 364,245,652 | 7,159,081 | 15,017,583 | 13,362,146 | 16,415,790 | 8,113,648 | 424,313,900 |
| | P740,885,337 | P18,440,841 | P26,916,723 | P23,469,566 | P29,189,985 | (P9,811,428) | P829,091,024 |
| Liabilities: | | | | | | | |
| Current liabilities | P575,558,848 | P2,463,592 | P4,019,000 | P317,324 | P6,816,393 | (P11,108,655) | P578,066,502 |
| Noncurrent liabilities | 68,358,018 | 651,039 | 1,113,781 | 92,136 | 6,043,487 | (3,838,515) | 72,419,946 |
| | P643,916,866 | P3,114,631 | P5,132,781 | P409,460 | P12,859,880 | (P14,947,170) | P650,486,448 |
| Investments in associates and joint ventures | P2,532,754 | P– | P1,643,304 | P11,049,385 | P– | P1,591,908 | P16,817,351 |
| Equity attributable to: | | | | | | | |
| Equity holders of the Company | 94,319,311 | 15,196,522 | 21,783,942 | 23,060,106 | 16,330,105 | (34,592,001) | 136,097,985 |
| Non-controlling interests | 2,649,162 | 129,688 | – | – | – | 39,727,741 | 42,506,591 |
| Additions to noncurrent assets: | | | | | | | |
| Property, plant and equipment | 2,133,146 | 612,136 | 1,987,832 | 3,946 | 29,258 | 2,693 | 4,769,011 |
| Investment properties | 681,510 | – | – | – | 389,314 | 1,466 | 1,072,290 |
| Short-term debts | – | – | 1,750,000 | – | – | – | 1,750,000 |
| Long-term debts | 3,497,798 | – | – | – | 4,070,949 | (2,000,000) | 5,568,747 |

For the year ended December 31, 2015:

| | Banking | Distilled Spirits | Beverage | Tobacco | Property Development | Eliminations, Adjustments and Others | Total |
|---|---|---|---|---|---|---|---|
| | | | | (In Thousands) | | | |
| Segment revenue: | | | | | | | |
| External customers | P26,600,160 | P12,002,266 | P10,386,308 | P– | P2,484,453 | P– | P51,473,187 |
| Inter-segment | 10,150 | 115,079 | 1,011,781 | – | – | (1,137,010) | – |
| | 26,610,310 | 12,117,345 | 11,398,089 | – | 2,484,453 | (1,137,010) | 51,473,187 |
| Cost of sales and services | 4,807,242 | 9,831,228 | 7,384,452 | – | 1,179,549 | (1,199,589) | 22,002,882 |
| Gross profit | 21,803,068 | 2,286,117 | 4,013,637 | – | 1,304,904 | 62,579 | 29,470,305 |
| Equity in net earnings of associates | – | – | – | 974,543 | – | 214,431 | 1,188,974 |
| | 21,803,068 | 2,286,117 | 4,013,637 | 974,543 | 1,304,904 | 277,010 | 30,659,279 |
| Selling expenses | – | 939,453 | 1,234,028 | – | 42,382 | (13,422) | 2,202,441 |
| General and administrative expenses | 18,449,228 | 653,396 | 744,400 | 141,260 | 588,292 | 579,957 | 21,156,533 |
| Operating income | 3,353,840 | 693,268 | 2,035,209 | 833,283 | 674,230 | (289,525) | 7,300,305 |
| Foreign exchange gains - net | 1,207,840 | 1,609 | – | 95,618 | 3,746 | 13,587 | 1,322,400 |
| Finance costs | – | (57,969) | (2,439) | – | (175,787) | 33,677 | (202,518) |
| Finance income | – | 154 | 19,572 | 92,549 | 50,830 | (52,729) | 110,376 |
| Others - net | 3,393,380 | 28,066 | 6,386 | 71,785 | 10,620 | 176,737 | 3,686,974 |
| Income before income tax | 7,955,060 | 665,128 | 2,058,728 | 1,093,235 | 563,639 | (118,253) | 12,217,537 |
| Provision for income tax | 1,543,789 | 243,043 | 609,464 | 53,229 | 250,358 | 28,936 | 2,728,819 |
| Segment profit (loss) from: | | | | | | | |
| Continuing operations | 6,411,271 | 422,085 | 1,449,264 | 1,040,006 | 313,281 | (147,189) | 9,488,718 |
| Discontinued operations | 357,931 | – | (349,995) | – | – | – | 7,936 |
| | P6,769,202 | P422,085 | P1,099,269 | P1,040,006 | P313,281 | (P147,189) | P9,496,654 |
| Segment profit attributable to: | | | | | | | |
| Equity holders of the Company | P3,673,284 | P427,930 | P1,099,269 | P1,035,563 | P312,091 | P50,898 | P6,599,035 |
| Non-controlling interests | 3,095,918 | (5,845) | – | 4,443 | 1,190 | (198,087) | 2,897,619 |
| Depreciation and amortization expense | 1,168,620 | 551,339 | 1,549,879 | 11,975 | 151,693 | 19,012 | 3,452,518 |

Other financial information of the operating segments as of December 31, 2015 is as follows:

| | Banking | Distilled Spirits | Beverage | Tobacco | Property Development | Eliminations, Adjustments and Others | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(In Thousands)* | | | |
| Assets: | | | | | | | |
| Current assets | P331,611,312 | P10,040,792 | P11,368,663 | P9,975,983 | P14,774,964 | (P7,510,083) | P370,261,631 |
| Noncurrent assets | 334,920,597 | 6,667,777 | 13,294,019 | 12,602,442 | 11,322,217 | 483,819 | 379,290,871 |
| | P666,531,909 | P16,708,569 | P24,662,682 | P22,578,425 | P26,097,181 | (P7,026,264) | P749,552,502 |
| Liabilities: | | | | | | | |
| Current liabilities | P494,826,886 | P2,044,210 | P3,443,633 | P319,367 | P7,045,991 | (P11,354,869) | P496,325,218 |
| Noncurrent liabilities | 79,378,819 | 536,539 | 1,278,930 | 113,459 | 3,122,295 | (960,853) | 83,469,189 |
| | P574,205,705 | P2,580,749 | P4,722,563 | P432,826 | P10,168,286 | (P12,315,722) | P579,794,407 |
| Investments in associates and a joint venture | P– | P– | P19,900 | P10,289,586 | P– | P1,451,804 | P11,761,290 |
| Equity attributable to: | | | | | | | |
| Equity holders of the Company | 50,946,819 | 14,008,783 | 19,940,119 | 22,047,721 | 15,897,492 | 6,035,084 | 128,876,018 |
| Non-controlling interests | 41,379,385 | 119,037 | – | 97,878 | 31,403 | (745,626) | 40,882,077 |
| Additions to noncurrent assets: | | | | | | | |
| Property, plant and equipment | 4,166,428 | 559,956 | 1,860,257 | 22,337 | 31,552 | 6,788 | 6,647,318 |
| Investment properties | 505,262 | – | – | – | 1,464,695 | (366,238) | 1,603,719 |
| Short-term debts | – | 350,000 | 1,400,000 | – | – | (350,000) | 1,400,000 |
| Long-term debts | 9,986,426 | – | – | – | 1,196,020 | – | 11,182,446 |

For the year ended December 31, 2014:

| | Banking | Distilled Spirits | Beverage | Tobacco | Property Development | Eliminations, Adjustments and Others | Total |
|---|---|---|---|---|---|---|---|
| | | | | *(In Thousands)* | | | |
| Segment revenue: | | | | | | | |
| External customers | P24,210,181 | P11,919,131 | P9,877,681 | P– | P2,278,600 | P– | P48,285,593 |
| Inter-segment | 735,384 | 101,386 | 1,033,901 | – | – | (1,870,671) | – |
| | 24,945,565 | 12,020,517 | 10,911,582 | – | 2,278,600 | (1,870,671) | 48,285,593 |
| Cost of sales and services | 4,378,367 | 9,819,049 | 7,130,795 | – | 1,582,589 | (1,278,717) | 21,632,083 |
| Gross profit | 20,567,198 | 2,201,468 | 3,780,787 | | 696,011 | (591,954) | 26,653,510 |
| Equity in net earnings of associates | – | – | – | 515,112 | – | 379,443 | 894,555 |
| | 20,567,198 | 2,201,468 | 3,780,787 | 515,112 | 696,011 | (212,511) | 27,548,065 |
| Selling expenses | – | 957,664 | 1,301,587 | – | 155,052 | (15,909) | 2,398,394 |
| General and administrative expenses | 18,693,960 | 665,807 | 750,396 | 356,238 | 427,417 | 100,309 | 20,994,127 |
| Operating income | 1,873,238 | 577,997 | 1,728,804 | 158,874 | 113,542 | (296,911) | 4,155,544 |
| Foreign exchange gains - net | 1,342,196 | (1,883) | | 6,599 | (1,154) | 1,946 | 1,347,704 |
| Finance costs | – | (418,214) | (11,892) | – | (49,317) | 24,568 | (454,855) |
| Finance income | – | 99 | 18,516 | 108,825 | 42,037 | (50,436) | 119,041 |
| Others - net | 4,038,751 | 15,506 | (24,702) | 205,733 | 96,882 | (542,594) | 3,789,575 |
| Income before income tax | 7,254,185 | 173,505 | 1,710,726 | 480,031 | 201,990 | (863,427) | 8,957,009 |
| Provision for income tax | 1,620,442 | 72,790 | 516,522 | 331,676 | 82,125 | 53,089 | 2,676,643 |
| Segment profit (loss) from: | | | | | | | |
| Continuing operations | 5,633,743 | 100,715 | 1,194,204 | 148,355 | 119,865 | (916,516) | 6,280,366 |
| Discontinued operations | 264,164 | – | (72,324) | – | – | – | 191,840 |
| Segment profit | P5,897,907 | P100,715 | P1,121,880 | P148,355 | P119,865 | (P916,516) | P6,472,206 |
| Segment profit attributable to: | | | | | | | |
| Equity holders of the Company | P3,117,161 | P99,668 | P1,121,880 | P147,731 | P118,966 | (P195,176) | P4,410,230 |
| Non-controlling interests | 2,780,746 | 1,047 | – | 624 | 899 | (721,340) | 2,061,976 |
| Depreciation and amortization expense | 1,137,939 | 539,345 | 1,675,598 | 10,983 | 174,001 | 17,126 | 3,554,992 |

## 5. Cash and Cash Equivalents

Cash and cash equivalents consist of:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Cash and other cash items | **P14,865,706** | P17,555,206 |
| Cash equivalents: | | |
| Due from *Bangko Sentral ng Pilipinas* (BSP) | **127,337,860** | 81,363,444 |
| Due from other banks | **22,709,805** | 18,287,308 |
| Interbank loans receivable | **9,763,418** | 20,350,383 |
| | **P174,676,789** | P137,556,341 |

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. Cash equivalents 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. Interest earned on cash and other cash items and cash equivalents are presented under “Finance income” and “Banking revenue”, respectively (see Notes 24 and 27).

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

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

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Held for trading: | | |
| Government securities | **P1,313,400** | P4,039,612 |
| Equity securities | **54,609** | 199,922 |
| Derivative assets (Notes 21 and 33) | **419,122** | 181,348 |
| Private debt securities | **196,757** | 143,800 |
| | **1,983,888** | 4,564,682 |
| Designated at FVPL - | | |
| Unit investment trust fund | **4,457,623** | 5,099,052 |
| | **P6,441,511** | P9,663,734 |

a. As of December 31, 2016 and 2015, unrealized loss on government and private debt securities amounted to P66.9 million and P261.5 million, respectively. In 2016 and 2015, the effective interest rates range from 2.75% to 10.63% and from 2.13% to 10.63%, respectively, for the government securities, and from 5.5% to 7.38% and from 4.80% to 7.38%, respectively, for the private debt securities.

b. The carrying amount of equity securities includes unrealized loss of P21.5 million and P53.4 million as of December 31, 2016 and 2015, respectively.

c. On various dates in 2014, the Group invested in PNB Institutional Money Market Fund which is a money market unit investment trust fund (UITF). The investment is subject to a minimum holding period of 30 days. Mark-to-market gains on financial assets at FVPL amounted to P63.0 million and P99.1 million in 2016 and 2015, respectively (see Note 28). Realized gains from redemption of investment presented under finance income amounted to P21.9 million in 2016 and P22.4 million in 2015 (see Notes 27 and 28).

## 7. Available-for-Sale and Held to Maturity Investments

Available for Sale Investments

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Government securities (Note 17 ) | **P38,367,465** | P45,802,968 |
| Other debt securities | **28,841,070** | 22,252,980 |
| Equity securities: | | |
| Quoted | **1,072,405** | 1,329,564 |
| Unquoted | **1,265,071** | 1,177,924 |
| | **69,546,011** | 70,563,436 |
| Allowance for impairment losses | **(944,112)** | (998,749) |
| | **68,601,899** | 69,564,687 |
| Noncurrent portion | **(60,128,678)** | (66,649,517) |
| | **P8,473,221** | P2,915,170 |

a. As of December 31, 2016 and 2015, the fair value of the AFS investments in the form of government and private bonds pledged to fulfill its collateral requirements with securities sold under repurchase agreements transactions with foreign banks amounted to P9.8 billion and P8.5 billion, respectively (see Note 17). The counterparties have an obligation to return the securities to PNB once the obligations have been settled. In case of default, the foreign banks have the right to hold the securities and sell them as settlement of the repurchase agreement.

b. Included in AFS investments are pledged securities for the Surety Bond with fair value of P800.0 million issued by PNB Gen. As of December 31, 2015, the carrying value of these pledged securities amounted to P873.0 million. As of December 31, 2016, a compromise agreement on the settlement of loans has been made and said Surety Bond was no longer renewed by PNB Gen.

c. Other debt securities consist of notes issued by private entities.

d. No impairment loss has been recognized on unquoted debt securities for the years ended December 31, 2016, 2015 and 2014.

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

| | 2016 | 2015 |
|---|---|---|
| Peso-denominated | **1.31% to 5.93%** | 1.03% to 5.62% |
| Foreign-currency denominated | **1.29% to 5.30%** | 1.10% to 5.39% |

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

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | **(P2,256,729)** | (P1,161,616) |
| Net changes in fair value of AFS investments during the year*: | | |
| Fair value changes during the year on AFS investments | **649,259** | (313,048) |
| Realized gains**(Note 24) | **(1,364,426)** | (782,065) |
| | **(715,167)** | (1,095,113) |
| Balance at end of year | **(P2,971,896)** | (P2,256,729) |
| Attributable to: | | |
| Equity holders of the Company*** | **(P1,623,111)** | (P1,099,193) |
| Non-controlling interests | **(1,348,785)** | (1,157,536) |
| | **(P2,971,896)** | (P2,256,729) |

** Net of deferred income tax effect amounting to P0.3 million and P2.9 million in 2016 and 2015, respectively.*
*** Included in “Trading and securities gains” under “Banking revenue”.*
**** Including accumulated fair value gain amounting to P348,786 as at December 31, 2015 in disposal group.*

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

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | **P998,749** | P929,881 |
| Provisions during the year | **15,856** | 32,995 |
| Disposals, transfers and others | **(70,493)** | 68,638 |
| Transfer to disposal group classified as held for sale (Note 37) | **–** | (32,765) |
| Balance at end of year | **P944,112** | P998,749 |

Held-to-Maturity Investments

As of December 31, 2016 and 2015, HTM investments of the Group consist of government securities and private debt securities amounting to P24.1 billion and P23.1 billion, respectively.

As of December 31, 2016 and 2015, the fair value of the HTM 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 P15.3 billion and P7.5 billion, respectively (see Note 17).

*Reclassification of Financial Assets*

On March 3 and March 5, 2014, the Group reclassified certain AFS investments with fair values of P15.9 billion and P6.8 billion, respectively, back to its original classification, as HTM investments, as management has established that it continues to have the positive intention and ability to hold these securities to maturity. The reclassification was approved by the BOD of PNB on February 28, 2014. The previous fair valuation gains amounting to P2.7 billion that have been recognized in OCI shall be amortized to profit or loss over the remaining life of the HTM investments using effective interest rates ranging from 3.60% to 5.64%.

As of December 31, 2016, the carrying values and fair values of the Group's reclassified investment securities amounted to P20.1 billion and P21.4 billion, respectively. As of December 31, 2015, the carrying values and fair values of the reclassified investment securities amounted to P20.3 billion and P21.8 billion, respectively. Had these securities not been reclassified as HTM, the additional mark-to-market loss that would have been recognized by the Group in the statements of comprehensive income amounts to P0.3 billion in 2016 and P0.8 billion in 2015.

## 8. Loans and Receivables

Loans and receivables consist of:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Finance receivables (Notes 17 and 22) | **P441,252,395** | P380,207,907 |
| Trade receivables | **12,703,799** | 12,288,478 |
| Other receivables | **1,784,649** | 2,404,704 |
| | **455,740,843** | 394,901,089 |
| Allowance for credit losses | **(17,306,554)** | (15,977,755) |
| | **438,434,289** | 378,923,334 |
| Noncurrent portion | **(248,621,351)** | (206,782,709) |
| | **P189,812,938** | P172,140,625 |

Finance Receivables

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Receivables from customers: | | |
| Loans and discounts | **P389,916,109** | P335,352,183 |
| Customers' liabilities on acceptances, letters of credit and trust receipts | **10,716,781** | 11,079,224 |
| Bills purchased (Note 20) | **3,622,690** | 3,858,750 |
| Credit card receivables | **7,102,207** | 5,439,554 |
| Finance lease receivables | **3,049,375** | 3,686,790 |
| | **414,407,162** | 359,416,501 |
| Unquoted debt securities | **6,972,710** | 4,245,069 |
| Other receivables: | | |
| Accounts receivable | **9,527,554** | 8,374,156 |
| Accrued interest receivable | **3,884,739** | 5,150,502 |
| Sales contract receivables | **7,449,020** | 4,428,062 |
| Miscellaneous | **501,674** | 429,924 |
| | **21,362,987** | 18,382,644 |
| | **442,742,859** | 382,044,214 |
| Unearned and other deferred income | **(1,490,464)** | (1,836,307) |
| | **441,252,395** | 380,207,907 |
| Allowance for credit losses | **(17,253,410)** | (15,934,483) |
| | **423,998,985** | 364,273,424 |
| Noncurrent portion | **(247,950,622)** | (206,430,391) |
| | **P176,048,363** | P157,843,033 |

a. Transactions with Maybank Philippines, Inc. (Maybank)

   As of December 31, 2015, the balance of these receivables amounted to P3.7 billion while the transferred liabilities amounted to P3.4 billion (P1.8 billion is included under "Bills payable to BSP and local banks" and P1.6 billion is included under "Accrued interest payable"). The excess of the transferred receivables over the transferred liabilities is fully covered by an allowance for credit losses amounting to P0.3 billion as of December 31, 2015.

   In 2016, the Group applied the transferred liabilities against the principal and interest components of the transferred receivables. As of December 31, 2016, the remaining receivables amounted to P0.3 billion, which is fully covered by an allowance.

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 years and at the principal amount of P3.4 billion (Tranche B Note) payable in eight 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. In 2016, PNB obtained additional non-resident unquoted debt investments amounting to P3.4 billion. These investments are zero-rated bonds issued by Chinese financial institutions. As of December 31, 2016 and 2015, the notes are carried at their recoverable values amounting to P3.3 billion and P0.6 billion, respectively.

c. Finance lease receivable

An analysis of the Group's finance lease receivables as of December 31 is presented as follows:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Gross investment in finance lease receivables | | |
| Due within one year | **P1,177,612** | P1,428,528 |
| Due beyond one year but not over five years | **1,127,371** | 1,498,041 |
| Due beyond five years | **36,500** | 47,900 |
| | **2,341,483** | 2,974,469 |
| Residual value of leased equipment | | |
| Due within one year | **249,923** | 225,590 |
| Due beyond one year but not over five years | **457,969** | 486,731 |
| | **707,892** | 712,321 |
| Total finance lease receivable | **P3,049,375** | P3,686,790 |

d. Interest income on loans and receivables consists of (see Note 24):

| | 2016 | 2015 (As represented, Note 37) | 2014 (As represented, Note 37) |
|---|---|---|---|
| Receivable from customers and sales contract receivables | **P19,454,187** | P17,080,888 | P14,705,383 |
| Unquoted debt securities | **51,160** | 63,478 | 521,555 |
| | **P19,505,347** | P17,144,366 | P15,226,938 |

As of December 31, 2016 and 2015, 75.2% and 82.8%, respectively, of the total receivable from customers of the Group were subject to interest repricing. Remaining receivables carry annual fixed interest rates ranging from 2.3% to 8.8% in 2016, from 1.1% to 7.0% in 2015 and from 2.5% to 9.0% in 2014 for foreign currency-denominated receivables, and from 1.00% to 35.0% in 2016, from 0.5% to 15.3% in 2015 and 0.03% to 23.0% in 2014 for peso-denominated receivables.

Sales contract receivables bear fixed interest rate per annum ranging from 5.0% to 21.0% and from 3.3% to 21.0% in 2016 and 2015, respectively. Interest income accrued on impaired loans and receivable of the Group amounted to P103.7 million in 2016, P217.0 million in 2015 and P274.8 million in 2014.

Trade receivables
Trade receivables consist of:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Consumer goods | **P10,897,219** | P9,383,633 |
| Contract receivables | **1,777,640** | 2,875,514 |
| Lease receivables | **28,940** | 29,331 |
| | **12,703,799** | 12,288,478 |
| Allowance for credit losses | **(41,904)** | (32,032) |
| | **12,661,895** | 12,256,446 |
| Noncurrent portion of contract receivables | **(670,729)** | (352,318) |
| | **P11,991,166** | P11,904,128 |

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 P27.0 million, P34.6 million and P24.7 million in 2016, 2015 and 2014, respectively (see Note 27).

