President's Report

For the First Nine Months of 2013

For the first nine months of 2013, LT Group, Inc. (LTG) reported an attributable net income of Php6.850 billion, 17.6% lower than the Php8.309 billion generated in the same period in 2012. On a pro-forma basis, with PNB's ownership at 59.9%, the attributable net income would have been Php7.792 billion versus Php8.967 billion, or 13.1% lower.

PNB contributed Php3.011 billion, followed by the tobacco business at Php2.788 billion, which accounted for 44% and 41% of total, respectively. Asia Brewery, Inc. (ABI) accounted for Php625 million or 9%, while Eton Properties added Php195 million. Tanduay Distillers, Inc. (TDI) and Other Income from Business Combination accounted for the balance.

LTG's balance sheet remained strong, with a cash balance of Php35.7 billion, excluding PNB's cash. Debt-to-Equity Ratio remained low at 0.32:1 as of end-September 2013, from 0.86.:1 as of end 2012.

Philippine National Bank (PNB)

PNB's 9M13 income reached Php6.676bn, a 40.6% growth year-on-year (y-o-y). Interest Income was 7.9% lower at Php14.425 billion despite the 13.2% y-o-y growth in loans to Php258.1 billion as of September 2013, as the low-interest rate regime resulted in a contraction of Net Interest Margin (NIM, annualized) to 2.8% from 3.3% in 9M12. However, the 18.6% rise in Other Income to Php10.062 billion, largely from trading gains in 1H13 helped boost the bank's bottom line. As a result of the higher earnings, the Bank's Return on Equity (RoE) improved to 10.0% from 7.3% over the same period, while Return on Assets (RoA) also increased to 1.2% from 0.9%. PNB's Capital Adequacy Ratio (CAR) stands at 20.3%, inclusive of Php11 billion in Tier 2 capital, as of September 2013.

PNB recently disclosed that it will be having a Stock Rights Offering of up to Php15 billion. This is targeted to improve the Bank's Tier1 Capital, which, under Basel 3, will result to a CAR of 15% to 18%, from the current 13%-14%. LTG intends to fully subscribe to the extent of its 60% ownership (LTG's stake in PNB is currently at 45%, but to increase to 60%, subject to local regulatory approval).

A major portion of the funds raised from the stock rights offering will be used to increase the capitalization of PNB Savings Bank, as the Bank intends to grow its consumer loans business via the savings bank. Currently, consumer loans only account for 10% or Php24.7 billion of PNB's total loan portfolio, and the target is to increase the share to 18% of total loans in 5 years. With over 4 million depositors from the merged PNB and Allied Bank, coupled with the biggest share of remittances among banks (21% of the US$14.5 billion total remittances for ytd August 2013), the Bank has the platform to increase its consumer loans.

Tobacco

LTG's income from the tobacco business amounted to Php2.799 billion in 9M13, 37.7% lower y-o-y than the Php4.493 billion in 9M12.