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 P133.4 million as of December 31, 2015 (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, 2016** | | | |
|---|---|---|---|---|
| | **Finance Receivables** | **Trade Receivables** | **Other Receivables** | **Total** |
| | *(In Thousands)* | | | |
| Balance at beginning of year | **P15,934,483** | **P32,032** | **P11,240** | **P15,977,755** |
| Provisions during the year (Note 26) | **3,212,694** | **6,211** | **–** | **3,218,905** |
| Accounts charged off, transfers and others | **(1,893,767)** | **3,661** | **–** | **(1,890,106)** |
| Balance at end of year | **P17,253,410** | **P41,904** | **P11,240** | **P17,306,554** |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Finance Receivables | Trade Receivables | Other Receivables | Total |
| | *(In Thousands)* | | | |
| Balance at beginning of year | P12,129,459 | P54,813 | P5,514 | P12,189,786 |
| Provisions during the year (Note 26) | 860,163 | – | 5,726 | 865,889 |
| Accounts charged off, transfers and others | 2,944,861 | (22,781) | – | 2,922,080 |
| Balance at end of year | P15,934,483 | P32,032 | P11,240 | P15,977,755 |

Below is the breakdown of provision for (reversal of) credit losses by type of loans and receivables:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| **Individual assessment** | | |
| Finance receivables: | | |
| Receivable from customers | **P1,957,409** | P487,496 |
| Unquoted debt securities | **81,457** | (166,627) |
| Other receivables | **(247,889)** | 69,304 |
| Trade receivables from customers of consumer goods and other receivables | **6,211** | 5,726 |
| | **1,797,188** | 395,899 |
| **Collective assessment** | | |
| Finance receivables: | | |
| Receivables from customers | **1,563,020** | 434,960 |
| Other receivables | **(141,303)** | 35,030 |
| | **1,421,717** | 469,990 |
| | **P3,218,905** | P865,889 |

## 9. Inventories

Inventories consist of:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| **At Cost:** | | |
| Consumer goods: | | |
| Alcohol | **P2,695,689** | P2,387,930 |
| Beverage | **1,923,260** | 1,887,224 |
| | **4,618,949** | 4,275,154 |
| Real estate inventories: | | |
| Condominium and residential units for sale | **1,326,758** | 3,978,857 |
| Subdivision land under development | **4,288,514** | 3,370,090 |
| Land held for future development | **1,111,274** | 1,137,156 |
| | **6,726,546** | 8,486,103 |
| Fuel, materials and supplies | **1,004,372** | 613,024 |
| | **12,349,867** | 13,374,281 |
| **At NRV** - Materials and supplies | **499,932** | 649,766 |
| | **P12,849,799** | P14,024,047 |

Allowance for inventory obsolescence on materials and supplies amounted to P6.3 million, and P7.0 million as of December 31, 2016 and 2015, respectively.

a. Components of the consumer goods inventories are as follows:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Finished goods | **P690,076** | P729,321 |
| Work in process | **1,080,555** | 1,008,228 |
| Raw materials | **2,848,318** | 2,537,605 |
| | **P4,618,949** | P4,275,154 |

Cost of consumer goods inventories recognized as expenses under cost of sales amounted to P10.9 billion, P12.2 billion and P11.9 billion in 2016, 2015 and 2014, respectively (see Note 24).

b. Movements in real estate inventories are set out below:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | **P8,486,103** | P7,248,823 |
| Construction/development costs incurred | **1,787,274** | 2,208,321 |
| Transfer from (to) investment property | **(2,457,805)** | (80,236) |
| Borrowing costs capitalized (Note 19) | **–** | 61,856 |
| Disposals (recognized as cost of real estate sales, Note 24) | **(1,089,026)** | (952,661) |
| Balance at end of year | **P6,726,546** | P8,486,103 |

The average capitalization rates used to determine the amount of borrowing costs eligible for capitalization is 4.5% in 2015.

## 10. Other Current Assets

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Creditable withholding taxes (CWT) | **P4,857,363** | P3,409,032 |
| Advances to suppliers | **2,198,733** | 985,053 |
| Input VAT | **998,003** | 802,637 |
| Excise tax (Note 38) | **934,066** | 959,654 |
| Prepaid expenses | **488,837** | 468,587 |
| Miscellaneous cash and other cash items | **256,063** | 103,668 |
| Stationeries, office supplies and stamps on hand | **274,904** | 300,156 |
| Deferred rent | **180,566** | 161,592 |
| Deferred charges | **9,095** | 271,257 |
| Advances to contractors | **1,315** | 326,188 |
| Deferred reinsurance premiums | **–** | 287,139 |
| Held-to-maturity investments | **–** | 68,173 |
| Others | **401,454** | 698,787 |
| | **P10,600,399** | P8,841,923 |

a. 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.

b. Advances to suppliers pertain to deposits made for raw material purchases and are applied upon delivery of the related inventories.

c. Excise tax pertains to advance tax payments to the Bureau of Internal Revenue (BIR) on sale of alcoholic beverages (see Note 38).

d. Prepaid expenses include prepaid importation charges amounting to P57.8 million and P72.9 million as of December 31, 2016 and 2015, respectively. 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. Investment in Associates and Joint Ventures

Investments in Associates and Joint Ventures

The Group has the power to participate in the financial and operating policy decisions of PMFTC, VMC, AB HPI, and APLII. The Group also has 50% interest in ABI Pascual Holdings Private Limited (ABI Pascual Holdings) and Ayala-Eton Development Corporation (AEDC) which are jointly controlled entities.

| | Ownership | | Amount | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| | | *(In Thousands)* | | |
| *Associates:* | | | | |
| PMFTC | **49.6%** | 49.6% | **P10,382,799** | P10,289,585 |
| VMC | **30.2%** | 22.5% | **2,238,494** | 1,451,805 |
| AB HPI | **50.0%** | – | **1,575,348** | – |
| APLII | **44.0%** | – | **2,532,754** | – |
| *Joint Ventures:* | | | | |
| ABI Pascual Holdings | **50.0%** | 50.0% | **67,956** | 19,900 |
| AEDC | **50.0%** | – | **20,000** | – |
| | | | **P16,817,351** | P11,761,290 |

*Investment in PMFTC*
Details of investment in PMFTC are as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Acquisition cost | **P13,483,541** | P13,483,541 | P13,483,541 |
| Accumulated equity in net earnings: | | | |
| Balance at beginning of year | **(3,221,410)** | (2,499,984) | 153,454 |
| Equity in net earnings | **2,587,224** | 974,543 | 515,112 |
| Cash dividends (Note 22) | **(2,555,576)** | (1,695,969) | (3,168,550) |
| Balance at end of year | **(3,189,762)** | (3,221,410) | (2,499,984) |
| Accumulated share in other comprehensive income | **89,020** | 27,454 | 27,454 |
| | **P10,382,799** | P10,289,585 | P11,011,011 |

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 industry 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 based on Standing Interpretations Committee (SIC) Interpretation 13, Jointly Controlled Entities-Non-Monetary Contributions by Venturers, where FTC recognized only that portion of the gain 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 a gain of about P293.0 million each year starting 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 | P33,090 |
| Inventories | 19,084,092 |
| Property, plant and equipment | 8,432,235 |
| Other current assets | 4,382,894 |
| Trade and other payable | (2,707,797) |
| Loans payable | (19,000,000) |
| Deferred income tax liability | (1,818,551) |
| | P8,405,963 |

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 as of December 31, are set out below:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Current assets | **P39,548,169** | P41,833,272 |
| Noncurrent assets | **30,055,095** | 31,592,808 |
| Current liabilities | **29,538,232** | 20,760,591 |
| Noncurrent liabilities | **8,024,478** | 21,944,755 |
| Equity | **32,040,554** | 30,720,734 |

Summarized statements of income of PMFTC for the years ended December 31 are as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Revenue | **P112,429,500** | P115,220,990 | P98,384,104 |
| Costs and expenses | **(105,770,205)** | (113,274,083) | (97,819,499) |
| Income before income tax | **6,659,295** | 1,946,907 | 564,605 |
| Provision for income tax | **(1,949,921)** | (533,067) | (116,876) |
| Net income | **4,709,374** | 1,413,840 | 447,729 |
| Other comprehensive income (loss) | **124,125** | 96,932 | (93,233) |
| Total comprehensive income | **P4,833,499** | P1,510,772 | P354,496 |
| Group's share of income for the year | **P2,587,224** | P974,543 | P515,112 |

*Investment in VMC*
Details of investment in VMC are as follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Acquisition cost | | |
| Balance at beginning of year | **P740,528** | P616,441 |
| Additions | **660,297** | 124,087 |
| Balance at end of year | **1,400,825** | 740,528 |
| Accumulated equity in net earnings: | | |
| Balance at beginning of year | **593,874** | 379,443 |
| Equity in net earnings | **77,185** | 196,838 |
| Excess of fair value of net assets of associate over cost of investment | **47,131** | 17,593 |
| Balance at end of the year | **718,190** | 593, 874 |
| Share in remeasurement gain on defined benefit plans | **2,076** | – |
| Balance of convertible notes | **117,403** | 117,403 |
| | **P2,238,494** | P1,451,805 |

In December 21, 2007, the Company acquired 170.1 million shares representing 10.67% ownership in the shares of stock of VMC for P85.1 million presented as AFS investments as of December 31, 2013.

On various dates in April and May 2014, LTG acquired shares of stock of VMC amounting to P413.6 million, which increased its ownership interest to 17.5%, and convertible notes amounting to P359.3 million, which would increase LTG's interest to 23.5% upon conversion. In 2014, portion of the convertible notes amounting to P117.8 million was converted to shares of stock of VMC resulting in an increase in LTG's ownership interest to 20.2% as of December 31, 2014. The cost-based approach was applied in accounting for the step acquisition of VMC as an associate. Accordingly, LTG reclassified the original cost of its AFS investments to investment in an associate and derecognized the net changes in fair value of AFS investments amounting to P238.2 million. The difference of P334.8 million between the sum of the consideration for the 17.5% ownership interest amounting to P498.7 million and the share in fair value of net assets of VMC at the date the investment became an associate amounting to P833.5 million was recognized as part of the equity in net earnings of VMC in 2014.

In 2015, a portion of the convertible notes amounting to P124.1 million was converted to shares of stock of VMC resulting to an increase in LTG's ownership interest to 22.5% as of December 31, 2015. The difference of P17.6 million between the sum of the consideration for the additional 2.3% ownership interest amounting to P124.1 million and the share in fair value of net assets of VMC at the date of the conversion amounting to P141.7 million was recognized as part of the equity in net earnings of VMC in 2015.

On February 15, 2016, VMC approved the acquisition of its own shares. The sale agreement had been executed on February 18, 2016 and led to the acquisition of 300.0 million treasury shares. This resulted in an increase in the Parent Company's percentage of ownership from 22.5% to 25.1%. On the same date, the Group, through FTC, acquired additional shares of stock of VMC amounting to P660.3 million resulting to an increase in the Group's effective ownership in VMC to 30.2%.

The summarized financial information of VMC as of November 30 follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Current assets | **P2,317,150** | P2,896,521 |
| Noncurrent assets | **6,460,726** | 5,660,979 |
| Current liabilities | **682,111** | 581,440 |
| Noncurrent liabilities | **2,993,433** | 1,816,696 |
| Equity | **5,102,332** | 6,159,364 |

Summarized statements of income of VMC for the years ended November 30 are as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Revenue | **P5,195,381** | P5,034,302 | P1,352,346 |
| Costs and expenses | **(4,296,953)** | (3,440,352) | (965,718) |
| Income before income tax | **898,428** | 1,593,950 | 386,628 |
| Provision for income tax | **(249,141)** | (483,712) | (120,357) |
| Net income | **649,287** | 1,110,238 | 266,271 |
| Other comprehensive income (loss) | **(53)** | 2,648 | – |
| Total comprehensive income | **P649,234** | P1,112,886 | 266,271 |
| Group's share of income for the year | **P196,069** | P250,399 | P53,787 |

*Investment in AB HPI*

On May 6, 2016, AB HPI was incorporated and registered with the Philippine SEC for 1,000 authorized shares at P1,000 par value per share under the name of Broncobrew, Incorporated (Broncobrew). The Philippine SEC approved the change in corporate name of Broncobrew to AB Heineken Philippines Inc. on July 12, 2016.

On May 30, 2016, the Group, through ABI, purchased 500 shares of stock of AB HPI for a consideration amounting to P5.0 million. On November 15, 2016, the Group purchased additional 782,400 common shares out of the proposed increase in the authorized capital stock of AB HPI for a consideration of P782.4 million. The Group's subscription to AB HPI represents 50% ownership interest.

In accordance with the Shareholders' Agreement entered into by the Group and Heineken, the Group sold nonmonetary assets, (i.e., inventories, returnable containers and brands), to AB HPI for a total consideration of P782.4 million. The nonmonetary assets were sold at their carrying amounts, except for the brands which resulted to a gain from fair valuation amounting to P46.3 million.

The Group's subscription to AB HPI's capital stock and sale of nonmonetary assets to AB HPI is viewed as linked-transaction and is accounted for as contribution of nonmonetary assets to an associate. As a result, the Group recognized the investment amounting to P1,843.6 million representing 50% of the fair value of AB HPI's net assets. The transaction was accounted for in accordance with PFRS 10, paragraph 25, where the Group recognized the gain arising from the contribution of nonmonetary assets amounting to P1,056.2 million in full (see Note 37).

Details of the investment in an associate as of December 31, 2016 are as follows (in thousands):

| | |
|---|---|
| Subscription to capital stock | P787,400 |
| Gain on investment in an associate arising from contribution of non-monetary assets in exchange for shares of stocks | 1,056,240 |
| Share in net loss of an associate | (268,292) |
| Ending balance | P1,575,348 |

Summarized financial information of AB HPI, based on its PFRSs financial statements, as of December 31, 2016 are as follows (in thousands):

| | |
|---|---|
| Current assets | P2,046,764 |
| Noncurrent assets | 2,905,148 |
| Current liabilities | 920,850 |
| Noncurrent liabilities | 880,384 |
| Total capital deficiency | 3,150,678 |

Summarized statements of income of AB HPI for the year ended December 31, 2016 are as follows (in thousands):

| | |
|---|---|
| Revenue | P341,790 |
| Costs and expenses | (878,374) |
| Loss before income tax | 536,584 |
| Provision for income tax | – |
| Net loss | 536,584 |
| Other comprehensive loss | 18 |
| Total comprehensive loss | P536,602 |
| Group's share of loss for the year | P268,292 |

*Investment in APLII*

On December 21, 2015, PNB entered into a 15-year exclusive partnership with Allianz SE under the following arrangements, subject to regulatory approvals:

- Allianz SE will acquire 12,750 shares representing 51% stockholdings of APLII and will have management control over the new joint venture company;
- The new joint venture company will operate under the name of "Allianz-PNB Life Insurance, Inc.";
- A 15-year distribution agreement which will provide Allianz an exclusive access to the branch network of PNB and PNB Savings Bank.

The sale of APLII was completed on June 6, 2016 for a total consideration of US$66.0 million (P3.1 billion). Pursuant to the sale of APLII, PNB also entered into a distribution agreement with APLII where PNB will allow APLII to have exclusive access to the distribution network of PNB and its subsidiary, PNB Savings Bank, over a period of 15 years. Both the share purchase agreement and distribution agreement have provisions referring to one another, making the distribution agreement an integral component of the sale transaction. Accordingly, the purchase consideration of US$66.0 million (P3.1 billion) was allocated between the sale of the 51% interest in APLII and the Exclusive Distribution Rights (EDR) amounting to US$44.9 million (P2.1 billion) and US$21.1 million (P1.0 billion), respectively.

PNB will also receive variable annual and fixed bonus earn out payments based on milestones achieved over the 15-year term of the distribution agreement.

The Group recognized gain on sale of the 51% interest in APLII amounting to P400.3 million, net of taxes and transaction costs amounting to P276.7 million and P153.3 million, respectively. The deferred revenue amounting to P976.2 million allocated to the EDR was presented as "Other deferred revenue" and will be amortized to income over 15 years from date of sale (see Note 20). Amortization amounting to P36.5 million was recognized in 2016 (see Note 28). Prior to the sale of shares to Allianz SE, PNB acquired additional 15% stockholdings from the minority shareholders for a consideration amounting to P292.4 million between June 2, 2016 and June 5, 2016.

Consequently, PNB accounted for its remaining 44% ownership interest in APLII as an associate. At the date of loss of control, PNB's investment in APLII was remeasured to P2.7 billion based on the fair value of its retained equity. PNB recognized gain on remeasurement amounting to P1.6 billion in the 2016 consolidated statement of income.

The fair value of the retained equity was based on a combination of the income approach and market approach.

On September 21, 2016, the Philippine SEC approved the amendment of PNB Life Insurance, Inc.'s article of incorporation to reflect the change in corporate name to Allianz-PNB Life Insurance, Inc.

Summarized financial information of APLII as of December 31, 2016 are as follows:

| | |
|---|---|
| Current assets | P14,812,452 |
| Noncurrent assets | 9,602,162 |
| Current liabilities | 14,287,861 |
| Noncurrent liabilities | 7,995,855 |
| Equity | 2,130,898 |

Summarized statements of income of APLII for the seven months ended December 31, 2016 are as follows (in thousands):

| | |
|---|---|
| Revenue | P1,164,407 |
| Costs and expenses | (1,022,543) |
| Income before income tax | 141,864 |
| Provision for income tax | (29,762) |
| Net income | 112,102 |
| Other comprehensive loss | (556,044) |
| Total comprehensive income | (P443,942) |
| Group's share of comprehensive income for the period | (P195,334) |

*Investment in ABI Pascual Holdings*
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.

The summarized financial information of ABI Pascual Holdings as of December 31 follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Current assets | **P164,783,352** | P70,080,249 |
| Noncurrent assets | **1,173,950** | 1,140,975 |
| Current liabilities | **29,617,526** | 163,760,511 |
| Noncurrent liabilities | **2,361,086** | 1,351,514 |
| Total equity (capital deficiency) | **133,978,690** | (93,890,801) |

The summarized statements of income of ABI Pascual Holdings for the years ended December 31 follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Revenue | **P184,512** | P124,247 | P93,591 |
| Costs and expenses | **(131,941)** | (128,969) | (116,678) |
| Income before income tax | **52,571** | (4,722) | (23,087) |
| Provision for income tax | **(2,612)** | – | – |
| Net income (loss) | **49,959** | (4,722) | (23,087) |
| Other comprehensive income (loss) | **104** | 2,916 | – |
| Total comprehensive income | **P50,063** | (P1,806) | (P23,087) |
| Group's share of income for the year | **P24,665** | (P2,067) | (P46,043) |

Disclosures on Subsidiary with Material Non-controlling Interest
Following is the financial information of PNB, which has material non-controlling interests of 43.53% as of and for the years ended December 31:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Accumulated balances of material non-controlling interest | **P38,202,847** | P38,103,827 | P35,600,617 |
| Net income allocated to material non-controlling interest | **3,235,013** | 2,860,406 | 2,507,994 |
| Total comprehensive income allocated to material non-controlling interest | **2,976,343** | 2,503,210 | 2,328,509 |

As discussed in Note 1, on February 9, 2013, PNB acquired 100% 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 the pooling-of-interests method. Thus, the summarized financial information of PNB below is based on the amounts in the consolidated financial statements of PNB prepared under the pooling-of-interests method before the Group's inter-company eliminations.

Statements of Comprehensive Income:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Revenue | **P29,302,092** | P26,610,310 | P24,945,565 |
| Cost of services | **(5,722,738)** | (4,807,242) | (4,378,367) |
| General and administrative expenses | **(23,215,141)** | (18,449,228) | (18,693,960) |
| Foreign exchange gains - net | **1,487,740** | 1,207,840 | 1,342,196 |
| Other income - net | **6,427,747** | 3,393,380 | 4,038,751 |
| Income before income tax | **8,279,700** | 7,955,060 | 7,254,185 |
| Provision for income tax | **(1,517,030)** | (1,543,789) | (1,620,442) |
| Net income from continuing operations | **6,762,670** | 6,411,271 | 5,633,743 |
| Net income from discontinued operations | **619,563** | 357,931 | 264,164 |
| Net income | **7,382,233** | 6,769,202 | 5,897,907 |
| Other comprehensive income (loss) | **(594,234)** | 1,380,871 | (463,460) |
| Total comprehensive income | **P6,787,999** | P8,150,073 | P5,434,447 |
| Net income attributable to: | | | |
| Equity holders of the Parent Company | **P4,705,162** | P3,673,284 | P3,117,161 |
| Non-controlling interests | **2,677,071** | 3,095,918 | 2,780,746 |
| Total comprehensive income attributable to: | | | |
| Equity holders of the Parent Company | **4,369,598** | 5,454,974 | 2,855,444 |
| Non-controlling interests | **2,418,401** | 2,695,099 | 2,579,003 |

Balance Sheets:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Current assets | **P363,527,807** | P331,611,312 |
| Noncurrent assets | **377,357,531** | 334,920,597 |
| Current liabilities | **575,558,848** | 494,826,885 |
| Noncurrent liabilities | **68,358,018** | 79,378,820 |
| Equity attributable to: | | |
| Equity holders of the Parent Company | **54,750,476** | 50,946,819 |
| Non-controlling interest | **42,217,996** | 41,379,385 |

Statements of Cash Flows:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Operating | **P28,108,324** | (P2,263,547) | (P61,400,140) |
| Investing | **3,482,266** | (10,634,340) | (542,830) |
| Financing | **2,823,720** | 5,275,983 | 17,168,222 |
| Net increase (decrease) in cash and cash equivalents | **P34,414,310** | (P7,621,904) | (P44,774,748) |

## 12. Property, Plant and Equipment

December 31, 2016

| | 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 |
| | | | | | *(In Thousands)* | | | | | | |
| **Cost** | | | | | | | | | | | |
| Balance at beginning of year | P20,206,827 | P19,976,979 | P24,508,145 | P64,691,951 | P4,340,393 | P1,791,570 | P7,120,021 | P10,061,063 | P1,121,978 | P24,435,025 | P89,126,976 |
| Additions/transfers (Note 13) | 1,366 | 1,171,957 | 1,068,927 | 2,242,250 | 269,152 | 161,169 | 473,441 | 1,369,699 | 253,300 | 2,526,761 | 4,769,011 |
| Disposals/transfers/others (Note 13 and 28) | (3,266,019) | (1,584,068) | 937,824 | (3,912,263) | 189,614 | (29,277) | (4,369,742) | (529,745) | (1,168,832) | (5,907,982) | (9,820,245) |
| Balance at end of year | 16,942,174 | 19,564,868 | 26,514,896 | 63,021,938 | 4,799,159 | 1,923,462 | 3,223,720 | 10,901,017 | 206,446 | 21,053,804 | 84,075,742 |
| **Accumulated Depreciation, Amortization and Impairment Losses** | | | | | | | | | | | |
| Balance at beginning of year | 953,589 | 6,226,112 | 17,974,105 | 25,153,806 | 3,514,582 | 1,521,638 | 6,053,838 | 8,045,236 | – | 19,135,294 | 44,289,100 |
| Depreciation and amortization | 141,787 | 569,268 | 863,188 | 1,574,243 | 265,234 | 138,244 | 460,267 | 848,363 | – | 1,712,108 | 3,286,351 |
| Disposals/transfers/others (Note 13 and 28) | 12,621 | (306,347) | 483,567 | 189,841 | (188,225) | (28,944) | (3,948,694) | (798,309) | – | (4,964,172) | (4,774,331) |
| Balance at end of year | 1,107,997 | 6,489,033 | 19,320,860 | 26,917,890 | 3,591,591 | 1,630,938 | 2,565,411 | 8,095,290 | – | 15,883,230 | 42,801,120 |
| **Net Book Value** | P15,834,177 | P13,075,835 | P7,194,036 | P36,104,048 | P1,207,568 | P292,524 | P658,309 | P2,805,727 | P206,446 | P5,170,574 | P41,274,622 |

December 31, 2015

| | 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 |
| | | | | | *(In Thousands)* | | | | | | |
| **Cost** | | | | | | | | | | | |
| Balance at beginning of year | P17,733,967 | P19,982,538 | P27,125,256 | P64,841,761 | P3,944,254 | P1,718,288 | P6,628,513 | P9,241,275 | P386,422 | P21,918,752 | P86,760,513 |
| Additions/transfers (Note 13) | 2,270,088 | 736,586 | 518,931 | 3,525,605 | 179,355 | 88,292 | 505,223 | 1,204,136 | 1,144,707 | 3,121,713 | 6,647,318 |
| Disposals/transfers/others (Note 28) | 202,772 | (742,145) | (3,136,042) | (3,675,415) | 216,784 | (15,010) | (13,715) | (384,348) | (409,151) | (605,440) | (4,280,855) |
| Balance at end of year | 20,206,827 | 19,976,979 | 24,508,145 | 64,691,951 | 4,340,393 | 1,791,570 | 7,120,021 | 10,061,063 | 1,121,978 | 24,435,025 | 89,126,976 |
| **Accumulated Depreciation, Amortization and Impairment Losses** | | | | | | | | | | | |
| Balance at beginning of year | 909,980 | 8,380,263 | 17,080,993 | 26,371,236 | 3,330,800 | 1,398,039 | 5,480,748 | 7,733,768 | – | 17,943,355 | 44,314,591 |
| Depreciation and amortization | 23,519 | 591,716 | 839,602 | 1,454,837 | 181,337 | 138,217 | 573,090 | 611,059 | – | 1,503,703 | 2,958,540 |
| Disposals/transfers/others (Note 28) | 20,090 | (2,745,867) | 53,510 | (2,672,267 ) | 2,445 | (14,618) | – | (299,591) | – | (311,764) | (2,984,031) |
| Balance at end of year | 953,589 | 6,226,112 | 17,974,105 | 25,153,806 | 3,514,582 | 1,521,638 | 6,053,838 | 8,045,236 | – | 19,135,294 | 44,289,100 |
| **Net Book Value** | P19,253,238 | P13,750,867 | P6,534,040 | P39,538,145 | P825,811 | P269,932 | P1,066,183 | P2,015,827 | P1,121,978 | P5,299,731 | P44,837,876 |

Revaluation of Land and Land Improvements, 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 Philippine SEC-accredited and 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, 2016 and 2011 (see Note 34). Movements in revaluation increment, net of deferred income tax effect, are as follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Revaluation increment on the property, plant and equipment, net of deferred income tax effect: | | |
| Balance at beginning of year | **P7,249,395** | P8,121,362 |
| Net revaluation decrease | **273,509** | (360,163) |
| Transfer of portion of revaluation increment on property, plant and equipment realized through depreciation and disposal | **(720,604)** | (511,804) |
| Balance at end of year | **P6,802,300** | P7,249,395 |
| Attributable to: | | |
| Equity holders of the Company | **P4,473,280** | P4,920,375 |
| Non-controlling interests | **2,329,020** | 2,329,020 |
| | **P6,802,300** | P7,249,395 |

If land and land improvements, plant buildings and building improvements, and machineries and equipment were measured using the cost model, the carrying amount would be as follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Cost: | | |
| Land and land improvements | **P7,367,949** | P9,514,421 |
| Plant buildings and improvements | **13,773,131** | 15,082,717 |
| Machineries and equipment | **28,406,332** | 20,145,218 |
| | **49,547,412** | 44,742,356 |

(Forward)

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Accumulated depreciation | | |
| Plant buildings and improvements | **(P5,937,751)** | (P5,124,987) |
| Machineries and equipment | **(19,098,833)** | (10,435,503) |
| | **(25,036,584)** | (15,560,490) |
| | **P24,510,828** | P29,181,866 |

Depreciation
Depreciation of property, plant and equipment charged to operations is as follows:

| | **2016** | 2015 (As represented, Note 37 | 2014 (As represented, Note 37 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Continuing operations: | | | |
| Cost of sales and services (Note 24) | **P1,078,798** | P997,229 | P1,060,426 |
| Selling expenses (Note 25) | **491,555** | 481,492 | 523,903 |
| General and administrative expenses (Note 26) | **1,320,606** | 1,019,248 | 1,050,626 |
| Discontinued operations (Note 37) | **395,392** | 460,571 | 443,612 |
| | **P3,286,351** | P2,958,540 | P3,078,567 |

As of December 31, 2015 and 2014, the Group's "Construction in progress" under the "Property, plant and equipment" account pertains to the construction of TDI's warehouse and bottle sorting facility, AAC's major rehabilitation of plant facilities, and ABI's construction of new manufacturing plant. These capital expenditure projects were completed in 2016.

Out of the total additions in 2016 and 2015, P86.6 million and P78.1 million remain to be unpaid as of December 31, 2016 and 2015, respectively.

Certain property and equipment of the Group with carrying amount of P178.5 million and P180.8 million are temporarily idle as of December 31, 2016 and 2015, respectively.

Borrowing Costs
Unamortized capitalized borrowing costs amounted to P12.5 million and P13.2 million as of December 31, 2016 and 2015, respectively. The average capitalization rate used to determine the amount of borrowing costs eligible for capitalization was 4.5% in 2015. There was no borrowing cost capitalized in 2016.

## 13. Investment Properties

Movements of the Group's investment properties are as follows (in thousands):

| | **December 31, 2016** | | | | |
|---|---|---|---|---|---|
| | **Land** | **Buildings and Improvements** | **Residential Unit** | **Construction in Progress** | **Total** |
| **Cost** | | | | | |
| Balance at beginning of year | **P18,703,010** | **P9,714,260** | **P7,620** | **P290,804** | **P28,715,694** |
| Additions | **667,914** | **24,846** | **–** | **379,530** | **1,072,290** |
| Transfers | **2,618,975** | **1,016,505** | **–** | **1,541,805** | **5,177,285** |
| Disposals | **–** | **(241,343)** | **–** | **–** | **(241,343)** |
| Balance at end of year | **21,989,899** | **10,514,268** | **7,620** | **2,212,139** | **34,723,926** |
| **Accumulated Depreciation and Impairment Losses** | | | | | |
| Balance at beginning of year | **3,382,883** | **3,093,666** | **7,620** | **–** | **6,484,169** |
| Depreciation | **–** | **261,027** | **–** | **–** | **261,027** |
| Provision for impairment losses | **810** | **1,890** | **–** | **–** | **2,700** |
| Disposals | **–** | **(241,343)** | **–** | **–** | **(241,343)** |
| Balance at end of year | **3,383,693** | **3,115,240** | **7,620** | **–** | **6,506,553** |
| **Net Book Value** | **P18,606,206** | **P7,399,028** | **P–** | **P2,212,139** | **P28,217,373** |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Land | Buildings and Improvements | Residential Unit | Construction in Progress | Total |
| **Cost** | | | | | |
| Balance at beginning of year | P23,541,887 | P10,064,779 | P7,620 | P138,979 | P33,753,265 |
| Additions | 1,339,183 | 218,252 | – | 46,284 | 1,603,719 |
| Transfers | (2,217,654) | – | – | 105,541 | (2,112,113) |
| Disposals/transfers/others | (3,960,406) | (568,771) | – | – | (4,529,177) |
| Balance at end of year | 18,703,010 | 9,714,260 | 7,620 | 290,804 | 28,715,694 |
| **Accumulated Depreciation and Impairment Losses** | | | | | |
| Balance at beginning of year | 3,248,922 | 3,298,790 | 7,620 | – | 6,555,332 |
| Depreciation | – | 369,803 | – | – | 369,803 |
| Provision for impairment losses | 133,961 | (309,718) | – | – | (175,757) |
| Disposals | – | (265,209) | – | – | (265,209) |
| Balance at end of year | 3,382,883 | 3,093,666 | 7,620 | – | 6,484,169 |
| **Net Book Value** | P15,320,127 | P6,620,594 | P– | P290,804 | P22,231,525 |

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 P155.4 million and P150.0 million as of December 31, 2016 and 2015, respectively. The Group is exerting continuing efforts to dispose these properties.

In 2015, investment properties with carrying value of P2.2 billion were converted as branches and head offices of PNB's subsidiaries and were transferred to property, plant and equipment (see Note 12). In 2016, the Group reclassified certain properties from "property, plant and equipment" to "Investment property" with aggregate carrying amount of P4.7 billion. These properties mainly consist of the office spaces in the Allied Bank Center in Makati City leased out and land in Buendia, Makati City being held for future development.

As of December 31, 2016 and 2015, the Group's "Construction in progress" under the "Investment property" account pertains to the contruction of building intended for leasing and which is expected to be completed in 2017.

Out of the total additions in 2015, P1,063.3 million remain to be unpaid as of December 31, 2015.

Fair Values of Investment Properties

Below are the fair values of the investment properties which were determined by professionally qualified, accredited and independent appraisers based on market values:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Land | **P24,971,630** | P30,136,203 |
| Buildings and improvements | **8,810,139** | 8,517,345 |
| | **P33,781,769** | P38,653,548 |

The fair value of investment properties of the Group was determined using various acceptable valuation approaches and both observable and unobservable inputs (see Note 34).

Rent Income and Direct Operating Expenses of Investment Properties

Rental income and direct operating expenses arising from the investment properties of property development segment amounted to P1,278.5 million and P253.8 million in 2016, P1,172.5 million and P226.9 million in 2015, and P740.3 million and P278.9 million in 2014, respectively (see Note 24).

Rental income of the banking segment on its investment properties is presented under "Other income (charges)" (see Note 28).

Depreciation of investment properties charged to operations follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Cost of rental income (Note 24) | **P137,457** | P130,493 | P145,680 |
| General and administrative expenses (Note 26) | **123,570** | 239,310 | 169,509 |
| | **P261,027** | P369,803 | P315,189 |

## 14. Other Noncurrent Assets

Other noncurrent assets consist of:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Software costs | **P1,448,022** | P1,131,041 |
| Deferred input VAT | **420,831** | 378,486 |
| Deposit for future investments | **334,060** | 348,511 |
| Deferred reinsurance premiums | **302,916** | 499,148 |
| Net retirement plan assets (Note 23) | **276,870** | 255,716 |
| Refundable and security deposits | **273,018** | 160,510 |
| Deferred charges | **251,682** | 129,974 |
| Goodwill | **163,735** | 163,735 |
| Chattel properties - net | **36,585** | 2,107 |
| Other investments | **22,201** | 19,861 |
| Receivable from SPV - net | **500** | 500 |
| Others - net | **197,352** | 290,655 |
| | **P3,727,772** | P3,380,244 |

a. Deferred input VAT arises mainly from the acquisition of capital goods.

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | **P1,131,041** | P667,364 |
| Additions | **420,205** | 587,390 |
| Other adjustments | **6,756** | 462 |
| Amortization (Note 26) | **(109,980)** | (124,175) |
| Balance at end of year | **P1,448,022** | P1,131,041 |

b. Deferred input VAT arises mainly from the acquisition of capital goods.

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 P154.8 million and P145.4 million as of December 31, 2016 and 2015, respectively, will be refunded upon termination of the service contract and completion of the projects' construction.

d. The Group recognized goodwill which pertains mainly to ADI and Eton amounting to P144.7 million and P19.0 million, respectively. As of December 31, 2016 and 2015, the Group performed its annual impairment testing of goodwill related to its CGUs, ADI and Eton.

   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 9.7% in 2016 and 2015. The growth rate used to extrapolate the cash flows of until beyond the five-year period is 6.2% as of December 31, 2016 and 6.0% as of December 31, 2015. 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, 2016 and 2015, the recoverable amount of ADI is higher than its carrying value.

e. As of December 31, 2016 and 2015, accumulated depreciation on chattel mortgage properties acquired by PNB in settlement of loans amounted to P79.1 million and P36.5 million, respectively.

f. The Group has receivable from SPV, OPII, which was deconsolidated upon adoption of PFRS 10.

   As of December 31, 2016 and 2015, receivable from SPV represents fully provisioned subordinated notes received by PNB from Golden Dragon Star Equities and its assignee, OPII, 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 OPII for the sale of the NPAs were executed on December 19, 2006. OPII was specifically organized to hold, manage, service and resolve the non-performing assets sold to Golden Dragon Star Equities. OPII has been financed through the issuance of equity securities and subordinated debt securities. Collection from OPII in 2016, 2015 and 2014 amounting to P500.0 million, P353.0 million, and P27.0 million, respectively are recorded part of "Other income (charges)" (see Note 28).

**15. Deposit Liabilities**

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Demand | **P112,532,681** | P113,168,584 |
| Savings | **368,798,751** | 302,476,256 |
| Time | **80,088,800** | 60,511,352 |
| | **561,420,232** | 476,156,192 |
| Presented as noncurrent | **(45,866,133)** | (39,793,338) |
| Presented as current | **P515,554,099** | P436,362,854 |

Of the total deposit liabilities of the Group, P19.9 billion and P23.8 billion are non-interest bearing as of December 31, 2016 and 2015, respectively. Annual interest rates of the deposit liabilities follow:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Foreign-currency denominated deposit liabilities | **0.00% to 3.71%** | 0.00% to 2.25% | 0.02% to 2.26% |
| Peso-denominated deposit liabilities | **0.00% to 6.23%** | 0.05% to 5.00% | 0.05% to 6.11% |

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.

BSP issued Circular Nos. 830 and 832 last March 27, 2014 and May 8, 2014, respectively, to approve the one-point percentage increase in the reserve requirements of universal and commercials banks. Under existing BSP regulations, non-FCDU deposit liabilities of PNB and PNB Savings Bank are subject to reserves equivalent to 20.00% and 8.00%, respectively. As of December 31, 2016 and 2015, available reserves booked under "Due from BSP" amounted to P89.0 billion and P74.3 billion, respectively.

*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 |
|---|---|---|---|---|---|
| December 6, 2016 | June 6, 2022 | P5,380,000 | P5,343,041 | 3.25% | Quarterly |
| December 12, 2014 | June 12, 2020 | 7,000,000 | 6,958,411 | 4.13% | Quarterly |
| October 21, 2013 | April 22, 2019 | 4,000,000 | 3,981,365 | 3.25% | Quarterly |
| August 5, 2013 | February 5, 2019 | 5,000,000 | 4,979,615 | 3.00% | Quarterly |
| November 18, 2011 | February 17, 2017 | 3,100,000 | 3,094,836 | 5.18% | Quarterly |

Other significant terms and conditions of the above LTNCDs follow:

a. Issue price at 100.00% of the face value of each LTNCD.

b. 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.

c. 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.

d. The LTNCDs constitute direct, unconditional, unsecured, and unsubordinated obligations of PNB, enforceable according to the related Terms and Conditions, and shall at all times rank paripassu and without any preference or priority among themselves and at least paripassu 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.

e. 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.

f. The LTNCDs are insured by the PDIC up to a maximum amount of P0.5 million subject to applicable laws, rules and regulations, as the same may be amended from time to time.

g. 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 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 P3.8 billion, P3.0 billion and P2.9 billion in 2016, 2015 and 2014, respectively (see Note 24).

In 2016, 2015 and 2014, interest expense on LTNCDs of the Group includes amortization of transaction costs amounting to P25.3 million, P16.9 million and P22.8 million, respectively. Unamortized transaction costs of the LTNCDs amounted to P97.9 million and P85.8 million as of December 31, 2016 and 2015, respectively.

## 16. Financial Liabilities at Fair Value through Profit or Loss (FVPL)

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

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Derivative liabilities (Notes 21 and 33) | **P232,832** | P135,193 |
| Less noncurrent portion | **–** | 9,118 |
| Current portion | **P232,832** | P126,075 |

## 17. Bills and Acceptances Payable

Bills and acceptances payable consist of:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Bills payable to: | | |
| BSP and local banks (Note 22) | **P26,575,782** | P17,580,304 |
| Foreign banks | **7,632,548** | 7,676,238 |
| Others | **18,277** | 150,864 |
| | **34,226,607** | 25,407,406 |
| Acceptances outstanding | **1,659,340** | 344,816 |
| | **35,885,947** | 25,752,222 |
| Less noncurrent portion | **10,817,679** | 19,915,383 |
| Current portion | **P25,068,268** | P5,836,839 |

Annual interest rates are shown below:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Foreign currency-denominated borrowings | **0.05% to 2.00%** | 0.01% to 2.50% | 0.03% - 2.50% |
| Peso-denominated borrowings | **0.63%** | 0.38% to 0.63% | 0.63% - 2.00% |

PNB's bills payable to BSP includes the transferred liabilities from Maybank Philippines, Inc. (Maybank) amounting to P1.8 billion as of December 31, 2015 which were applied against the principal component of the transferred receivables in May 2016 (see Note 8).

Bills payable to foreign banks consist of various repurchase agreements and a three-year syndicated borrowing, with carrying value of P7.4 billion and P7.0 billion as of December 31, 2016 and 2015, respectively.

Significant terms and conditions of the three-year syndicated borrowing include the following:

- The lenders agree to provide PNB with a term loan facility of up to US$150.00 million (P7.5 billion). PNB must repay all utilized loans at April 24, 2018, the final maturity date, which is three years from the agreement date.
- The borrowing bears interest at 1.38% over USD LIBOR. PNB may select an interest period of one or three months for each utilization, provided that the interest period for a utilization shall not extend beyond the final maturity date.
- PNB shall ensure that so long as any amount of the facility is utilized, the Common Equity Tier 1 Risk Weighted Ratio, the Tier 1 Risk Weighted Ratio, and the Qualifying Capital Risk Weighted Ratio will, at all times, be equal to or greater than the percentage prescribed by BSP from time to time. Failure to comply with such financial covenants will result to cancellation of the total commitments of the lenders and declare all or part of the loans, together with accrued interest, be immediately due and payable.
- PNB may voluntarily prepay whole or any part of any loan outstanding and in integral multiples of US$1.0 million (P49.7 million), subject to prior notice of the Agent for not less than 15 business days. Prepayment shall be made on the last day of an interest period applicable to the loan. Mandatory prepayment may occur if a change of control or credit rating downgrade occurs. In this case, the lenders may cancel the facility and declare all outstanding loans, together with accrued interest, immediately due and demandable.

As of December 31, 2016 and 2015, PNB has complied with the above debt covenants.

As of December 31, 2016 and 2015, the unamortized transaction cost of the syndicated borrowing amounted to P32.7 million and P54.9 million, respectively.

As of December 31, 2016, bills payable with a carrying amount of P20.6 billion is secured by a pledge of certain AFS investments with carrying value and fair value of P10.0 billion and P9.8 billion, respectively, and HTM investments with carrying value and fair value of P14.5 billion and P15.3 billion, respectively (see Note 7).

As of December 31, 2015, bills payable with a carrying amount of P12.8 billion is secured by a pledge of certain AFS with carrying value and fair value of P8.5 billion and HTM investments with carrying value and fair value of P7.0 billion and P7.5 billion, respectively (see Note 7).

Following are the significant terms and conditions of the repurchase agreements entered into by PNB:

a. 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;

b. The term or life of this borrowing is up to three years;

c. Some borrowings bear a fixed interest rate while others have floating interest rate;

d. PNB has pledged its AFS and ATM investments, in form of ROP Global bonds, in order to fulfill its collateral requirement;

e. Haircut from market value ranges from 15.00% to 25.00% depending on the tenor of the bond;

f. Certain borrowings are subject to margin call up to US$1.4 million; and

g. 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 P1.0 billion in 2016 and 2015 and P0.9 billion in 2014 (see Note 24).

## 18. Accounts Payable and Accrued Expenses

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Trade payables | **P9,913,554** | P8,785,564 |
| Nontrade payables | **281,765** | 377,087 |
| Accrued expenses: | | |
| Project development costs | **1,663,547** | 1,932,508 |
| Purchase of materials and supplies and others | **946,185** | 759,244 |
| Taxes and licenses | **613,023** | 374,908 |
| Interest | **591,310** | 2,085,701 |
| Rent and utilities payable | **542,631** | 103,043 |
| PDIC insurance premiums | **517,148** | 470,701 |
| Advertising and promotional expenses | **415,536** | 284,281 |
| Information technology-related expenses | **122,039** | 194,974 |
| Retention payable | **658,346** | 690,714 |
| Output value added tax | **522,422** | 661,368 |
| Due to government agencies | **353,234** | 275,757 |
| Other payables | **150,537** | 83,970 |
| | **P17,291,277** | P17,079,820 |

Trade Payables
Trade payables are non-interest bearing and are normally settled on 30 to 60 days terms. Trade payables arise mostly from trade purchases of the banking group and 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 Project Development Costs
Accued project development costs represent costs incurred by the Property Development segment in the development and construction of real estate projects.

Accrued Expenses
Other accrued expenses consist of accruals for commission, outside services, fuel and oil, 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 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
As of December 31, 2016 and 2015, outstanding unsecured short-term debts amounted to P1,750 million and P1,400 million, respectively. The loans are subject to annual interest rates ranging from 3.3% to 3.5% in 2016 and 2015, are payable lump-sum on various dates within one year and subject to renewal upon agreement by the Group and counterparty banks. In 2015, the Group obtained additional short-term loans from BDO amounting to P1.1 billion which are payable in lump-sum after 60 days.

Long-term Debts

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Subordinated debts | **P3,497,798** | P9,986,427 |
| Unsecured term loan | **1,604,003** | 720,004 |
| Notes payable | **466,946** | 476,015 |
| | **5,568,747** | 11,182,446 |
| Current portion | **(466,946)** | (476,015) |
| Noncurrent portion | **P5,101,801** | P10,706,431 |

*PNB's Subordinated Debts*

5.875% 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. EIR on this note is 6.04%.

Significant terms and conditions of the subordinated notes follow:

(1) 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 May of each year, commencing on May 9, 2012, unless the 2012 Notes are redeemed at a redemption price equal to 100% of the principal amount on May 10, 2017, Call Option Date.

(2) 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 PNB arising under or in connection with the 2012 Notes.

In a resolution dated January 26, 2017, the BSP Monetary Board approved the request of PNB to exercise its call option on the P3.5 billion Subordinated Notes, subject to compliance of relevant regulations. The 2012 Notes will be redeemed on May 10, 2017 at an amount equal to the aggregate issue price of the Notes plus accrued and unpaid interest thereon up to but excluding May 10, 2017 (Call Option Amount). The Call Option Amount shall be paid to all noteholders on record as of April 25, 2017. No transfers shall be allowed from April 25 to May 9, 2017.

6.75% P6.5 Billion Subordinated Notes
On May 15, 2011, PNB's BOD approved the issuance of unsecured subordinated notes of P6.5 billion that qualify as Lower Tier 2 capital. EIR on this note is 6.94%.

Significant terms and conditions of the subordinated notes follow:

(1) 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 redeemed at a redemption price equal to 100% of the principal amount on June 16, 2016, Call Option Date.

(2) 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.

On June 16, 2016, PNB exercised its call option and paid P6.5 billion to all noteholders as of June 1, 2016.

As of December 31, 2016 and 2015, the unamortized transaction cost of subordinated debt amounted to P2.2 million and P13.6 million respectively. In 2016, 2015 and 2014, amortization of transaction costs amounting to P11.4 million, P16.9 million, and P15.8 million, respectively, were charged to "Cost of banking services" in the consolidated statements of income (see Note 24).

*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 8.6% 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 matured and were redeemed on February 13, 2015.

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.

*Unsecured term loans of Eton*

On January 28, 2013, Eton entered into an unsecured term loan agreement with BDO amounting to P2.0 billion to finance the construction of Eton projects. 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. Effective on October 28, 2013, Eton and BDO agreed to the new interest rate of 4.75%.

In 2016, Eton entered into an unsecured term loan agreement with Asia United Bank (AUB) amounting to P1.5 billion, to finance the construction of Eton's projects. The term loan bears a nominal interest rate of 5% and will mature on September 28, 2023. Principal repayments will commence two years from the date of availment and are due quarterly while interest payments are due quarterly starting December 28, 2016.

*Notes payable of Eton*

Notes payable include various notes from BDO which arose from the assignment of the Groups' contract receivables on a with recourse basis in 2013 and 2012 (see Note 8). These notes bear interest based on Philippine Dealing System Treasury Fixing (PDSTF) rate for one year plus 1.5% net of gross receipts tax. In 2016 and 2015, interest rates ranged from 5.10% to 6.66%, 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. In 2016, the outstanding notes payable were fully paid by the Group.

Interest on loans payable from general borrowings capitalized as part of investment properties amounted to P30.0 million in 2014 and real estate inventories amounted to P61.9 million and P163.4 million in 2015 and 2014, respectively. Capitalization rates were 4.5% in 2015 and 5% in 2014, respectively. The Group stopped capitalizing interest on loans payable as contruction of projects involved in the loans are substantially done as of December 31, 2016.

*Finance costs*
Interest recognized in profit or loss on short-term and long-term debts, except for subordinated debts, are presented under "Finance costs" in the consolidated statements of income (see Note 27). Interest costs from subordinated debts are included in the "Cost of banking services" (see Note 24).

*Compliance with debt covenants*
As of December 31, 2016 and 2015, the Group has complied with the covenants of its long-term debts.

## 20. Other Liabilities

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Insurance contract liabilities | **P4,581,800** | P4,719,336 |
| Bills purchased - contra (Note 8) | **3,260,308** | 3,418,002 |
| Payable to landowners | **3,250,573** | 1,732,923 |
| Provisions (Note 38) | **1,300,290** | 1,168,011 |
| Managers' checks and demand drafts outstanding | **1,174,872** | 937,799 |
| Reserve for unearned premiums | **1,075,732** | 1,191,405 |
| Other deferred revenue (Note 12) | **939,672** | – |
| Due to other banks | **923,777** | 461,100 |
| Other dormant credits | **918,217** | 753,338 |
| Customers' deposits | **892,286** | 1,426,649 |
| Deposit on lease contracts | **805,377** | 854,817 |
| Accounts payable - electronic money | **791,223** | 556,618 |
| Due to Treasurer of the Philippines | **543,002** | 438,943 |
| Tenants' rental deposits | **428,785** | 306,524 |
| Miscellaneous tax securities | **300,226** | – |
| Payment order payable | **292,336** | 407,196 |
| Margin deposits and cash letters of credit | **174,206** | 182,640 |
| Advanced rentals | **167,203** | 207,470 |
| Transmission liability | **31,732** | 24,976 |
| Others | **924,254** | 2,422,913 |
| | **22,775,871** | 21,210,660 |
| Presented as noncurrent | **(5,411,870)** | (7,961,017) |
| Presented as current | **P17,364,001** | P13,249,643 |

Payables to Landowners
In September 2012, Eton executed a P556.8 million promissory note, subject to interest rate of PDSTF 3 years +1.00%, to a landowner in relation to its purchase of land located in Makati City with total purchase price of P742.4 million. In 2015, the promissory was fully paid.

In November 2012, Eton executed a promissory note to a landowner amounting to P740.0 million, subject to interest rate of PDSTF 3 years +0.50%, in relation to its purchase of land located in Quezon City with total purchase price of P1.0 billion. The promissory note is due on the third year from its execution date. In November 2015, the promissory note was extended and was subsequently settled in February 2016.

In various dates in 2014, Eton executed a P992.9 million promissory note, subject to interest rate of PDSTF 3 years +0.50%, to various landowners in relation to its purchase of land located in Laguna with total purchase price of P1.3 billion. The promissory note is due on the third year of its execution date.

Interest expense recognized related to these promissory notes amounted to P55.3 million in 2015 (nil in 2016 and 2014), net of capitalized portion amounting to nil, P52.6 million and P81.5 million in 2016, 2015 and 2014, respectively (see Notes 12, 13 and 27).

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 P0.9 billion and P1.4 billion as of December 31, 2016 and 2015, respectively.

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 statement of income (see Note 14).

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.

## 21. Derivative Financial Instruments

The tables in the next page show the fair values of derivative financial instruments entered into by the Group, recorded as derivative assets or derivative liabilities (included under "Financial assets and liabilities at FVPL"), 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, 2016 and 2015 and are not indicative of either market risk or credit risk (amounts in thousands, except average forward rate).

| | **December 31, 2016** | | | | December 31, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Average Forward Rate** | **Notional Amount*** | Assets | Liabilities | Average Forward Rate | Notional Amount* |
| | | | | *(In Thousands)* | | | | |
| **Freestanding derivatives:** | | | | | | | | |
| **Currency forwards** | | | | | | | | |
| **BUY:** | | | | | | | | |
| **USD** | **P99** | **P3,766** | **P49.99** | **P200,498** | P42 | P5,210 | P47.37 | P155,521 |
| **EUR** | **94** | **48** | **1.05** | **979** | 122 | – | 1.09 | 898 |
| **GBP** | **–** | **160** | **1.23** | **2,595** | – | 168 | 1.36 | 1,104 |
| **CAD** | **277** | **–** | **0.74** | **1,861** | – | 170 | 0.72 | 1,385 |
| **HKD** | **630** | **–** | **0.13** | **412,710** | – | 66 | 7.75 | 13,012 |
| **SELL:** | | | | | | | | |
| **USD** | **46,155** | **10,601** | **49.85** | **382,664** | 66,932 | – | 47.31 | 374,421 |
| **JPY** | **45,957** | **504** | **0.01** | **16,524,949** | – | 86,305 | 0.39 | 4,492,495 |
| **GBP** | **5,227** | **–** | **1.24** | **9,550** | 455 | 139 | 1.49 | 5,700 |
| **EUR** | **740** | **–** | **1.05** | **4,000** | 4 | 11 | 1.10 | 2,200 |
| **CAD** | **873** | **258** | **0.74** | **1,861** | 520 | 34 | 0.72 | 3,444 |
| **SGD** | **–** | **361** | **0.69** | **5 ,573** | 411 | 190 | 1.41 | 4,600 |
| **AUD** | **483** | **–** | **0.74** | **450** | – | 149 | 0.72 | 450 |
| **HKD** | **–** | **1,032** | **0.13** | **144,748** | 86 | 184 | 7.75 | 63,733 |
| **Interest rate swaps (Php)** | **257,042** | **216,102** | **–** | **–** | 49,444 | 42,567 | – | – |
| **Warrants** | **61,545** | **–** | **–** | **–** | 63,332 | – | – | – |
| | **P419,122** | **P232,832** | | | P181,348 | P135,193 | | |

* The notional amounts pertain to the original currency except for the embedded derivatives, which represent the equivalent to USD amount.

a. As of December 31, 2016 and 2015, PNB holds 306,405 shares of ROP Warrants Series B1 at their fair value of US$1.2 million (P56.7 million) and US$1.3 million (P64.6 million), respectively.

b. The table below shows the rollforward analysis of net derivatives assets (liabilities):

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | | |
| Derivative assets | **P181,348** | P136,551 |
| Derivative liabilities | **135,193** | 44,903 |
| | **46,155** | 91,648 |
| Changes in fair value | | |
| Currency forwards and spots* | **(723,245)** | (571,666) |
| Interest rate swaps and warrants** | **25,174** | (11,709) |
| | **(698,071)** | (583,375) |
| Availments | **838,206** | 537,882 |
| Balance at end of year | | |
| Derivative assets | **419,122** | 181,348 |
| Derivative liabilities | **232,832** | 135,193 |
| Balance at end of year | **P186,290** | P46,155 |

* Presented as part of "Foreign exchange gains".

** Recorded under "Trading and investment securities gains".

The changes in fair value of the derivatives are included in "Trading and investments securities gains" presented as part of "Banking revenues" in the consolidated statements of income (see Note 24).

## 22. Related Party Transactions

The Company has transacted with its subsidiaries, associates and other related parties as follows:

| **Parent Company, Subsidiaries, Associates and Joint Ventures** | **Entities Under Common Control** |
|---|---|
| *Parent Company* | Ascot Holdings, Inc. |
| Tangent | Pol Holdings, Inc. |
| | Sierra Holdings & Equities, Inc. |
| *Subsidiaries* | 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 Systems, Inc. | Himmel Industries Inc. |
| Interbev | Lapu Lapu Packaging |
| Waterich | Lucky Travel Corporation |
| Packageworld | Philippine Airlines, Inc. |
| AB Nutribev | Rapid Movers & Forwarders Co. Inc. |
| Asia Pacific Beverage Pte Ltd | Upright Profits Ltd. |
| FTC | Dyzum Distillery Inc. |
| Shareholdings | Parity Packaging Corp. |
| Saturn | Heritage Holdings Corp. |
| Paramount and Subsidiaries | Maxell Holdings, Corp. |
| Eton | Networks Holdings & Equities, Inc. |
| BCI | Cube Factor Holdings, Inc. |
| ECI | Trustmark Holdings Corporation |
| FHI | Polima International Limited |
| EPMC | Cosmic Holdings Corp. |
| Bank Holding Companies:(1) | Negros Biochem Corporation |
| Allmark Holdings Corp. | Grandway Konstruct, Inc. |
| Dunmore Development Corp. | Harmonic Holdings Corp. |
| Kenrock Holdings Corp. | Proton Realty & Development Corporation |
| Leadway Holdings, Inc. | Billinge Investments Limited |
| Multiple Star Holdings Corp. | Step Dragon Co. Limited |
| Pioneer Holdings & Equities, Inc. | High Above Properties Ltd. |
| Donfar Management Ltd. | Penick Group Limited |
| Fast Return Enterprises Ltd. | In Shape Group Ltd. |
| Mavelstone International Ltd. | Hibersham Assets Ltd. |
| Uttermost Success, Ltd. | Orient Legend Developments Ltd. |
| Ivory Holdings, Inc. | Complete Best Development Ltd. |
| Merit Holdings & Equities Corp. | Cormack Investments Ltd |
| True Success Profits Ltd. | Link Great International Ltd. |
| Key Landmark Investments Ltd. | Bright Able Holdings Ltd. |
| Fragile Touch Investments Ltd. | |
| Caravan Holdings, Corp. | |
| Solar Holdings Corp. | |
| 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 | |
| | |
| *Associates* | |
| PMFTC | |
| VMC | |
| APLII | |
| ABHPI | |
| | |
| *Joint Ventures* | |
| ABI Pascual Holdings | |
| ABI Pascual Foods | |
| AEDC | |

*(1) 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 | 2016 | 2015 | 2014 |
|---|---|---|---|---|
| | | | *(In Thousands)* | |
| Associates | Dividend income | **P2,555,576** | P1,695,969 | P3,168,550 |
| | Purchases of inventories | **1,793,767** | 1,203,300 | 812,405 |
| | Sales | **423,335** | – | – |
| | Lease | **4,388** | – | – |
| Entities Under Common Control | Banking revenue - interest on loans and receivables | **388,599** | 337,899 | 153,707 |
| | Sales of consumer products | **26,752** | 24,519 | 21,011 |
| | Interest income on loans and advances | **12,853** | 22,613 | 16,806 |
| | Rent income | **30,647** | 27,861 | 30,942 |
| | Other income | **150,599** | 136,908 | 52,938 |
| | Freight and handling | **(15,004)** | (4,716) | (7,772) |
| | Purchases of inventories | **(123,426)** | – | (160,914) |
| | Cost of banking services - interest expense on deposit liabilities | **(25,807)** | (23,461) | (14,898) |
| | Cost of sales and services | **(38,901)** | (26,296) | (25,864) |
| | Management and professional fees | **(263,142)** | (527,279) | (335,016) |
| | Outside services | **(62,865)** | (59,400) | (57,150) |
| | Rent expense | **(27,890)** | (58,710) | (31,054) |
| Key Management | Short-term employee benefits | **(636,114)** | (716,317) | (588,709) |
| | Post-employment benefits | **(72,891)** | (62,633) | (62,097) |

The consolidated balance sheets include the following asset (liability) account balances with related parties:

| | Financial Statement Account | Terms and Conditions | Amount/Volume 2016 | Amount/Volume 2015 | Outstanding Balance 2016 | Outstanding Balance 2015 |
|---|---|---|---|---|---|---|
| | | | | *(In Thousands)* | | |
| Parent Company | Due to related parties | On demand; non-interest bearing | **P–** | P– | **(P41,975)** | (P41,975) |
| | Due from related parties | On demand; non-interest bearing | **320,000** | – | **320,000** | – |
| Associate | Other receivables - dividends | 30 to 90 days terms; non-interest bearing | **2,555,576** | 1,695,969 | **337,810** | 228,017 |
| | Trade receivables | - do - | **423,335** | 17,590 | **234,825** | 17,771 |
| | Account payable and other liabilities | 30 to 60 days terms; non-interest bearing | **1,793,767** | 1,203,300 | **(24,078)** | (4,990) |
| Entities Under Common Control | Finance receivables | Secured by hold-out on deposits, government securities, real estate and mortgage trust identure; Unimpaired; With interest rates ranging from 2.82% to 6.00% with maturity terms of ranging from monthly to quarterly payments | **388,599** | 337,899 | **17,226,371** | 18,168,623 |
| | Trade receivables | - do - | **26,752** | 24,519 | **12,986** | 9,469 |
| | Other receivables | - do - | **150,599** | 136,908 | **–** | – |
| | Due from related parties | On demand; non-interest bearing | **9,433** | 204,356 | **1,602,467** | 1,593,034 |
| | Advances to suppliers | - do - | **20,659** | 269 | **26,742** | 47,401 |
| | Deposit liabilities | With annual rates ranging from 0.38% to 1.73% and maturity ranging from 30 days to one year | **225,851** | 23,461 | **(7,644,701)** | (7,418,850) |
| | Account payable and other liabilitites | 30 to 90 days terms; non-interest bearing | **123,426** | – | **(283,819)** | (330,434) |
| | Due to related parties | On demand; non-interest bearing | **10,284** | 3,089 | **(15,079)** | (4,795) |
| | Other payables | 30 to 90 days terms; non-interest bearing | **197** | 673,566 | **(4,142)** | (4,339) |

As of December 31, 2016 and 2015, 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*

- On April 12, 2016 and May 12, 2015, LTG declared cash dividends of P0.15 per share to all stockholders of record as of April 28, 2016 and May 27, 2015, respectively, of which P1.2 billion were paid to Tangent.

*Transactions with Associates*

- Dividend income from PMFTC amounted to P2.6 billion in 2016, P1.7 billion in 2015 and P3.2 billion in 2014 (see Note 11). Dividends receivable from PMFTC as of December 31, 2016 and 2015 are presented as part of nontrade receivables.

- The Group purchases raw materials from VMC.

- ABI entered into an operating lease agreement with AB HPI to lease portions of its two breweries, in Cabuyao, Laguna and El Salvador, Misamis Oriental, subject to the terms and conditions of an asset lease agreement signed last November 15, 2016. The lease has a fixed yearly increase as specified in the contract. As of December 31, 2016, the related rent receivable for the lease of land amounted to P4.4 million.

- ABI sold inventories to AB HPI aside from the nonmonetary assets sold on November 15, 2016, including work in progress, amounting to P423.3 million.

*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 services agreements with Basic Holdings Corporation for certain considerations. Management fees are recorded under “Outside services” in “Cost of goods sold” and “Professional fees” in the “General and administrative expenses”.

- The property development segment purchases parcels of land from other related parties for use in its various projects.

- 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 24).

## 23. 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, 2016 and 2015, 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:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Net retirement plan assets: | | |
| FTC | **P233,604** | P227,524 |
| TDI | **20,836** | – |
| AAC | **13,038** | 19,347 |
| LTG | **9,392** | 8,845 |
| | **P276,870** | P255,716 |
| Accrued retirement benefits: | | |
| PNB | **P3,138,824** | P2,955,003 |
| ABI and subsidiaries | **682,396** | 861,051 |
| TDI and ADI | **22,004** | 37,931 |
| Eton | **56,118** | 46,941 |
| | **P3,899,342** | P3,900,926 |

The following tables summarize the components of net retirement plan assets and net retirement benefits liability recognized in the consolidated balance sheets, the net benefit expenses recognized in the consolidated statements of income and the remeasurement losses (gains) recognized in consolidated statements of comprehensive income.

Net retirement plan assets:

| | **2016** | | | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Defined Benefit Obligations** | **Fair Value of Plan Assets** | **Net Retirement Plan Assets** | Defined Benefit Obligations | Fair Value of Plan Assets | Net Retirement Plan Assets | Defined Benefit Obligations | Fair Value of Plan Assets | Net Retirement Plan Assets |
| | | | | | *(In Thousands)* | | | | |
| Beginning balance | **161,701** | **(P417,417)** | **(P255,716)** | P131,057 | (P395,175) | (P264,118) | P75,033 | (P318,826) | (P243,793) |
| Change in status of retirement plan | **96,347** | **(82,267)** | **14,080** | 18,453 | (11,392) | 7,061 | 102,970 | (81,708) | 21,262 |
| Net retirement benefits cost in profit or loss: | | | | | | | | | |
| Current service cost | **17,832** | **–** | **17,832** | 29,759 | – | 29,759 | 18,037 | – | 18,037 |
| Net interest cost | **9,126** | **(21,674)** | **(12,548)** | 4,107 | (15,112) | (11,005) | 7,673 | (10,726) | (3,053) |
| Curtailment gain | **–** | **–** | **–** | (12,523) | – | (12,523) | – | – | – |
| | **26,958** | **(21,674)** | **5,284** | 21,343 | (15,112) | 6,231 | 25,710 | (10,726) | 14,984 |
| Contributions | **–** | **(2,252)** | **(2,252)** | – | (5,084) | (5,084) | | (1,201) | (1,201) |
| Benefits paid | **(2,820)** | **2,820** | **–** | (3,642) | 3,642 | – | (16,757) | 16,757 | – |
| Re-measurement losses (gains) in other comprehensive income - actuarial changes arising from changes in: | | | | | | | | | |
| Financial assumptions | **(38,796)** | **–** | **(38,796)** | – | – | – | – | – | – |
| Demographic assumptions | **(851)** | **–** | **(851)** | – | – | – | – | – | – |
| Experience adjustments | **(14,091)** | **15,472** | **1,381** | (5,510) | 5,704 | 194 | (55,899) | 529 | (55,370) |
| | **(53,738)** | **15,472** | **(38,266)** | (5,510) | 5,704 | 194 | (55,899) | 529 | (55,370) |
| Ending balance | **P228,448** | **(P505,318)** | **(P276,870)** | P161,701 | (P417,417) | (P255,716) | P131,057 | (P395,175) | (P264,118) |

Accrued retirement benefits:

| | **2016** | | | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Defined Benefit Obligations** | **Fair Value of Plan Assets** | **Accrued Retirement Bene fits** | Defined Benefit Obligations | Fair Value of Plan Assets | Accrued Retirement Benefits | Defined Benefit Obligations | Fair Value of Plan Assets | Accrued Retirement Benefits |
| | | | | | *(In Thousands)* | | | | |
| Beginning balance | **P9,666,274** | **(P5,765,348)** | **P3,900,926** | P9,290,310 | (P5,514,049) | P3,776,261 | P7,992,151 | (P3,645,889) | P4,346,262 |
| Change in status of retirement plan | **(96,347)** | **82,267** | **(14,080)** | (18,453) | 11,392 | (7,061) | (102,968) | 81,708 | (21,260) |
| Net retirement benefits cost in profit or loss: | | | | | | | | | |
| Current service cost | **701,627** | **–** | **701,627** | 889,132 | – | 889,132 | 561,720 | – | 561,720 |
| Net interest cost | **377,343** | **(190,977)** | **186,366** | 343,297 | (165,172) | 178,125 | 281,403 | (86,831) | 194,572 |
| Past service cost | **–** | **–** | **–** | 7,529 | – | 7,529 | 45,767 | – | 45,767 |
| | **1,078,970** | **(190,977)** | **887,993** | 1,239,958 | (165,172) | 1,074,786 | 888,890 | (86,831) | 802,059 |
| Contributions | **–** | **(1,123,041)** | **(1,123,041)** | – | (996,283) | (996,283) | – | (2,447,710) | (2,447,710) |
| Benefits paid from plan assets | **(728,330)** | **650,142** | **(78,188)** | (527,023) | 527,023 | – | (593,393) | 593,393 | – |
| Benefits paid directly from book reserves | **–** | **–** | **–** | (23) | – | (23) | – | – | – |
| Others | **–** | **–** | **–** | 69,366 | 34,084 | 103,450 | – | – | – |
| Re-measurement losses (gains) in other comprehensive income - actuarial changes arising from changes in: | | | | | | | | | |
| Financial assumptions | **302,114** | **–** | **302,114** | (471,608) | (69) | (471,677) | 124,093 | – | 124,093 |
| Demographic assumptions | **–** | **–** | **–** | 485 | – | 485 | – | – | – |
| Experience adjustments | **(28,864)** | **52,482** | **23,618** | 83,262 | 337,726 | 420,988 | 981,537 | (8,720) | 972,817 |
| | **273,250** | **52,482** | **325,732** | (387,861) | 337,657 | (50,204) | 1,105,630 | (8,720) | 1,096,910 |
| Ending balance | **P10,193,817** | **(P6,294,475)** | **P3,899,342** | P9,666,274 | (P5,765,348) | P3,900,926 | P9,290,310 | (P5,514,049) | P3,776,261 |

The fair value of plan assets as of December 31 is as follows:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Cash and cash equivalents | **P3,165,371** | P2,184,326 |
| Receivables | **2,007,993** | 1,813,219 |
| Equity investments: | | |
| Financial institutions | **711,701** | 1,694,001 |
| Other | **55,613** | 39,466 |
| Investments in government securities | **663,788** | 442,391 |
| Others | **195,327** | 9,362 |
| Fair value of plan assets | **P6,799,793** | P6,182,765 |

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

| | 2016 | 2015 |
|---|---|---|
| Cash and cash equivalents | **47%** | 35% |
| Receivables | **29%** | 29% |
| Equity investments | **11%** | 26% |
| Investments in government securities | **10%** | 7% |
| Others | **3%** | 1% |
| Fair value of plan assets | **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 as of January 1 are shown below:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Discount rate | **4%-5%** | 4%-5% | 5%-6% |
| Future salary increases | **5%-10%** | 5%-10% | 5%-10% |

As of December 31, 2016, the discount and future salary increase rates are 4-5% and 5-10%, respectively.

The sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligations as of the end of the reporting period, assuming all other assumptions were held constant (in thousands):

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | **Increase (Decrease)** | **Increase (Decrease) in Present Value of Defined Benefit Obligations** | Increase (Decrease) | Increase (Decrease) in Present Value of Defined Benefit Obligations |
| Discount rates | **+0.5%** | **(P865,242)** | +0.5% | (P774,421) |
| | **-0.5%** | **1,014,972** | -0.5% | 901,270 |
| Future salary increases | **+1.0%** | **P1,028,578** | +1.0% | P920,284 |
| | **-1.0%** | **(886,617)** | -1.0% | (794,886) |

Full actuarial valuations were performed to test the sensitivity of the defined benefit obligation to a 1% increment in salary increase rate, 0.5% 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, 0.5% 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.

Shown below is the maturity analysis of the undiscounted benefit payments of the Group:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| One year and less | **P365,206** | P347,360 |
| More than one year up to five years | **1,769,646** | 1,728,105 |
| More than five years up to 10 years | **3,894,954** | 3,905,062 |
| More than 10 years up to 15 years | **5,886,466** | 5,729,414 |
| More than 15 years | **59,397,929** | 48,508,346 |

The Group expects to contribute P1.6 billion to the defined benefit pension plan in 2017. The average duration of the defined benefit obligations at the end of the reporting period range from 17 to 24 years as of December 31, 2016 and 14 to 21 years as of December 31, 2015.

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, 2016 and 2015, the retirement fund of the Group includes 9,008,864 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, 2016 and 2015, 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.

## 24. Revenue and Cost of Sales and Services

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Banking revenue (Note 5) | **P29,111,818** | P26,600,160 | P24,210,181 |
| Sale of consumer goods | **25,836,669** | 22,388,574 | 21,796,812 |
| Real estate sales | **1,573,067** | 1,311,914 | 1,538,260 |
| Rental income | **1,278,447** | 1,172,539 | 740,340 |
| | **P57,800,001** | P51,473,187 | P48,285,593 |

Banking revenue consists of:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Interest income on: | | | |
| Loans and receivables | **P19,505,347** | P17,144,366 | P15,226,938 |
| Trading and investment securities | **4,026,594** | 3,742,036 | 2,992,864 |
| Deposits with banks and others | **597,500** | 785,414 | 1,919,443 |
| Interbank loans receivable | **33,862** | 36,747 | 19,218 |
| | **24,163,303** | 21,708,563 | 20,158,463 |
| Trading and securities gains | **1,378,557** | 578,698 | 633,072 |
| Service fees and commission income | **3,569,958** | 4,312,899 | 3,418,646 |
| | **P29,111,818** | P26,600,160 | P24,210,181 |

Sale of consumer goods consists of:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Gross sales | **P27,810,969** | P23,886,547 | P23,250,047 |
| Less sales returns, discounts and allowances | **1,974,300** | 1,497,973 | 1,453,235 |
| | **P25,836,669** | P22,388,574 | P21,796,812 |

Cost of sales and services consists of:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Cost of consumer goods sold: | | | |
| Materials used and changes in inventories (Note 9) | **P10,859,240** | P12,203,739 | P11,944,515 |
| Taxes and licenses | **3,800,493** | 11,370 | 7,458 |
| Depreciation and amortization (Note 12) | **1,078,798** | 997,229 | 1,060,426 |
| Outside services | **843,531** | 479,231 | 460,288 |

(Forward)

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Fuel and power | **P642,949** | P564,609 | P653,862 |
| Communication, light and water | **653,102** | 558,525 | 513,582 |
| Personnel costs | **531,912** | 621,224 | 568,842 |
| Repairs and maintenance | **408,766** | 340,108 | 354,469 |
| Freight and handling | **148,005** | 100,366 | 76,308 |
| Others | **134,522** | 212,418 | 174,808 |
| | **19,101,318** | 16,088,819 | 15,814,558 |
| Cost of banking services | **5,682,707** | 4,734,514 | 4,234,936 |
| Cost of real estate sales | **1,089,026** | 952,661 | 1,303,734 |
| Cost of rental income | **253,830** | 226,888 | 278,855 |
| Cost of sales and services | **P26,126,881** | P22,002,882 | P21,632,083 |

Other expenses include insurance, utilities and outside services which are individually not significant as to amounts.

Cost of banking services consist of:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Interest expense on: | | | |
| Deposit liabilities (Note 15) | **P3,770,558** | P2,987,670 | P2,894,689 |
| Bills payable and other borrowings (Note 19) | **997,621** | 1,029,995 | 856,926 |
| Services fees and commission expense | **914,528** | 716,849 | 483,321 |
| | **P5,682,707** | P4,734,514 | P4,234,936 |

## 25. Selling Expenses

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Advertising and promotions | **P1,019,650** | P958,441 | P1,054,238 |
| Depreciation and amortization (Note 12) | **491,555** | 481,492 | 523,903 |
| Freight and handling | **380,180** | 379,732 | 369,263 |
| Outside services | **128,990** | 112,307 | 119,341 |
| Personnel costs | **98,626** | 96,728 | 91,418 |
| Materials and consumables | **79,428** | 20,176 | 25,786 |
| Repairs and maintenance | **52,922** | 44,728 | 51,505 |
| Commissions | **40,183** | 22,730 | 138,877 |
| Travel and transportation | **19,408** | 12,616 | 16,599 |
| Others | **40,580** | 73,491 | 7,464 |
| | **P2,351,522** | P2,202,441 | P2,398,394 |

Others include occupancy fees, fuel and oil, insurance, donations, membership and subscription dues, which are individually not significant as to amounts.

## 26. General and Administrative Expenses

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37)) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Personnel costs | **P9,175,493** | P8,799,535 | P7,944,923 |
| Provision for credit losses (Note 8) | **3,218,905** | 865,889 | 1,734,502 |
| Taxes and licenses | **2,403,784** | 2,219,798 | 2,216,654 |
| Depreciation and amortization (Notes 12, 13 and 14) | **1,554,156** | 1,382,733 | 1,381,371 |
| Occupancy | **1,552,248** | 1,451,117 | 1,483,130 |
| Outside services | **1,471,963** | 1,306,491 | 1,181,840 |
| Insurance | **1,156,159** | 1,089,782 | 964,466 |
| Marketing and promotional | **1,064,993** | 814,767 | 708,999 |
| Management, consulting and professional fees | **993,847** | 800,381 | 800,322 |
| Information technology | **499,319** | 489,036 | 407,074 |
| Travel and transportation | **350,788** | 281,787 | 278,840 |
| Materials and consumables | **300,719** | 206,490 | 244,477 |
| Repairs and maintenance | **224,325** | 192,775 | 185,178 |
| Litigation | **97,097** | 262,551 | 229,886 |
| Communication, light and water | **58,481** | 272,827 | 243,063 |
| Freight and handling | **45,727** | 81,855 | 76,366 |
| Fuel and oil | **31,065** | 36,751 | 66,519 |
| Provision for (reversal of) legal cases and other losses - net (Notes 12, 14 and 38) | **401,553** | (292,643) | 473,362 |
| Others | **962,462** | 894,611 | 373,155 |
| | **P25,563,084** | P21,156,533 | P20,994,127 |

Others include expense items mainly relating to banking operations, which are individually not significant as to amounts.

## 27. Finance Costs and Finance Income

Details of finance costs and finance income (other than the banking segment) are as follows:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Finance costs (Note 19): | | | |
| Unsecured term loan and notes payable (Note 20) | **P161,992** | P144,549 | P36,641 |
| Bonds payable | **38,473** | 55,957 | 402,750 |
| Amortization of bond issue costs | **2,025** | 2,012 | 15,464 |
| | **P202,490** | P202,518 | P454,855 |
| Finance income: | | | |
| Cash and other cash items (Note 6) | **P76,132** | P71,345 | P91,371 |
| Interest-bearing contracts receivable (Note 8) | **26,984** | 34,618 | 24,670 |
| AFS investments (Note 7) | **3,310** | 4,413 | 3,000 |
| | **P106,426** | P110,376 | P119,041 |

## 28. Other Income (Charges)

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Net gains on sale or exchange of assets | **P1,823,200** | P1,562,020 | P1,889,744 |
| Gain on remeasurement of a previously held interest (Note 11) | **1,644,339** | – | – |
| Recoveries from charged off assets | **729,594** | 592,181 | 117,520 |
| Recovery from insurance claims (Note 38) | **630,198** | 709,160 | – |
| Rental income and dues (Note 13) | **460,224** | 565,083 | 805,235 |
| Mark-to-market gain on financial assets designated at FVPL | **62,955** | 99,084 | – |
| Dividend income | **53,729** | 22,464 | 32,351 |
| Referral, processing and trust fees | **2,811** | 2,382 | 97,715 |
| Share in net losses of associates and a joint venture (Note 11) | **(438,961)** | (2,067) | (46,043) |
| Gain on disposal of AFS investments | **–** | 2,928 | 245,216 |
| Gain on retirement | **–** | 12,523 | 10,912 |
| Others (Note 12) | **58,358** | 121,216 | 636,925 |
| | **P5,026,447** | P3,686,974 | P3,789,575 |

a. Net gains on sale or exchange of assets include sale of investment properties of the banking segment in 2016, 2015 and 2014 amounting to P1,496.5 million, P1,435.8 million and P1,072.7 million, respectively.

b. Others include income and expense items mainly relating to banking operations, which are individually not significant as to amounts.

## 29. Income Taxes

Income taxes include the corporate income tax, which is 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 consolidated 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 consolidated 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% income tax.

a. Details of the Group's deferred income tax assets and liabilities as of December 31 follow:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | **Net Deferred Income Tax Assets[(1)]** | **Net Deferred Income Tax Liabilities[(2)]** | Net Deferred Income Tax Assets[(3)] | Net Deferred Income Tax Liabilities[(4)] |
| | | *(In Thousands)* | | |
| *Recognized directly in the consolidated statements of income:* | | | | |
| **Deferred income tax assets on:** | | | | |
| Allowance for impairment loss on: | | | | |
| Receivables | **P5,142,623** | **P11,502** | P4,854,631 | P14,035 |
| Inventories | **–** | **3,740** | – | 1,681 |
| Property, plant and equipment | **–** | **48,383** | – | 54,725 |
| Accumulated depreciation on investment properties | **611,940** | **–** | 603,158 | – |
| Unrealized losses on: | | | | |
| Inventories on hand | – | **–** | – | 1,868 |
| Sale of property to a subsidiary | **384,523** | **–** | – | 4,529 |
| Difference between tax and book basis of accounting for real estate and banking transactions | **105,247** | **–** | 17,180 | – |
| Net retirement benefits liabilities | **54,593** | **241,550** | 26,595 | 258,683 |
| Deferred rent expense | **44,192** | **–** | 37,384 | – |
| Advance rentals | **27,350** | **–** | 26,005 | – |
| Accrued expenses | **18,505** | **11,053** | 34,328 | 11,095 |
| Reserve for unearned premiums | **7,498** | **–** | – | – |
| Unamortized past service cost | **4,224** | **15,003** | – | 1,140 |
| Gain on sale of asset | **–** | **6,678** | – | – |
| Provision for losses | **–** | **3,372** | – | – |
| NOLCO | **–** | **–** | 94,914 | 13,240 |
| Excess MCIT | **18,445** | **–** | 16,042 | – |
| Reserves and others | **38,601** | **1,087** | 43,746 | 1,187 |
| | **6,457,741** | **342,368** | 5,753,983 | 362,183 |
| **Deferred income tax liabilities on:** | | | | |
| Revaluation increment on property, plant and equipment | **(2,398,472)** | **(830,472)** | (2,641,023) | (562,197) |
| Fair value gain on investment properties | **(1,448,798)** | **–** | (1,593,081) | – |
| Unrealized foreign exchange gains | **(666,382)** | **(15,789)** | (579,661) | (31,519) |
| Gain on remeasurement of a previously held interest | **(160,272)** | **–** | – | – |
| Net changes in fair values of FVPL financial assets | **(105,646)** | **(20,357)** | – | (24,370) |
| Deferred rental income accounting for real estate transactions | **(47,434)** | **(1,676)** | (29,958) | – |
| Difference between tax and book basis of accounting for real estate transactions | **(31,613)** | **–** | (47,006) | – |
| Net retirement plan assets | **–** | **(86,352)** | – | (87,192) |
| Borrowing cost capitalized to property, plant, and equipment | **–** | **(15,306)** | – | (16,760) |
| Excess of fair values over carrying values of property, plant and equipment acquired through business combination | **–** | **–** | – | (33,472) |
| Temporary difference associated with investments in disposal group classified as held for sale | **–** | **–** | (91,299) | – |
| Others | **(157,426)** | **(38,568)** | (208,205) | (309,110) |
| | **(5,016,043)** | **(1,008,520)** | (5,190,233) | (1,064,620) |
| | **1,441,698** | **(666,152)** | 563,750 | (702,437) |
| *Recognized directly in equity:* | | | | |
| **Deferred income tax assets on:** | | | | |
| Re-measurement losses on retirement benefits | **–** | **–** | – | 19,365 |
| **Deferred income tax liabilities on:** | | | | |
| Re-measurement gains on defined benefit plans | **(17,539)** | **(48,131)** | (12,513) | (4,554) |
| Change in AFS | **–** | **(9,032)** | – | (2,895) |
| Revaluation increment on property, plant and equipment | **–** | **(599,806)** | – | (492,455) |
| | **(17,539)** | **(656,969)** | (12,513) | (499,904) |
| | **(17,539)** | **(656,969)** | (12,513) | (480,539) |
| | **P1,424,159** | **(P1,323,121)** | P551,237 | (P1,182,976) |

*[(1)] Pertains to Eton and PNB*
*[(2)] Pertain to LTG, Saturn, PLI, AAC, ADI, PWI, TDI, ABI, FTC and IPI*
*[(3)] Pertains to LTG, Eton and PNB*
*[(4)] Pertain to Saturn, PLI, AAC, ADI, PWI, TDI, ABI, FTC and IPI*

b. Provision for current income tax consists of:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| RCIT | **P2,020,769** | P1,900,395 | P1,545,964 |
| MCIT | **9,002** | 14,272 | 23,962 |
| Final tax | **506,090** | 575,860 | 696,899 |
| Provision for current income tax | **P2,535,861** | P2,490,527 | P2,266,825 |

c. As of December 31, 2016 and 2015, 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:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Allowance for credit losses | **P2,288,791** | P1,813,269 |
| Net retirement benefits liability | **952,686** | 786,600 |
| NOLCO | **711,195** | 802,203 |
| Unamortized past service cost | **666,118** | 631,977 |
| Accrued expenses | **648,784** | 426,911 |
| Unearned income | **122,269** | 112,500 |
| Derivative liabilities | **69,593** | 40,503 |
| Allowance for inventory obsolescence | **18,314** | 18,314 |
| Excess MCIT | **13,930** | 38,456 |
| Others | **159,208** | 59,703 |

Details of the Group's NOLCO follow (in thousands):

| Year Incurred | Amount | Applied | Expired | Balance | Expiry Year |
|---|---|---|---|---|---|
| 2013 | P616,862 | (P611,075) | (P5,787) | P– | 2016 |
| 2014 | 231,270 | – | – | 231,270 | 2017 |
| 2015 | 314,584 | – | – | 314,584 | 2018 |
| 2016 | 165,341 | – | – | 165,341 | 2019 |
| | P1,328,057 | (P611,075) | (P5,787) | P711,195 | |

Details of the Group's MCIT follow (in thousands):

| Year Incurred | Amount | Applied | Expired | Balance | Expiry Year |
|---|---|---|---|---|---|
| 2013 | P32,173 | P– | (P32,173) | P– | 2016 |
| 2014 | 8,053 | – | – | 8,053 | 2017 |
| 2015 | 14,272 | – | – | 14,272 | 2018 |
| 2016 | 10,050 | – | – | 10,050 | 2019 |
| | P64,548 | P– | (P32,173) | P32,375 | |

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:

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Provision for income tax at statutory income tax rate from: | | | |
| Continuing operations | **P3,880,696** | P3,665,261 | P2,687,103 |
| Discontinued operations | **415,619** | (29,327) | 61,205 |
| | **4,296,315** | 3,635,934 | 2,748,308 |
| Adjustments resulting from: | | | |
| NOLCO and other deductible temporary differences for which no deferred income tax assets were recognized | **284,487** | 2,683 | 349,209 |
| Application of NOLCO and other deductible temporary differences for which no deferred income tax assets were recognized in prior years | **(333,810)** | (153,656) | (665,685) |
| Nontaxable gain on remeasurement | **(493,302)** | – | – |
| Nontaxable gain on investment in an associate arising from contribution of non-monetary assets | **(316,872)** | – | – |
| Nontaxable income | **(126,066)** | (553,381) | (861,891) |
| Difference of itemized deduction against 40% of taxable income | **(1,965)** | (30,229) | (4,685) |
| Income subjected to final tax | **(618,319)** | (700,972) | – |
| Equity in net earnings of an associate | **(813,462)** | (356,692) | (154,534) |
| Non-deductible expenses | **354,889** | 779,439 | 1,278,096 |
| Provision for income tax | **P2,231,895** | P2,623,126 | P2,688,818 |
| Provision for income tax from continuing operations | **P2,174,468** | P2,728,819 | P2,676,643 |
| Provision for (benfit from) income tax from discontinued operations | **57,427** | (105,693) | 12,175 |
| Provision for income tax | **P2,231,895** | P2,623,126 | P2,688,818 |

## 30. Equity

Capital Stock
Authorized and issued capital stock of the Company are as follows:

| | |
|---|---|
| Authorized capital stock at P1 par value | |
| At beginning and end of year | **25,000,000,000 shares** |
| Issued capital stock at P1 par value: | |
| At beginning and end of year | **P10,821,388,889** |

a. Capital stock is held by a total of 376 stockholders as of December 31, 2016 and 2015.

b. Track record of registration:

| Date | Number of Shares Licensed | Issue/Offer Price |
|---|---|---|
| August 1948 | 100,000 | P1.00 |
| November 1958 | 500,000 | 1.00 |
| December 1961 | 1,000,000 | 1.00 |
| March 1966 | 2,000,000 | 1.00 |
| March 1966 | 6,000,000 | 1.00 |
| October 1995 | 247,500,000 | 1.00 |
| October 2011 | 398,138,889 | 4.22 |
| April 2013 | 1,840,000,000 | 20.50 |

c. 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 April 8, 2014, LTG's BOD and stockholders, respectively, approved the declaration and distribution of cash dividends of P0.16 per share or a total of P1,731.4 million to all shareholders of record as of July 3, 2014 and to be paid out not later than May 22, 2014.

b. On May 12, 2015, LTG's BOD and stockholders, respectively, approved the declaration and distribution of cash dividends of P0.15 per share or a total of P1,623.2 million to all stockholders of record as of May 27, 2015 and to be paid not later than June 10, 2015.

c. On April 12, 2016, LTG's BOD and stockholders, respectively, approved the declaration and distribution of cash dividends of P0.15 per share or a total of P1,623.2 million to all shareholders of record as of April 28, 2016 and to be paid out not later than May 6, 2016.

d. Retained earnings include undistributed earnings amounting to P55.7 billion in 2016, P47.0 billion in 2015 and P42.1 billion in 2014, representing accumulated earnings of subsidiaries and equity in net earnings of associates and joint ventures, 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 (shares of stock of the company held by subsidiaries), unrealized foreign exchange gains except those attributable to cash and cash equivalents, 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, 2016 and 2015.

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 invesments in certain Bank Holding Companies (see Note 22). Upon approval of the SEC of the increase in authorized capital stock of Bank Holding Companies on 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" as of December 31, 2013. Upon approval of the SEC on various dates in 2014, the remaining preferred shares of P6.0 billion and additional conversion of advances to preferred shares during the year of P4.7 billion were issued to Tangent. As of December 31, 2016 and 2015, preferred shares of the subsidiary issued to the Parent Company amounted to P18.1 billion.

The preferred shares 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:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Equity adjustments arising from business combination under common control (Note 1) | **P445,113** | P445,113 |
| Equity adjustments from sale of Company's shares held by a subsidiary | **193,212** | 193,212 |
| Effect of transaction with non-controlling interest | **66,658** | 66,658 |
| Effect of sale of a subsidiary to Company | **99,655** | 99,655 |
| Effect of sale of direct interest in a subsidiary | **(543)** | (543) |
| | **P804,095** | P804,095 |

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, 2016 and 2015 and 76.5 million shares owned by Saturn amounting to P150.9 million as of December 31, 2011. 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:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Balance as of January 1 | **P40,882,077** | P38,494,303 | P32,235,085 |
| Net income attributable to non-controlling interests | **2,698,749** | 2,897,619 | 2,061,976 |
| Share in other comprehensive income, net of deferred income tax effect: | | | |
| Net changes in AFS financial assets (Note 7) | **(191,249)** | (746,334) | 426,879 |
| Cumulative translation adjustments | **131,789** | 283,115 | (119,903) |
| Remeasurement gains (losses) on defined benefit plans (Notes 2 and 23) | **(199,210)** | (39,302) | (537,431) |
| Dividends received | **(543,751)** | (7,324) | – |
| Capital contribution of non-controlling interest during the year | **–** | – | 4,427,697 |
| Effect of changes in ownership interest (Note 37) | **(271,814)** | – | – |
| Balance as of December 31 | **P42,506,591** | P40,882,077 | P38,494,303 |

Capital contribution of non-controlling interest in 2014 pertains to the gross proceeds from PNB's stock right offering of common shares following the closure of the offer period on February 3, 2014. A total of 162,931,262 PNB Right shares were issued to its stockholders at a proportion of 15 Rights shares for every 100 existing common shares held as of the record date at the offer price of P17 per Right share.
The offer raised gross proceeds of P11.6 billion for PNB, out of which LTG and

the non-controlling shareholders of PNB subscribed P6.9 billion and P4.4 billion, respectively, net of stock issue cost. Part of the proceeds was used as capital injection to PNB Savings Bank (PNB SB) to build and refocus PNB SB's lending business. The offer also strengthened PNB SB's capital position under BASEL III standards effective January 1, 2014.

## 31. Equity Basic/Diluted Earnings Per Share

The following tables reflect the net income and share data used in the earnings per share computations:

Basic/diluted earnings per share were calculated as follows:

| | 2016 | 2015 (As re-presented, Note 37) | 2014 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Net income attributable to equity holders of the Company | **P9,390,407** | P6,599,035 | P4,410,230 |
| Divided by weighted-average number of shares | **10,821,389** | 10,821,389 | 10,821,389 |
| Basic/diluted EPS for net income attributable to equity holders of the Company | **P0.87** | P0.61 | P0.41 |

Earnings per share attributable to equity holders of the Group from continuing operations:

| | 2016 | 2015 (As re-presented, Note 37) | 2015 (As re-presented, Note 37) |
|---|---|---|---|
| | | *(In Thousands)* | |
| Net income from continuing operations attributable to equity holdersof the Company | **P9,342,679** | P6,312,690 | P4,198,899 |
| Divided by weighted-average number of shares | **10,821,389** | 10,821,389 | 10,821,389 |
| Basic/diluted EPS for net income from continuing operations attributable to equity holders of the Company | **P0.86** | P0.58 | P0.39 |

There are no potential common shares with dilutive effect on the basic earnings per share in 2016, 2015 and 2014.

## 32. Financial Risk Management Objectives and Policies

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.

### Financial Risk Management Objectives and Policies of the Banking Segment

Risk Management Strategies

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 Group's banking segment continuing profitability.

The Group 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 Group 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
- Interest Rate Risk in Banking Book (IRRBB)
- Business Risk
- Strategic Risk
- Compliance Risk
- Legal Risk
- Reputational Risk
- Concentration Risk
- Country Risk
- Risks arising from the Group's shareholdings and equity interests

The banking segment's BOD has overall responsibility for the establishment and oversight of the Group's risk management framework. As delegated by the BOD, the Risk Oversight Committee (ROC) is mandated to set risk appetite, approve frameworks, policies and processes for managing risk, and accept risks beyond the approval discretion provided to management. The ROC advises on the overall current and future risk appetite and strategy and assists in overseeing the implementation of those strategies and business plans by the banking segment's senior management.

The Risk Management Group (RMG) provides the legwork for the ROC in its role of formulating the risk management strategy, the development and maintenance of the internal risk management framework, and the definition of the governing risk management principles. The RMG provides assistance to the Assets and Liabilities Committee (ALCO) on capital management and the Board Policy Committee on the management of regulatory capital.

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

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 the banking segment's 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 collects 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 consolidated balance sheet.

*Unit-linked financial assets*
The banking segment issues unit-linked insurance policies. In the unit-linked business, the policy holder bears the investment risk in the assets held in the unit-linked funds as the policy benefits are directly linked to the values of the assets in the fund. Therefore, the banking segment has no material credit risk on unit-linked financial assets.

*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.

The banking segment's 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.

*Maximum exposure to credit risk after collateral held or other credit enhancements*
An analysis of the maximum exposure to credit risk after taking into account any collateral held or other credit enhancements for the Group's banking segment is shown below:

| | **2016** | | | |
|---|---|---|---|---|
| | **Gross Maximum Exposure** | **Fair Value of Collateral** | **Net Exposure** | **Financial Effect of Collateral** |
| | *(In Millions)* | | | |
| Securities held under agreements to resell | **P1,972** | **P1,969** | **P4** | **P1,969** |
| Loans and receivables: | | | | |
| Receivable from customers*: | | | | |
| Business loans | **345,154** | **275,990** | **276,725** | **68,430** |
| Consumers | **41,225** | **24,792** | **28,464** | **12,761** |
| GOCCs and National Government Agencies (NGAs) | **19,897** | **25,595** | **3,089** | **16,808** |
| LGUs | **7,336** | **1,053** | **6,806** | **529** |
| Fringe benefits | **588** | **743** | **292** | **296** |
| Unquoted debt securities | **6,973** | **2,789** | **4,126** | **2,789** |
| Other receivables | **21,040** | **10,746** | **15,157** | **5,883** |
| | **P444,185** | **P343,677** | **P334,663** | **P109,465** |

** Receivables from customers exclude residual value of the leased asset.*

| | 2015 | | | |
|---|---|---|---|---|
| | Gross Maximum Exposure | Fair Value of Collateral | Net Exposure | Financial Effect of Collateral |
| | *(In Millions)* | | | |
| Securities held under agreements to resell | P14,550 | P14,516 | P34 | P14,516 |
| Loans and receivables: | | | | |
| Receivable from customers*: | | | | |
| Business loans | 290,095 | 251,693 | 232,050 | 58,046 |
| Consumers | 33,616 | 46,756 | 15,652 | 17,964 |
| GOCCs and NGAs | 23,038 | 27,561 | 3,941 | 19,097 |
| LGUs | 7,793 | 1,431 | 7,051 | 742 |
| Fringe benefits | 552 | 830 | 247 | 305 |
| Unquoted debt securities | 4,245 | 3,435 | 810 | 3,435 |
| Other receivables | 19,102 | 8,554 | 14,857 | 4,245 |
| | P392,991 | P354,776 | P274,642 | P118,350 |

** Receivables from customers exclude residual value of the leased asset.*

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 38 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% 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:

| | 2016 | 2015 |
|---|---|---|
| | *(In Millions)* | |
| Philippines | **P598,849** | P521,193 |
| Asia (excluding the Philippines) | **49,359** | 44,699 |
| USA and Canada | **19,821** | 6,813 |
| Other European Union Countries | **7,012** | 7,365 |
| Oceania | **3,594** | – |
| United Kingdom | **2,454** | 1,316 |
| Middle East | **39** | 14 |
| | **P681,128** | P581,400 |

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:

| | **2016** | | | |
|---|---|---|---|---|
| | **Loans and receivables*** | **Trading and investment securities** | **Other financial assets***** | **Total** |
| | | *(In Millions)* | | |
| Primary target industry: | | | | |
| Financial intermediaries | **P60,774** | **P10,066** | **P30,507** | **P101,347** |
| Electricity, gas and water | **63,359** | **–** | **9** | **63,367** |
| Wholesale and retail | **49,858** | **4,772** | **5** | **54,635** |
| Manufacturing | **38,352** | **7,250** | **1** | **45,603** |
| Transport, storage and communication | **40,987** | **497** | **–** | **41,484** |
| Public administration and defense | **23,290** | **–** | **–** | **23,290** |
| Agriculture, hunting and forestry | **5,971** | **–** | **–** | **5,971** |
| Secondary target industry: | | | | |
| Government | **626** | **63,321** | **129,310** | **193,257** |
| Real estate, renting and business activities | **67,321** | **6,815** | **50** | **74,186** |
| Construction | **18,250** | **100** | **1** | **18,351** |
| Others** | **58,533** | **609** | **495** | **59,637** |
| | **P427,321** | **P93,430** | **P160,378** | **P681,128** |

*Loans and receivables exclude residual value of the leased asset.*

*** 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' and other financial assets booked under 'Other Assets'*

| | 2015 | | | |
|---|---|---|---|---|
| | Loans and receivables* | Trading and investment securities | Other financial assets*** | Total |
| | | *(In Millions)* | | |
| Primary target industry: | | | | |
| Financial intermediaries | P38,776 | P8,420 | P24,088 | P71,284 |
| Electricity, gas and water | 49,527 | 1,800 | 3 | 51,330 |
| Wholesale and retail | 50,575 | – | 6 | 50,581 |
| Manufacturing | 40,697 | 31 | – | 40,728 |
| Transport, storage and communication | 28,873 | 1 | 1 | 28,875 |
| Public administration and defense | 25,294 | – | – | 25,294 |
| Agriculture, hunting and forestry | 5,996 | – | – | 5,996 |
| Secondary target industry: | | | | |
| Government | 626 | 72,458 | 95,913 | 168,997 |
| Real estate, renting and business activities | 43,751 | 5,489 | 28 | 49,268 |
| Construction | 11,517 | – | – | 11,517 |
| Others** | 69,380 | 7,885 | 265 | 77,530 |
| | P365,012 | P96,084 | P120,304 | P581,400 |

*Loans and receivables exclude residual value of the leased asset.*

*** 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' and other financial assets booked under 'Other Assets'.*

The internal limit of the banking segment based on the Philippine Standard Industry Classification (PSIC) sub-industry is 12% for priority industry, 8% for regular industry and 30% for power industry, versus total loan portfolio.

*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 CRR as of December 31, 2016 and 2015, but net of residual values of leased assets.

| | **2016** | | | |
|---|---|---|---|---|
| | **Neither Past Due nor Individually Impaired** | **Past Due and not Individually Impaired** | **Individually Impaired** | **Total** |
| | *(In Millions)* | | | |
| **Rated Receivable from Customers** | | | | |
| 1 – Excellent | **P9,427** | **P1** | **P–** | **P9,428** |
| 2 - Super Prime | **50,660** | **–** | **–** | **50,660** |
| 3 - Prime | **81,566** | **–** | **–** | **81,566** |
| 4 - Very Good | **46,455** | **–** | **–** | **46,455** |
| 5 – Good | **28,223** | **–** | **–** | **28,223** |
| 6 - Satisfactory | **37,119** | **34** | **–** | **37,153** |
| 7 - Average | **26,039** | **5** | **–** | **26,044** |
| 8 - Fair | **21,057** | **–** | **–** | **21,057** |
| 9 - Marginal | **5,856** | **–** | **–** | **5,856** |
| 10 - Watchlist | **44,136** | **5** | **–** | **44,141** |
| 11 - Special Mention | **2,786** | **79** | **149** | **3,014** |
| 12 - Substandard | **777** | **484** | **611** | **1,872** |
| 13 – Doubtful | **6** | **113** | **414** | **533** |
| 14 - Loss | **3** | **656** | **3,502** | **4,161** |
| | **354,110** | **1,377** | **4,676** | **360,163** |
| **Unrated Receivable from Customers** | | | | |
| Business Loans | **37,549** | **803** | **27** | **38,379** |
| Consumers | **8,026** | **465** | **568** | **9,059** |
| LGUs | **7,196** | **10** | **131** | **7,337** |
| GOCCs and NGAs | **561** | **12** | **–** | **573** |
| Fringe Benefits | **178** | **–** | **–** | **178** |
| | **53,510** | **1,290** | **726** | **55,526** |
| | **P407,620** | **P2,667** | **P5,402** | **P415,689** |

(Forward)

| | 2015 | | | |
|---|---|---|---|---|
| | Neither Past Due nor Individually Impaired | Past Due and not Individually Impaired | Individually Impaired | Total |
| **Rated Receivable from Customers** | | | | |
| 1 - Excellent | P4,090 | P– | P– | P4,090 |
| 2 - Super Prime | 65,178 | – | – | 65,178 |
| 3 - Prime | 55,510 | – | – | 55,510 |
| 4 - Very Good | 29,060 | – | – | 29,060 |
| 5 - Good | 53,998 | – | 76 | 54,074 |
| 6 - Satisfactory | 31,701 | 8 | 86 | 31,795 |
| 7 - Average | 19,304 | 1 | – | 19,305 |
| 8 - Fair | 24,465 | 2 | 139 | 24,606 |
| 9 - Marginal | 9,847 | 2 | 49 | 9,898 |
| 10 - Watchlist | 18,885 | – | 3 | 18,888 |
| 11 - Special Mention | 2,312 | 88 | 148 | 2,548 |
| 12 - Substandard | 613 | 192 | 648 | 1,453 |
| 13 - Doubtful | – | 26 | 1,306 | 1,332 |
| 14 - Loss | – | 1,364 | 2,264 | 3,628 |
| | 314,963 | 1,683 | 4,719 | 321,365 |
| **Unrated Receivable from Customers** | | | | |
| Business Loans | P15,144 | P151 | P46 | P15,341 |
| Consumers | 7,944 | 1,399 | 32 | 9,375 |
| LGUs | 7,697 | 27 | 65 | 7,789 |
| GOCCs and NGAs | 2,455 | – | 47 | 2,502 |
| Fringe Benefits | 519 | 11 | 26 | 556 |
| | 33,759 | 1,588 | 216 | 35,563 |
| | P348,722 | P3,271 | P4,935 | P356,928 |

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.

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Less than 30 days** | **31 to 90 days** | **More than 90 days** | **Total** | Less than 30 days | 31 to 90 days | More has 90 days | Total |
| | | | | *(In Millions)* | | | | |
| Consumers | **P236** | **P20** | **P583** | **P839** | P172 | P96 | P1,184 | P1,452 |
| Business loans | **118** | **160** | **1,529** | **1,807** | 60 | 11 | 1,712 | 1,783 |
| LGUs | – | – | **10** | **10** | – | – | 27 | 27 |
| Fringe benefits | **–** | – | **12** | **12** | 1 | – | 9 | 10 |
| Total | **P354** | **P180** | **P2,134** | **P2,668** | P233 | P107 | P2,932 | P3,272 |

<u>Trading and Investment Securities and Other Financial Assets</u>
In ensuring quality investment portfolio, PNB uses the credit risk rating based on the external ratings of eligible external credit rating institutions (i.e., Moody's Investors Service) as follows:

Aaa to Aa3 - fixed income are judged to be of high quality and are subject to very low credit risk, but their susceptibility to long-term risks appears somewhat greater.

A1 to A3 - fixed income obligations are considered upper-medium grade and are subject to low credit risk, but have elements present that suggest a susceptibility to impairment over the long term.

Baa1 and below - represents those investments which fall under any of the following grade:

- Baa1, Baa2, Baa3 - fixed income obligations are subject to moderate credit risk. They are considered medium grade and as such protective elements may be lacking or may be characteristically unreliable.
- Ba1, Ba2, Ba3 - obligations are judged to have speculative elements and are subject to substantial credit risk.
- B1, B2, B3 - obligations are considered speculative and are subject to high credit risk.
- Caa1, Caa2, Caa3 - are judged to be of poor standing and are subject to very high credit risk.
- Ca - are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.
- C - are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

Below are the financial assets of the banking segment, excluding receivables from customers, which are monitored using external ratings.

| | **December 31, 2016** | | | | | |
|---|---|---|---|---|---|---|
| | **Rated** | | | | | |
| | **Aaa to Aa3** | **A1 to A3** | **Baa1 and below** | **Subtotal** | **Unrated[6/]** | **Total** |
| | | | *(In Millions)* | | | |
| Due from BSP[1/] | **P–** | **P–** | **P127,338** | **P127,338** | **P–** | **P127,338** |
| Due from other banks | **5,051** | **6,462** | **10,580** | **22,093** | **617** | **22,710** |
| Interbank loans receivables | **4,929** | **1,867** | **996** | **7,792** | **–** | **7,792** |
| Securities held under agreements to resell | **–** | **–** | **1,972** | **1,972** | **–** | **1,972** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **–** | **–** | **949** | **949** | **364** | **1,313** |
| Derivative assets[2/] | **44** | **28** | **10** | **82** | **338** | **420** |
| Private debt securities | **–** | **–** | **–** | **–** | **121** | **121** |
| Equity securities | **–** | **–** | **27** | **27** | **27** | **54** |
| Investment in Unit Investment Trust Funds (UITFs) | **–** | **–** | **6** | **6** | **–** | **6** |
| AFS investments[5/]: | | | | | | |
| Government securities | **1,548** | **–** | **36,202** | **37,750** | **84** | **37,834** |
| Private debt securities | **4,299** | **2,880** | **4,964** | **12,143** | **16,697** | **28,840** |

(Forward)

| | **December 31, 2016** | | | | | |
|---|---|---|---|---|---|---|
| | **Rated** | | | | | |
| | **Aaa to Aa3** | **A1 to A3** | **Baa1 and below** | **Subtotal** | **Unrated[6/]** | **Total** |
| | | | *(In Millions)* | | | |
| Quoted equity securities | **P–** | **P–** | **P54** | **P54** | **P440** | **P494** |
| Unquoted equity securities | **17** | **–** | **1** | **18** | **154** | **172** |
| HTM investments | | | | | | |
| Government securities | **100** | **–** | **22,842** | **22,942** | **1,233** | **24,175** |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[3/] | **–** | **–** | **–** | **–** | **3,285** | **3,285** |
| Others[4/] | **–** | **–** | **–** | **–** | **18,208** | **18,208** |

*[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 mark-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 ( see Note 7).*
*[6/] As of December 31, 2016, financial assets that are unrated are neither past due nor impaired.*

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Rated | | | | | |
| | Aaa to Aa3 | A1 to A3 | Baa1 and below | Subtotal | Unrated[6/] | Total |
| | | *(In Millions)* | | | | |
| Due from BSP [1/] | P– | P– | P– | P– | P81,363 | P81,363 |
| Due from other banks | 5,974 | 3,771 | 7,701 | 17,446 | 842 | 18,288 |
| Interbank loans receivables | 1,814 | 3,525 | 461 | 5,800 | – | 5,800 |
| Securities held under agreements to resell | – | – | – | – | 14,550 | 14,550 |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | – | – | 3,723 | 3,723 | 245 | 3,968 |
| Private debt securities | – | – | 113 | 113 | 31 | 144 |
| Derivative assets[2/] | 12 | 11 | 35 | 58 | 123 | 181 |
| Equity securities | – | – | – | – | 200 | 200 |
| Investment in Unit Investment Trust Funds (UITFs) | – | – | – | – | 17 | 17 |
| AFS investments[4/]: | | | | | | |
| Government securities | 1,829 | – | 28,626 | 30,455 | 14,806 | 45,261 |
| Private debt securities | 3,321 | 397 | 10,939 | 14,657 | 7,596 | 22,253 |
| Quoted equity securities | – | – | 203 | 203 | 451 | 654 |
| Unquoted equity securities | – | – | 1 | 1 | 173 | 174 |
| HTM investments | | | | | | |
| Government securities | 94 | 5 | 23,133 | 23,232 | – | 23,232 |
| Loans and receivables: | | | | | | |
| Unquoted debt securities[3/] | – | – | 75 | 75 | 550 | 625 |
| Others[4/] | – | – | – | – | 15,923 | 15,923 |

*[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 mark-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 (see Note 7).*
*[6/] As of December 31, 2015, financial assets that are unrated are neither past due nor impaired.*

*Impairment assessment*

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 actors, 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

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.

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 Month | More than 1 Month to 3 Months | More than 3 Months to 6 Months | More than 6 Months to 1 Year | Beyond 1 year | Total |
| | | | *(In Millions)* | | | |
| **Financial Assets** | | | | | | |
| COCI | **P11,015** | **P–** | **P–** | **P–** | **P–** | **P11,015** |
| Due from BSP and other banks | **150,054** | **–** | **–** | **–** | **–** | **150,054** |
| Interbank loans receivable | **6,488** | **1,006** | **150** | **151** | **–** | **7,795** |
| Securities held under agreements to resell | **1,973** | **–** | **–** | **–** | **–** | **1,973** |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | **1,318** | **–** | **–** | **–** | **–** | **1,318** |
| Equity securities | **55** | **–** | **–** | **–** | **–** | **55** |
| Private debt securities | **121** | **–** | **–** | **–** | **–** | **121** |
| Derivative assets: | | | | | | |
| Gross contractual receivable | **23,135** | **603** | **363** | **97** | **945** | **25,143** |
| Gross contractual payable | **(23,027)** | **(603)** | **(360)** | **(82)** | **(652)** | **(24,724)** |
| | **108** | **–** | **3** | **15** | **293** | **419** |
| Designated at FVPL: | | | | | | |
| Investment in UITFs | **6** | **–** | **–** | **–** | **–** | **6** |
| AFS investments: | | | | | | |
| Government securities | **445** | **1,360** | **833** | **952** | **44,484** | **48,074** |
| Private debt securities | **216** | **181** | **312** | **608** | **33,527** | **34,844** |
| Equity securities | **–** | **–** | **–** | **–** | **666** | **666** |
| HTM investments: | | | | | | |
| Government securities | **187** | **188** | **268** | **639** | **42,326** | **43,608** |

(Forward)

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 Month** | **More than 1 Month to 3 Months** | **More than 3 Months to 6 Months** | **More than 6 Months to 1 Year** | **Beyond 1 year** | **Total** |
| | | | *(In Millions)* | | | |
| Loans and receivables: | | | | | | |
| Receivables from customers | **P51,282** | **P61,017** | **P22,992** | **P21,983** | **P322,823** | **P480,097** |
| Unquoted debt securities | **58** | **2,732** | **3** | **3** | **4,211** | **7,007** |
| Other receivables | **7,747** | **690** | **1,609** | **330** | **12,234** | **22,610** |
| Other assets | **459** | **1** | **2** | **20** | **86** | **568** |
| Total financial assets | **P231,532** | **P67,175** | **P26,172** | **P24,701** | **P460,650** | **P810,230** |
| **Financial Liabilities** | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | **P117,329** | **P–** | **P–** | **P–** | **P–** | **P117,329** |
| Savings | **291,611** | **31,169** | **12,960** | **18,754** | **15,869** | **370,363** |
| Time | **23,862** | **17,471** | **8,226** | **6,372** | **33,651** | **89,582** |
| Financial liabilities at FVPL: | | | | | | |
| Derivative liabilities: | | | | | | |
| Gross contractual payable | **4,267** | **1,032** | **338** | **97** | **795** | **6,529** |
| Gross contractual receivable | **(4,259)** | **(1,028)** | **(336)** | **(85)** | **(589)** | **(6,297)** |
| | **8** | **4** | **2** | **12** | **206** | **232** |
| Bills and acceptances payable | **14,828** | **1,108** | **4,390** | **5,075** | **12,967** | **38,368** |
| Subordinated debt | | **51** | **51** | **103** | **4,425** | **4,630** |
| Accrued interest payable and accrued other expenses payable | **586** | **233** | **248** | **620** | **–** | **1,687** |
| Other liabilities | **19,115** | **57** | **58** | **12** | **1,483** | **20,725** |
| Total financial liabilities | **P467,339** | **P50,093** | **P25,935** | **P30,948** | **P68,601** | **P642,916** |

| | 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 Month | More than 1 Month to 3 Months | More than 3 Months to 6 Months | More than 6 Months to 1 Year | Beyond 1 year | Total |
| | | | *(In Millions)* | | | |
| Financial Assets | | | | | | |
| COCI | P15,221 | P– | P– | P– | P– | P15,221 |
| Due from BSP and other banks | 99,654 | – | – | – | – | 99,654 |
| Interbank loans receivable | 5,384 | 416 | 2 | – | – | 5,802 |
| Securities held under agreements to resell | 14,583 | - | - | - | - | 14,583 |
| Financial assets at FVPL: | | | | | | |
| Held-for-trading: | | | | | | |
| Government securities | 3,979 | - | - | - | - | 3,979 |
| Equity securities | 200 | - | - | - | - | 200 |
| Private debt securities | 144 | - | - | - | - | 144 |
| Derivative assets: | | | | | | |
| Gross contractual receivable | 16,818 | 2,059 | 28 | 41 | 349 | 19,295 |
| Gross contractual payable | (16,753) | (2,040) | (19) | (27) | (275) | (19,114) |
| | 65 | 19 | 9 | 14 | 74 | 181 |
| Designated at FVPL: | | | | | | |
| Investment in UITFs | 17 | – | – | – | – | 17 |
| AFS investments: | | | | | | |
| Government securities | 1,059 | 521 | 952 | 1,001 | 56,959 | 60,492 |
| Private debt securities | 184 | 534 | 307 | 12 | 27,717 | 28,754 |
| Equity securities | – | – | – | – | 828 | 828 |
| HTM investments: | | | | | | |
| Government securities | 180 | 181 | 259 | 678 | 38,629 | 39,927 |
| Loans and receivables: | | | | | | |
| Receivables from customers | 66,383 | 52,578 | 14,540 | 22,197 | 271,348 | 427,046 |
| Unquoted debt securities | – | 1 | 7 | 77 | 4,179 | 4,264 |

(Forward)

| | 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 Month | More than 1 Month to 3 Months | More than 3 Months to 6 Months | More than 6 Months to 1 Year | Beyond 1 year | Total |
| | | | *(In Millions)* | | | |
| Other receivables | P2,726 | P574 | P1,452 | P346 | P14,761 | P19,859 |
| Other assets | 128 | 2 | 1 | 1 | 51 | 183 |
| Total financial assets | P209,907 | P54,826 | P17,529 | P24,326 | P414,546 | P721,134 |
| Financial Liabilities | | | | | | |
| Deposit liabilities: | | | | | | |
| Demand | P110,030 | P– | P– | P– | P– | P110,030 |
| Savings | 260,880 | 25,251 | 11,251 | 5,732 | 13,746 | 316,860 |
| Time | 14,064 | 9,319 | 6,450 | 3,815 | 27,445 | 61,093 |
| Financial liabilities at FVPL: | | | | | | |
| Derivative liabilities: | | | | | | |
| Gross contractual payable | 5,543 | 2,891 | 255 | 41 | 284 | 9,014 |
| Gross contractual receivable | (5,500) | (2,830) | (246) | (27) | (275) | (8,878) |
| | 43 | 61 | 9 | 14 | 9 | 136 |
| Bills and acceptances payable | 4,075 | 1,437 | 90 | 538 | 20,204 | 26,344 |
| Subordinated debt | – | 161 | 161 | 103 | 10,103 | 10,528 |
| Accrued interest payable and accrued other expenses payable | 1,019 | 159 | 18 | 23 | 1,565 | 2,784 |
| Other liabilities | 16,995 | 336 | 397 | 127 | 1,433 | 19,288 |
| Total financial liabilities | P407,106 | P36,724 | P18,376 | P10,352 | P74,505 | P547,063 |

Market Risks

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.

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. Both the Parametric models and Historical Simulation models were validated by an external independent validator. Volatilities used in the parametric are updated on a daily basis and are based on historical data for a rolling 261-day period while yields and prices in the historical VaR approach are also updated daily. The RMG reports the VaR utilization and breaches to limits to the risk taking personnel on a daily basis and to the ALCO and ROC on a monthly basis. All risk reports discussed in the ROC meeting are noted by the banking segment's BOD. The VaR figures are back-tested to validate the robustness of the VaR model. Results of backtesting on a rolling one year period are also reported to the ROC. Below are the objectives and limitations of the VaR methodology, VaR assumptions/parameters, backtesting, stress testing 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. Backtesting

The validity of the assumptions underlying the banking segment's VaR models can only be checked by appropriate backtesting procedures. Backtesting is a formal statistical framework that consists of verifying that actual losses are within the projected VaR approximations. The banking segment adopts both the clean backtesting and dirty backtesting approaches approach in backtesting. Clean backtesting, consists of comparing the VaR estimates with some hypothetical P&L values of the portfolio, having kept its composition unchanged. In this case, the same portfolio is repriced or marked-to-market at the end of the time interval and the hypothetical P&L is then compared with the VaR. The other method, called dirty backtesting, consists of comparing the VaR estimates with the actual P&L values at the end of the time horizon. This method, however, may pose a problem if the portfolio has changed drastically because of trading activities between the beginning and the end of the time horizon since VaR models assume that the portfolio is "frozen" over the horizon. The Parent Company uses the regulatory 3-zone (green, yellow and red) boundaries in evaluating the backtesting results. For the years 2016 and 2015, the number of observations which fell outside the VaR is within the allowable number of exceptions in the green and yellow zones to conclude that there is no problem with the quality and accuracy of the VaR models at 99.00% confidence level. Nonetheless, closer monitoring and regular review of the model's parameters and assumptions are being conducted.

d. Stress Testing

To complement the VaR approximations, the baking segment conducts stress testing on a quarterly basis, the results of which are being reported to the banking segment's BOD. Scenarios used in the conduct of stress test are event driven and represent the worst one-off event of a specific risk factor. Results of stress testing are analyzed in terms of the impact to earnings and capital.

e. 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** |
|---|---|---|---|---|
| | | *(In Millions)* | | |
| **December 31, 2016** | **P1.65** | **P77.87** | **P1.39** | **P80.91** |
| **Average Daily** | **3.35** | **161.09** | **4.73** | **169.17** |
| **Highest** | **12.09** | **444.55** | **9.14** | **465.79** |
| **Lowest** | **0.62** | **34.67** | **1.33** | **36.62** |
| December 31, 2015 | 1.99 | 296.83 | 8.81 | 307.63 |
| Average Daily | 3.67 | 306.33 | 8.99 | 318.99 |
| Highest | 14.52 | 420.79 | 10.5 | 392.93 |
| Lowest | 0.92 | 144.96 | 7.19 | 170.35 |

** 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 days*

The table below shows the interest rate VaR for AFS investments:

| | 2016 | 2015 |
|---|---|---|
| | *(In Millions)* | |
| End of year | **P1,399** | P1,303 |
| Average Daily | **1,262** | 1,250 |
| Highest | **1,575** | 1,444 |
| Lowest | **859** | 798 |

The following table sets forth the repricing gap position of the banking segment:

**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.

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | **Up to 1 Month** | **More than 1 to 3 Months** | **More than 3 to 6 Months** | **More than 6 to 12 months** | **Beyond 1 year** | **Total** |
| | | | *(In Millions)* | | | |
| **Financial Assets*** | | | | | | |
| Due from BSP and other banks | **P57,092** | **P3,964** | **P1,552** | **P149** | **P191** | **P62,948** |
| Interbank loans receivable | **6,483** | **1,159** | **–** | **149** | **–** | **7,791** |
| Receivable from customers and other receivables - gross** | **112,590** | **69,562** | **13,940** | **3,331** | **66,612** | **266,035** |
| Total financial assets | **P176,165** | **P74,685** | **P15,492** | **P3,629** | **P66,803** | **P336,774** |
| **Financial Liabilities*** | | | | | | |
| Deposit liabilities: | | | | | | |
| Savings | **P87,934** | **P30,744** | **P19,342** | **P26,084** | **P14,472** | **P178,576** |
| Time | **22,628** | **11,628** | **8,195** | **6,214** | **11,328** | **59,993** |
| Bills and acceptances payable | **11,917** | **13,623** | **5,417** | **1,085** | **3,844** | **35,886** |
| Total financial liabilities | **P122,479** | **P55,995** | **P32,954** | **P33,383** | **P29,644** | **P274,455** |
| **Repricing gap** | **P53,685** | **P18,689** | **(P17,462)** | **(P29,754)** | **P37,160** | **P62,318** |
| **Cumulative gap** | **53,685** | **72,374** | **54,912** | **25,158** | **62,318** | **–** |

**Financial instruments that are not subject to repricing/rollforward were excluded.*
***Receivable from customers excludes residual value of leased assets.*

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 Month | 1 to 3 Months | 3 to 6 Months | 6 to 12 months | Beyond 1 year | Total |
| | | | (In Millions) | | | |
| **Financial Assets*** | | | | | | |
| Due from BSP and other banks | P23,069 | P2,140 | P442 | P415 | P227 | P26,293 |
| Interbank loans receivable | 5,251 | 158 | 391 | – | – | 5,800 |
| Receivable from customers and other receivables - gross** | 119,503 | 54,698 | 7,568 | 2,524 | 51,382 | 235,675 |
| Total financial assets | P147,823 | P56,996 | P8,401 | P2,939 | P51,609 | P267,768 |
| **Financial Liabilities*** | | | | | | |
| Deposit liabilities: | | | | | | |
| Savings | P82,042 | P26,460 | P18,737 | P19,105 | P12,365 | P158,709 |
| Time | 19,330 | 8,793 | 6,358 | 3,958 | 3,099 | 41,538 |
| Bills and acceptances payable | 3,850 | 1,081 | 1,006 | 1,141 | 18,674 | 25,752 |
| Total financial liabilities | P105,222 | P36,334 | P26,101 | P24,204 | P34,138 | P225,999 |
| **Repricing gap** | P42,601 | P20,662 | (P17,700) | (P21,265) | P17,471 | P41,769 |
| **Cumulative gap** | 42,601 | 63,263 | 45,563 | 24,298 | 41,769 | – |

**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:

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **Income Before Income Tax** | **Equity** | Income Before Income Tax | Equity |
| | | *(In Millions)* | | |
| +50bps | **P410** | **P410** | P358 | P358 |
| -50bps | **(410)** | **(410)** | (358) | (358) |
| +100bps | **820** | **820** | 716 | 716 |
| -100bps | **(820)** | **(820)** | (716) | (716) |

As one of the long-term goals in the risk management process, the banking segment has has also implemented the adoption of the economic value approach in measuring the impact of the interest rate risk in the banking books to complement the earnings at risk approach using the modified duration approach. Cognizant of this requirement, the Parent Company has undertaken the initial activities such as identification of the business requirement and design of templates for each account and the inclusion of this requirement in the Asset Liability Management business requirement definition.

*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, 2016** | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| | **USD** | **Others** | **Total** | USD | Others | Total |
| | | | *(In Millions)* | | | |
| **Assets** | | | | | | |
| COCI and due from BSP | **P2,440** | **P365** | **P2,805** | P2442 | P368 | P2,810 |
| Due from other banks | **6,964** | **12,843** | **19,807** | 8,864 | 8,879 | 17,743 |
| Interbank loans receivable and securities held under agreements to resell | **2,466** | **1,650** | **4,116** | 2309 | 1,207 | 3,516 |
| Financial assets at FVPL | **–** | **–** | **–** | – | 31 | 31 |
| Loans and receivables | **13,444** | **697** | **14,141** | 17,533 | 509 | 18,042 |
| AFS investments | **1,877** | **1,959** | **3,836** | 484 | 943 | 1,427 |
| HTM Investments | **8** | **–** | **8** | 3 | | 3 |
| Other assets | **93** | **82** | **175** | 47 | 49 | 96 |
| Total assets | **P27,292** | **P17,596** | **P44,888** | P31,682 | P11,986 | 43,668 |
| **Liabilities** | | | | | | |
| Deposit liabilities | **P9,857** | **P3,680** | **P13,537** | P9,778 | P3,355 | P13,133 |
| Bills and acceptances payable | **4,932** | **226** | **5,158** | 2,968 | 292 | 3,260 |
| Accrued taxes, interest and other expenses | **41** | **106** | **147** | 1,592 | 39 | 1,631 |
| Other liabilities | **1,070** | **520** | **1,590** | 678 | 409 | 1,087 |
| Total liabilities | **15,900** | **4,532** | **20,432** | 15,016 | 4,095 | 19,111 |
| Net Exposure | **P11,392** | **P13,064** | **P 24,456** | P16,666 | P7,891 | P24,557 |

Information relating to the banking segment's currency derivatives is contained in Note 21.

**Financial Risk Management Objectives and Policies of the Companies in the Group other than the Banking Segment**

Risk Management Strategies
The Group's principal financial instruments comprise of short-term and long-term debts and 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).

Credit Risk
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 annual sales pertain mainly to two trusted parties with sales to them comprising about 84% of the total segment revenue.
- 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, 2016:

| | Neither past due nor impaired | | Past due but not impaired | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Standard Grade** | **Sub-standard Grade** | **31 to 60 days** | **61 to 90 days** | **91 to 120 days** | **Over 120 Days** | **Impaired Financial Assets** | **Total** |
| | | | | | *(In Millions)* | | | |
| **Loans and receivables:** | | | | | | | | |
| Cash, cash equivalents and other cash items Cash and other cash items | **P3,779** | **P–** | **P–** | **P–** | **P–** | **P–** | **P–** | **P3,779** |
| Trade receivables | **3,106** | **–** | **3,354** | **1,445** | **3,486** | **648** | **665** | **12,704** |
| Other receivables | **1,595** | **4** | **4** | **11** | **2** | **152** | **17** | **1,785** |
| Due from related parties | **1,922** | **–** | **–** | **–** | **–** | **–** | **–** | **1,922** |
| Refundable deposits | **8** | **–** | **5** | **142** | **–** | **–** | **–** | **155** |
| **Financial assets at FVPL** | **4,451** | **–** | **–** | **–** | **–** | **–** | **–** | **4,451** |
| **AFS investments** | **2,205** | **–** | **–** | **–** | **–** | **–** | **–** | **2,205** |
| | **P17,066** | **P4** | **P3,363** | **P1,598** | **P3,488** | **P800** | **P682** | **P27,001** |

December 31, 2015:

| | Neither past due nor impaired | | Past due but not impaired | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Standard Grade | Sub-standard Grade | 31 to 60 days | 61 to 90 days | 91 to 120 days | Over 120 Days | Impaired Financial Assets | Total |
| | | | | *(In Millions)* | | | | |
| Loans and receivables: | | | | | | | | |
| Cash, cash equivalents and other cash items | P2,331 | P– | P– | P– | P– | P– | P– | P2,331 |
| Trade receivables | 3,004 | – | 3,245 | 1,398 | 3,373 | 625 | 643 | 12,288 |
| Other receivables | 2,149 | 5 | 5 | 15 | 1 | 207 | 23 | 2,405 |
| Due from related parties | 1,594 | – | – | – | – | – | – | 1,594 |
| Refundable deposits | 145 | – | – | – | – | – | – | 145 |
| Financial assets at FVPL | 5,082 | – | – | – | – | – | – | 5,082 |
| AFS investments | 2,222 | – | – | – | – | – | – | 2,222 |
| | P16,527 | P5 | P3,250 | P1,413 | P3,374 | P832 | P666 | P26,067 |

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.

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):

| | **2016** | | | 2015 | | |
|---|---|---|---|---|---|---|
| | **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 | **P3,779** | **P–** | **P3,779** | P2,331 | P– | P2,331 |
| Trade receivables | **12,704** | **–** | **12,704** | 12,288 | – | 12,288 |
| Other receivables | **1,769** | **15** | **1,785** | 2,384 | 21 | 2,405 |
| Due from related parties | **1,387** | **536** | **1,922** | 1,150 | 444 | 1,594 |
| Refundable deposits | **155** | **–** | **155** | 145 | – | 145 |
| Financial assets at FVPL | **4,451** | **–** | **4,451** | 5,082 | – | 5,082 |
| AFS investments | **–** | **2,205** | **2,205** | – | 2,222 | 2,222 |
| | **P24,245** | **P2,756** | **P27,001** | P23,380 | P2,687 | P26,067 |
| Short term debts | **P1,750** | **P–** | **P1,750** | P1,400 | P– | P1,400 |
| Accounts payable and other liabilities* | **6,855** | **–** | **6,855** | 6,550 | – | 6,550 |
| Long-term debts | **1,171** | **433** | **1,604** | 526 | 194 | 720 |
| Due to related parties | **–** | **–** | **–** | | – | – |
| Other liabilities | **608** | **1,238** | **1,846** | 798 | 1,626 | 2,424 |
| | **P10,384** | **P1,671** | **P12,055** | P9,274 | P1,820 | P11,094 |

** Excluding non-financial liabilities amounting to P78.18 million and P128.2 million as of December 31, 2016 and 2015, respectively.*

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 2016, 2015 and 2014, 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 P44.2 million, P42.1 million and P39.7 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.

*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, 2016 and 2015, 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. 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.

*Foreign currency risk*

The non-banking segment of the Group is not significantly affected by foreign currency risk since the Group has no significant foreign currency transactions.

33**. Offsetting of Financial Assets and Financial 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, 2016 | | | | | | |
|---|---|---|---|---|---|---|
| | | | | **Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria** | | |
| **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 the consolidated balance sheet [a-b]** | **Financial instruments** | **Fair value of Financial collateral** | **Net exposure [c-d]** |
| | **[a]** | **[b]** | **[c]** | **[d]** | | **[e]** |
| | | | *(In Thousands)* | | | |
| **Derivative assets** (Notes 6 and 21) | **P28,500,758** | **(P28,152,954)** | **P347,804** | **P199,855** | **P–** | **P147,949** |
| **Securities sold under agreements to repurchase** (Note 8) | **1,972,310** | **–** | **1,972,310** | **–** | **1,968,603*** | **3,707** |
| | **P30,473,068** | **(P28,152,954)** | **P2,320,114** | **P199,855** | **P1,968,603** | **P151,656** |

** Included in bills and acceptances payable in the consolidated balance sheets.*

| December 31, 2015 | | | | | | |
|---|---|---|---|---|---|---|
| | | | | Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria | | |
| Financial assets recognized at end of reporting period by type | Gross carrying Amounts (before offsetting) | Gross amounts offset in acco dance with the offsetting criteria | Net amount presented in the consolidated balance sheet [a-b] | Financial instruments | Fair value of Financial collateral | Net exposure [c-d] |
| | [a] | [b] | [c] | | [d] | [e] |
| | | | | *(In Thousands)* | | |
| Derivative assets (Notes 6 and 21) | P14,550,000 | P– | P14,550,000 | P– | P14,516,223* | P33,777 |

** Included in bills and acceptances payable in the consolidated balance sheets.*

*Financial liabilities*

| December 31, 2016 | | | | | | |
|---|---|---|---|---|---|---|
| | | | | **Effect of remaining rights of set-off (including rights to set off financial collateral) that do not meet PAS 32 offsetting criteria** | | |
| **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 the consolidated balance sheet [a-b]** | **Financial instruments** | **Fair value of Financial collateral** | **Net exposure [c-d]** |
| | **[a]** | **[b]** | **[c]** | **[d]** | | **[e]** |
| | | | | *(In Thousands)* | | |
| **Derivative liabilities** (Notes 16 and 21) | **P15,217,658** | **(P15,449,106)** | **(P231,448)** | **P273,191** | **P–** | **P–** |
| **Securities sold under agreements to repurchase** (Note 8)* | **20,635,171** | **–** | **20,635,171** | **–** | **24,657,929** | **–** |
| **Total** | **P35,852,829** | **(P15,449,106)** | **P20,403,723** | **P273,191** | **P24,657,929** | **P–** |

** Included in bills and acceptances payable in the consolidated balance sheets.*

December 31, 2015

| 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 the consolidated 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: Financial instruments | Fair value of Financial collateral | Net exposure [c-d] |
|---|---|---|---|---|---|---|
| | [a] | [b] | [c] | [d] | | [e] |
| | | | *(In Thousands)* | | | |
| Derivative liabilities (Notes 16 and 21) | P216,636 | P– | P216,636 | P465 | P250,830 | P– |
| Securities sold under agreements to repurchase (Note 17)* | 12,806,499 | – | 12,806,499 | – | 15,941,143 | – |
| Total | P13,023,135 | P– | P13,023,135 | P465 | P16,191,973 | P– |

** Included in bills and acceptances payable in the consolidated balance sheets.*

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.

34**. 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 PFRSs 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 PFRSs 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, 2016 and 2015, the carrying values of the Group's financial assets and liabilities approximate their respective fair values, except for the following financial instruments:

| | **December 31, 2016** | | December, 31, 2015 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Market Value** | Carrying Value | Fair Market Value |
| | | *(In Thousands)* | | |
| **Financial Assets:** | | | | |
| Loans and receivables: | | | | |
| Receivables from customers | **P406,505,998** | **P412,208,402** | P349,139,278 | P351,626,538 |
| Unquoted debt securities | **3,285,222** | **3,305,345** | 625,803 | 648,046 |
| | **P409,791,220** | **P415,513,747** | P349,765,081 | P352,274,584 |
| **Financial Liabilities:** | | | | |
| Financial liabilities at amortized cost: | | | | |
| Deposit liabilities - | | | | |
| Time deposits | **P84,364,874** | **P86,098,591** | P60,511,353 | P60,762,710 |
| Bills payables | **34,226,607** | **38,468,732** | 25,407,406 | 25,033,940 |
| Long term debts: | | | | |
| Subordinated debt | **3,497,797** | **3,551,484** | 9,986,427 | 10,241,659 |
| Unsecured term loan | **4,070,949** | **3,712,316** | 720,004 | 720,004 |
| Notes payable | **–** | **–** | 476,015 | 470,370 |
| Other liabilities: | | | | |
| Payable to landowners | **3,250,573** | **3,186,369** | 1,723,923 | 1,803,770 |
| Tenants' rental deposits | **428,785** | **390,791** | 306,524 | 351,781 |
| Advance rentals | **–** | **–** | 207,470 | 186,687 |
| | **P129,839,585** | **P135,408,283** | P99,339,122 | P99,570,921 |

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.

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 2.70% to 6.75% and 2.66% to 3.77% as of December 31, 2016 and 2015, 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 1.89% to 3.88% as of December 31, 2016 and from 2.67% to 3.89% as of December 31, 2015, respectively.

*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, 2016 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | | *(In Thousands)* | | |
| **Assets measured at fair value:** | | | | |
| **Financial Assets** | | | | |
| Financial assets at FVPL: | | | | |
| Held-for-trading: | | | | |
| Government securities | **P1,300,293** | **P13,107** | **P–** | **P1,313,400** |
| Derivative assets | **–** | **357,577** | **61,545** | **419,122** |
| Private debt securities | **188,773** | **7,984** | **–** | **196,757** |
| Equity securities | **54,609** | **–** | **–** | **54,609** |
| Designated at FVPL: | | | | |
| Investment in UITFs | **–** | **4,457,623** | **–** | **4,457,623** |
| | **P1,543,675** | **P4,836,291** | **P61,545** | **P6,441,511** |
| AFS investments: | | | | |
| Government securities | **P34,416,112** | **P3,418,446** | **–** | **P37,834,558** |
| Private debt securities | **26,177,419** | **2,663,651** | **–** | **28,841,070** |
| Equity securities** | **571,296** | **73,746** | **–** | **645,042** |
| | **P61,164,827** | **P6,155,843** | **–** | **P67,320,670** |
| **Non-financial assets** | | | | |
| Property, plant and equipment*** | | | | |
| Land and land improvements | **P–** | **P–** | **P15,834,177** | **P15,834,177** |
| Plant buildings and building improvements | **–** | **–** | **13,075,835** | **13,075,835** |
| Machineries and equipment | **–** | **–** | **7,194,036** | **7,194,036** |
| | **P–** | **P–** | **P36,104,048** | **P36,104,048** |
| **Liabilities measured at fair value:** | | | | |
| **Financial liabilities** | | | | |
| Financial liabilities at FVPL: | | | | |
| Designated at FVPL: | | | | |
| Derivative liabilities | **P–** | **P232,832** | **P–** | **P232,832** |
| | **P–** | **P232,832** | **P–** | **P232,832** |

(Forward)

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | | *(In Thousands)* | | |
| **Assets for which fair values are disclosed:** | | | | |
| **Financial Assets** | | | | |
| HTM investment | **P21,010,056** | **P3,164,423** | **P–** | **P24,174,479** |
| Loans and receivables: | | | | |
| Receivables from customers | **–** | **–** | **396,257,262** | **396,257,262** |
| Unquoted debt securities | **–** | **–** | **3,253,457** | **3,253,457** |
| | **P21,010,056** | **P3,164,423** | **P399,510,719** | **P423,685,198** |
| **Non-financial Assets** | | | | |
| Investment properties*** | | | | |
| Land | **P–** | **P–** | **P24,971,630** | **P24,971,630** |
| Buildings and improvements | **–** | **–** | **8,810,139** | **8,810,139** |
| | **P–** | **P–** | **P33,781,769** | **P33,781,769** |
| **Liabilities for which fair values are disclosed:** | | | | |
| **Financial liabilities** | | | | |
| Financial liabilities at amortized cost: | | | | |
| Deposit liabilities: | | | | |
| Time deposits | **P–** | **P–** | **P86,181,252** | **P86,181,252** |
| Long term debts: | | | | |
| Subordinated debt | **–** | **–** | **3,551,484** | **3,551,484** |
| Bills payable | **–** | **–** | **34,226,607** | **34,226,607** |
| Unsecured term loan | **–** | **–** | **1,604,003** | **1,604,003** |
| Other liabilities: | | | | |
| Payable to landowners | **–** | **–** | **3,186,369** | **3,186,369** |
| Tenants' rental deposits | **–** | **–** | **393,496** | **393,496** |
| Advance rentals | **–** | **–** | **59,255** | **59,255** |
| | **P–** | **P–** | **P129,202,466** | **P129,202,466** |

** 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, 2015 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | | *(In Thousands)* | | |
| Assets measured at fair value: | | | | |
| Financial Assets | | | | |
| Financial assets at FVPL: | | | | |
| Held-for-trading: | | | | |
| Government securities | P2,707,811 | P1,331,801 | P– | P4,039,612 |
| Derivative assets | –– | 118,016 | 63,332 | 181,348 |
| Private debt securities | 143,800 | – | – | 143,800 |
| Equity securities | 199,752 | 170 | – | 199,922 |
| Designated at FVPL: | | | | |
| Investment in UITFs | – | 17,261 | – | 17,261 |
| | P3,051,363 | P1,467,248 | P63,332 | P4,581,943 |
| AFS investments: | | | | |
| Government securities | P33,499,835 | P11,760,562 | P– | P45,260,397 |
| Private debt securities | 21,614,280 | 638,700 | – | 22,252,980 |
| Equity securities** | 560,272 | 93,659 | – | 653,931 |
| | P55,674,387 | P12,492,921 | P– | P68,167,308 |

(Forward)

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | | (In Thousands) | | |
| Assets of disposal group classified as held for sale: | | | | |
| Financial assets at FVPL: | | | | |
| Segregated fund assets | P7,854,450 | P– | P5,780,237 | P13,634,687 |
| AFS investments: | | | | |
| Government securities | 2,485,902 | – | – | 2,485,902 |
| Private debt securities | 3,604,065 | – | – | 3,604,065 |
| Equity securities | 1,378,686 | – | – | 1,378,686 |
| | P15,323,103 | P– | P5,780,237 | P21,103,340 |
| Non-financial assets | | | | |
| Property, plant and equipment*** | | | | |
| Land and land improvements | P– | P– | P19,253,238 | P19,253,238 |
| Plant buildings and building improvements | – | – | 13,750,867 | 13,750,867 |
| Machineries and equipment | – | – | 6,534,040 | 6,534,040 |
| | P– | P– | P39,538,145 | P39,538,145 |
| Liabilities measured at fair value: | | | | |
| Financial liabilities | | | | |
| Financial liabilities at FVPL: | | | | |
| Designated at FVPL: | | | | |
| Segregated fund liabilities* | P7,945,084 | P– | P5,780,237 | P13,725,321 |
| Derivative liabilities | – | 135,193 | – | 135,193 |
| | P7,945,084 | P135,193 | P5,780,237 | P13,860,514 |
| Assets for which fair values are disclosed: | | | | |
| Financial Assets | | | | |
| HTM investment | P18,661,871 | P5,887,982 | P– | P24,549,853 |
| Loans and receivables: | | | | |
| Receivables from customers | – | – | 351,626,538 | 351,626,538 |
| Unquoted debt securities | – | – | 648,046 | 648,046 |
| Assets of disposal group classified as held for sale | 1,336,814 | 1,336,814 | – | 2,673,628 |
| | P19,998,685 | P7,224,796 | P352,274,584 | P379,498,065 |
| Non-financial Assets | | | | |
| Investment properties*** | | | | |
| Land | P– | P– | P30,136,203 | P30,136,203 |
| Buildings and improvements | – | – | 8,517,345 | 8,517,345 |
| | P– | P– | P38,653,548 | P38,653,548 |
| Liabilities for which fair values are disclosed: | | | | |
| Financial liabilities | | | | |
| Financial liabilities at amortized cost: | | | | |
| Deposit liabilities: | | | | |
| Time deposits | P– | P– | P60,762,710 | P60,762,710 |
| Long term debts: | | | | |
| Subordinated debt | – | – | 10,241,659 | 10,241,659 |
| Bills payable | – | – | 25,033,940 | 25,033,940 |
| Unsecured term loan | – | – | 720,004 | 720,004 |
| Notes payable | – | – | 470,370 | 470,370 |
| Other liabilities: | | | | |
| Payable to landowners | – | – | 1,803,770 | 1,803,770 |
| Tenants' rental deposits | – | – | 351,781 | 351,781 |
| Advance rentals | – | – | 186,687 | 186,687 |
| | P– | P– | P99,570,921 | P99,570,921 |

** 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.*

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.

Significant input used in determining fair values of financial instruments under Level 2 comprises of interpolated market rates of benchmark securities. For investments in UITFs, fair values are determined based on published NAVPU as of reporting date.

As of December 31, 2016 and 2015, 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:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| **Financial assets** | | |
| Balance at beginning of year | **P5,843,569** | P5,339,628 |
| Add (deduct) total gain (loss) recorded in profit or loss | **(5,782,024)** | 503,941 |
| Balance at end of year | **P61,545** | P5,843,569 |
| **Nonfinancial assets** | | |
| Balance at beginning of year | **P39,538,145** | P38,470,525 |
| Additions during the year | **2,242,250** | 3,525,605 |
| Revaluation decrement during the year | **(720,604)** | (528,159) |
| Depreciation and amortization | **(1,574,243)** | (1,290,186) |
| Net carrying value of disposed/transferred assets and other adjustments | **(3,381,500)** | (639,640) |
| Balance at end of the year | **P36,104,048** | P39,538,145 |
| **Financial liabilities** | | |
| Balance at beginning of year | **P5,780,237** | P5,346,467 |
| Add (deduct) total loss (gain) recorded in profit or loss | **(5,780,237)** | 433,770 |
| Balance at end of year | **P–** | P5,780,237 |

Equity and/or Credit-Linked Notes are shown as "Asset of Disposal Group Classified as Held for Sale" as of December 31, 2015 (Note 37).

The structured Variable Unit-Linked Notes can be decomposed into bond components and options components. The fair value of structured notes has been computed by counterparties using present value calculations and option pricing models, as applicable. The valuation requires management to make certain assumptions about the model inputs particularly the credit spread of the Issuer. The model also used certain market observable inputs including the counterparty's credit default swap (CDS), PHP interest rate swap (IRS) rates (for the Peso-denominated issuances) and ROP CDS rates (for the USD-denominated issuances).

Description of valuation techniques are as follows:

| Structured Notes | Valuation Methods | Significant Unobservable Inputs | Significant Observable Inputs |
|---|---|---|---|
| Peso-denominated | DCF Method / Monte Carlo Simulation | Issuer's Funding rate / Issuer's CDS as proxy | PHP IRS |
| Dollar-denominated | DCF Method / Monte Carlo Simulation | Issuer's Funding rate / Issuer's CDS as proxy | ROP CDS / USD IRS |

The sensitivity analysis of the fair market value of the structured notes as of December 31, 2015 is performed for the reasonable possible movement in the significant inputs with all other variables held constant, showing the impact to profit and loss follows:

Sensitivity of the fair value measurement to changes in unobservable inputs:

| | | 2015 | |
|---|---|---|---|
| **Structured Investments** | **Significant Unobservable Input** | Range of Input* | Sensitivity of the Input to Fair Value** |
| **Peso-denominated** | **Bank CDS Levels** | 47.28 - 93.27 bps | 50 bps increase/(decrease) in change inputs would result in a (decrease) / increase in the market value of the note by P65,500,462 |
| **Dollar-denominated** | **Bank CDS Levels** | 40.719 - 76.344 bps | 50 bps increase/(decrease) in change inputs would result in a (decrease) / increase in the market value of the note by P41,710,217 |

** The sensitivity analysis is performed only on the fixed income portion of the Note, thus are based on assumptions that if changed may cause the value to fall out of range*

Sensitivity of the fair value measurement to changes in observable inputs:

| | | **2016** | |
|---|---|---|---|
| **Structured Investments** | **Significant Observable Input** | **Range of Input*** | **Sensitivity of the Input to Fair Value**** |
| **Peso-denominated** | **PHP IRS (3Y)** | **180.25 - 355.00 bps** | **50 bps increase/(decrease) in change inputs would result in a (decrease) / increase in the market value of the note by P65,500,462** |
| **Dollar-denominated** | **ROP CDS (5Y)** | **126.15 - 193.33 bps** | **50 bps increase/(decrease) in change inputs would result in a (decrease) / increase in the market value of the note by P28,095,617** |

** The sensitivity analysis is performed only on the fixed income portion of the Note, thus are based on assumptions that if changed may cause the value to fall out of range*

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.

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 | P6,000 - P6,200 |
| Plant buildings and building improvements | | | |
| Building | Replaceable Fixed Asset Valuation Approach | Replacement cost<br>Estimated total floor area | P4,287 - P10,000<br>24 - 1548 sq.m |
| Building improvements | Replaceable Fixed Asset Valuation Approach | Replacement cost<br>Estimated number of components | P2.8 million - P26.5 million<br>315 - 723 components |
| Machineries and equipment | Market Data Approach | Replacement cost<br>Estimated number of components | 3,200 - P8.6 million<br>P465 - 1,162 components |
| Investment properties: | | | |
| Land | Market Data Approach and Replacement Cost Approach | Price per square meter, size, location, shape, time element and corner influence | P800 - P100,000 |
| 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 |
|---|---|
| Valuation Techniques | |
| 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. |
| 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. |

## 35. Notes to Consolidated Statements of Cash Flows

*Non-cash Investing Activities*

a. As of December 31, 2016 and 2015, unpaid additions to property, plant and equipment amounted to P86.6 million and P78.1 million, respectively, which is included as part of "Accounts payable and accrued expenses".

b. In 2015, the Group reclassified cost of land, which was previously recognized as real estate inventory amounting to P1.1 billion, to investment property in view of management's plan to develop thereon additional buildings to be held for lease.

c. In 2015, the Group transferred investment properties with a carrying value of P2.0 billion and P1.2 billion to inventories, respectively.

d. In 2015, the Group classified APLII as disposal group held for sale and as discontinued operations and classified assets, liabilities and equity and reserves of APLII amounting to P23.5 billion, P21.5 billion and P0.6 billion, respectively.

e. In 2016, the Group reclassified certain properties from property, plant and equipment with aggregate carrying amount of P4.7 billion to investment properties.

f. Construction costs of building intended for leasing amounting to P105.5 million under real estate inventory, which were still under construction as of December 31, 2015, were transferred to investment properties.

*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. As of December 31, 2016 and 2015, accrued interest payable amounted to P662.3 million and P2.1 billion, respectively. Finance costs and cost of hauling services include amortization of bond issue costs and unamortized transaction cost of subordinates debt amounting to P2.0 million and P17.3 million in 2016 and P2.0 million and P16.8 million in 2015, respectively.

c. As discussed in Note 30, 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 are deducted from additional paid in capital.

## 36. 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 2016 and 2015.

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 2016 and 2015.

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:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands, except ratios)* | |
| Total liabilities | **P650,486,448** | P579,794,407 |
| Total equity | **178,604,576** | 169,758,095 |
| Total liabilities and equity | **P829,091,024** | P749,552,502 |
| Debt ratio | **0.78:1** | 0.77:1 |
| Debt-to-equity ratio | **3.64:1** | 3.42:1 |

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 PFRSs 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.

## 37. Assets and Liabilities of Disposal Group Classified as Held for Sale and Discontinued Operations

*Sale of PNB's 51% share in APLII to Allianz SE*
On December 21, 2015, PNB entered into a 15-year exclusive partnership with Allianz SE under the following arrangements, subject to regulatory approvals:

- Allianz SE will acquire 12,750 shares representing 51% stockholdings of APLII and will have management control over the new joint venture company;
- The new joint venture company will operate under the name of "Allianz PNB Life Insurance, Inc.";
- A 15-year distribution agreement which will provide Allianz an exclusive access to the more than 660 branches nationwide of PNB.

As of December 31, 2015, APLII was classified as disposal group held for sale and as discontinued operation.

The sale of APLII was completed on June 6, 2016 for a total consideration of US$66.0 million (P3.1 billion). Pursuant to the sale of APLII, PNB also entered into a distribution agreement with APLII where PNB will allow APLII to have exclusive access to the distribution network of PNB and its subsidiary, PNB Savings Bank, over a period of 15 years. Both the share purchase agreement and distribution agreement have provisions referring to one another; making the distribution agreement an integral component of the sale transaction. Accordingly, the purchase consideration of US$66.0 million (P3.1 billion), was allocated between the sale of the 51% interest in APLII and the Exclusive Distribution Rights (EDR) amounting to US$44.9 million (P2.1 billion) and US$21.1 million (P1.0 billion), respectively.

PNB will also receive variable annual and fixed bonus earn out payments based on milestones achieved over the 15-year term of the distribution agreement.

PNB recognized gain on sale of the 51% interest in APLII amounting to P400.3 million, net of taxes and transaction costs amounting to P276.7 million and P153.3 million, respectively. The consideration amounting to P939.7 million allocated to the EDR was recognized as "Other deferred revenue" and will be amortized to income over 15 years from date of sale (see Note 20).

Prior to the sale of shares to Allianz SE, PNB acquired additional 15% stockholdings from the minority shareholders for a consideration amounting to P292.4 million between June 2, 2016 and June 5, 2016.

PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, requires assets and liabilities of APLII, together with the results of operations, to be classified separately from continuing operations. As a result, the Group reclassified all the assets and liabilities of APLII to "Assets of disposal group classified as held for sale" and "Liabilities of disposal group classified as held for sale", respectively, in the 2015 consolidated balance sheet.

The business of APLII represented the entirety of PNB's life insurance business until December 21, 2015. APLII was previously presented in the "Others" section of the business segment disclosure. With APLII being classified as a discontinued operation in 2015, the comparative consolidated statement of income and comprehensive income in 2014 have been re-presented to show the discontinued operations separately from the continued operations.

On June 6, 2016, the sale of APLII was completed. PNB recognized gain on sale amounting to P834.5 million recognized in "Net Income from Discontinued Operations" in the consolidated statements of income.

The results of operation of APLII are presented below:

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| | | *(In Thousands)* | |
| **Interest income** | | | |
| Loans and receivables | **P7,610** | P20,343 | P18,707 |
| Trading and investment securities | **195,605** | 443,116 | 396,586 |
| Deposits with banks and others | **5,151** | 3,504 | 324 |
| | **208,366** | 466,963 | 415,6177 |
| **Net service fees and commission expense** | **(67,591)** | (281,639) | (335,635) |
| Net insurance premiums | **508,770** | 1,716,308 | 1,604,500 |
| Net insurance benefits and claims | **(441,090)** | (1,290,439) | (1,191,359) |
| **Net insurance premiums** | **67,680** | 425,869 | 413,141 |
| **Other income (charges)** | | | |
| Trading and investment securities gains - net | **1,800** | 20,874 | 14,661 |
| Foreign exchange gains (losses) - net | **(876)** | 11,806 | (1,999) |
| Miscellaneous | **80,667** | 149,061 | 101,111 |
| **Total operating income** | **290,046** | 792,934 | 606,896 |
| **General and administrative expenses** | | | |
| Compensation and fringe benefits | **71,741** | 223,322 | 166,757 |
| Taxes and licenses | **16,759** | 39,570 | 36,544 |
| Occupancy and equipment-related costs | **7,610** | 9,764 | 9,196 |
| Depreciation and amortization | **4,707** | 10,704 | 14,039 |
| Provision for impairment, credit and other losses | **4,704** | 32,765 | – |
| Miscellaneous | **39,692** | 74,573 | 73,025 |
| **Total general and administrative expenses** | **145,213** | 390,698 | 299,561 |
| **Result from operating activities** | **144,833** | 402,236 | 307,335 |
| Provision for income tax | **(21,049)** | (44,305) | (43,171) |
| **Result from operating activities, net of tax** | **123,784** | 357,931 | 264,164 |
| Gain on sale of discontinued operation | **834,535** | – | – |
| Transaction cost | **(153,307)** | – | – |
| Provision for income tax | **(185,449)** | – | – |
| **Net income from discontinued operations** | **P619,563** | P357,931 | P264,164 |
| ***Attributable to:*** | | | |
| Equity holders of the Company | **P279,894** | P161,699 | P119,339 |
| Non-controlling interests | **339,669** | 196,232 | 144,825 |
| | **P619,563** | P357,931 | P264,164 |

Earnings per share attributable to equity holders of the Company from discontinued operations are computed as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Net income attributable to equity holders of the banking segment | **P279,894** | P161,699 | P119,339 |
| Weighted average number of common shares for basic earnings per share | **10,821,389** | 10,821,389 | 10,821,389 |
| Basic earnings per share | **P0.03** | P0.02 | P0.01 |

The net cash flows directly associated with disposal group follow:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | *(In Thousands)* | |
| Net cash provided by operating activities | **P171,535** | P1,210,588 | P1,535,951 |
| Net cash used in investing activities | **(267,458)** | (903,161) | (1,395,508) |

The major classes of assets and liabilities of APLII classified as disposal group held for sale as of December 31, 2015 are as follows (in thousands):

| | |
|---|---|
| **Assets** | |
| Cash and other cash items | P642,544 |
| Financial assets at fair value through profit or loss Segregated fund assets | 13,634,687 |
| AFS investments | 7,468,653 |
| HTM Investments | 1,269,398 |
| Other receivables | 437,210 |
| Property and Equipment - net | 29,546 |
| Other assets | 44,719 |
| **Assets of disposal group classified as held for sale** | P23,526,757 |
| **Liabilities** | |
| Financial liabilities at fair value through profit or loss Segregated fund liabilities | P13,725,321 |
| Accrued taxes, interest and other expenses | 161,817 |
| Insurance contract liabilities | 6,837,144 |
| Other liabilities | 728,339 |
| **Liabilities of disposal group classified as held for sale** | **P21,452,621** |
| **Reserves** | |
| Net unrealized gain on AFS investments | P617,649 |
| Remeasurement losses on retirement plan | (24,412) |
| **Reserves of disposal group classified as held for sale** | P593,237 |
| Attributable to: | |
| Equity holders of the Company | P335,000 |
| Non-controlling interests | 258,237 |
| | P593,237 |

*Transactions with Heineken*
On May 27, 2016, the Group entered into a joint venture agreement with Heineken to establish AB HPI to manage its beer segment. In accordance with the agreement, ABI transferred its beer business comprising of the related inventories, returnable containers and brands to AB HPI in exchange for shares of stock at the fair value of P787.4 million. The Group has significant influence over AB HPI and therefore, treats the investment as investment in associate.

The Group recognized the difference amounting to P1,056.2 million between its investment and its equity interest in AB HPI as gain on investment in an associate arising from contribution of non-monetary assets in exchange for shares of stock. Also, the Group recognized P46.3 million as gain from the sale of its brands (see Note 6). These amounts are presented as part of discontinued operations in 2016.

The results generated from discontinued operations of the beer segment of the Group follow (in thousands):

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| **NET SALES** | **P3,136,595** | P2,900,686 | P3,410,688 |
| **COST OF GOODS SOLD** | | | |
| Taxes and licenses | **1,306,050** | 1,352,173 | 1,440,781 |
| Materials used and changes in inventories | **816,349** | 458,775 | 529,406 |
| Depreciation and amortization | **249,654** | 289,436 | 359,691 |
| Utilities | **77,478** | 83,417 | 96,987 |
| Outside services | **63,056** | 135,265 | 113,950 |
| Fuel and oil | **90,191** | 107,400 | 125,916 |
| Repairs and maintenance | **79,347** | 102,491 | 106,266 |
| Salaries, wages and other employee benefits: | | | |
| Salaries and wages | **108,093** | 125,696 | 108,241 |
| Retirement benefits costs | **32,080** | 32,458 | 41,324 |
| Professional fees | **49,181** | 59,875 | 50,440 |
| Supplies | **86,625** | 72,416 | 88,645 |
| Others | **81,446** | 58,088 | 45,648 |
| | **3,039,550** | 2,877,490 | 3,107,295 |
| **GROSS PROFIT** | **97,045** | 23,196 | 303,393 |
| **SELLING EXPENSES** | | | |
| Advertising and promotions | **305,174** | 167,369 | 188,742 |
| Depreciation and amortization (Note 12) | **141,031** | 160,431 | 69,882 |
| Personnel costs | **36,175** | 37,343 | 34,497 |
| Materials and consumables | **7,371** | 39,486 | 5,419 |
| Repairs and maintenance | **2,516** | 2,946 | 11,208 |
| Travel and transportation | **8,639** | 8,385 | 9,207 |
| Others | **30,754** | 25,695 | 29,291 |
| | **531,660** | 441,655 | 348,246 |
| **GENERAL AND ADMINISTRATIVE EXPENSES** | | | |
| Taxes and licenses | **40,442** | 31,792 | 29,673 |
| Management, consulting and professional fees | **34,595** | 26,097 | 24,053 |
| Personnel costs | **26,918** | 22,405 | 15,526 |
| Travel and transportation | **3,779** | 4,781 | 2,090 |
| Communication, light and water | **3,042** | 1,751 | 1,541 |
| Repairs and maintenance | **865** | 940 | 75 |
| Occupancy | **490** | – | – |
| Materials and consumables | **284** | 73 | 96 |
| Insurance | **53** | 36 | 35 |
| Others | **1,584** | 794 | 861 |
| | **112,052** | 88,669 | 73,950 |
| **OPERATING LOSS** | **(546,667)** | (507,128) | (118,803) |
| **OTHER INCOME** | | | |
| Gain on investment in an associate arising from contribution of non-monetary assets | **P1,056,240** | P– | P– |

(Forward)

| | Years Ended December 31 | | |
|---|---|---|---|
| | **2016** | 2015 | 2014 |
| Gain on sale of brands | **P46,300** | P– | P– |
| Others | **3,463** | 7,135 | 15,483 |
| **INCOME (LOSS) FROM DISCONTINUED OPERATIONS BEFORE INCOME TAX** | **559,336** | (499,993) | (103,320) |
| **PROVISION FOR (BENEFIT FROM) INCOME TAX** | | | |
| Current | **(132,184)** | (131,000) | 9,379 |
| Deferred | **(16,887)** | (18,998) | (40,375) |
| | **(149,071)** | (149,998) | (30,996) |
| **NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS** | **P708,407** | (P349,995) | (P72,324) |

The net cash flows directly associated from discontinued operations follow:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| | | (In Thousands) | |
| Net cash provided by operating activities | **(P401,289,143)** | P185,264,589 | (P389,338,445) |
| Net cash used in investing activities | **(230,836,659)** | (807,443,468) | 93,005,208 |
| | **(P632,125,802)** | (P622,178,879) | P296,323,237 |

## 38. 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, certain motor vehicles and items of machinery. 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. Security deposits and advance rentals amounted to P273.0 million and P180.6 million as of December 31, 2016 and P387.6 million and P145.6 million as of December 31, 2015, respectively.

Future minimum rental receivables under noncancellable operating leases as of December 31 are as follows:

| | **2016** | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Within one year | **P1,130,072** | P1,179,758 |
| After one year but not more than five years | **1,605,790** | 2,508,002 |
| More than five years | **305,486** | 264,551 |
| | **P3,041,348** | P3,952,311 |

*Operating lease commitments - the Group as lessee*
The future aggregate minimum lease payments under several operating leases of the Group are as follows:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Within one year | **P457,055** | P487,388 |
| Within two to five years | **1,066,976** | 856,828 |
| More than five years | **1,667,333** | 1,526,715 |
| | **P3,191,364** | P2,870,931 |

Future minimum lease receivables under finance leases are as follows:

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Within one year | **P1,738,954** | P1,654,119 |
| Beyond one year but not more than five years | **1,273,921** | 1,984,772 |
| More than five years | **36,500** | 47,900 |
| Total | **3,049,375** | 3,686,791 |
| Less amounts representing finance charges | **355,743** | 62,206 |
| Present value of minimum lease payments | **P2,693,632** | P3,624,585 |

*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 P75.2 billion and P78.7 billion as of December 31, 2016 and 2015, respectively. In connection with the trust functions of PNB, government securities amounting to P0.7 billion, (included under "AFS investments") as of December 31, 2016 and 2015 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 P19.4 million, P16.6 million and P13.6 million in 2016, 2015 and 2014, respectively, which correspond to 10% 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% 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.

*Claim from PNB Gen*
In 2015, PNB recognized income amounting to P716.2 million under "Other income (charges)" arising from the fire insurance claims of PNB from PNB Gen involving the Ever Gotesco Grand Central ("Insured Property") which was mortgaged to PNB by Gotesco Investment, Inc. and Ever Emporium, Inc. (collectively "Ever Gotesco Group") to secure certain credit accommodations. The insurable interest of PNB (as mortgagee) was insured with PNB Gen. The Insured Property was razed by fire on March 19, 2012, which justified the payment by PNB Gen of the insurance claims of PNB, after the Court cleared the legal issues between PNB and Ever Gotesco Group that might potentially bar the payment thereof.

Movements of provision for legal claims included in "Other liabilities" in the consolidated balance sheets for the Group are as follows (see Note 20):

| | 2016 | 2015 |
|---|---|---|
| | *(In Thousands)* | |
| Balance at beginning of year | **P898,737** | P1,640,648 |
| Provisions (reversals) during the year (Note 26) | **401,553** | (741,911) |
| Balance at end of year | **P1,300,290** | P898,737 |

*Excise Tax Refund Claim*
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 is undertaking 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.

Other Matters
*Property development tax incentives*
The property development segment 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. The ITH incentives entitlements of the Group already expired in 2012.

*Effluent Supply Agreement*
On September 26, 2013, ADI and Aseagas Corporation (Aseagas) entered into an effluent (wastewater) supply agreement wherein ADI will supply effluent to Aseagas to be used in the generation of liquid bio-methane for a period of 20 years (delivery period) from the date Aseagas notifies ADI that the liquid bio-methane plant to be constructed by Aseagas becomes ready for commercial operations. The delivery period is renewable for another ten (10) years upon mutual agreement of both parties. As of March 14, 2017, the liquid bio-methane plant is still under construction.

39**. Events after the Reporting Period**

On March 14, 2017, LTG's BOD approved the declaration and distribution of regular cash dividends of P0.15 per share and special cash dividends of P0.03 per share to all stockholders of record as of March 29, 2017, to be paid not later than April 7, 2017.

## BOARD OF **DIRECTORS**

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*President*
*& Chief Operating Officer*

**Juanita T. Tan Lee**
*Director / Treasurer*

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

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**Johnip G. Cua**
*Advisor*

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*Chief Finance Officer*

**Nestor C. Mendones**
*Deputy Chief Finance Officer*

**Atty. Ma. Maria Cecilia L. Pesayco**
*Corporate Secretary*

**Atty. Marivic T. Moya**
*Assistant Corporate Secretary*

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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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LT Group, Inc.

Annual Report 2016

| | |
|---|---|
| Paper used: | MOHAWK Options PC White 216 gsm<br>210mm x 297 mm<br>100% post consumer recycled fiber |
| | Limited Edition Planner Cream 80 gsm<br>50% post consumer recycled pulp |
| Ink used: | Printed with soy based ink<br>Alcohol free fountain solution |
| Printer: | Velprint Corp.<br>SMETA-certified printer<br>www.Velprint.com.ph |

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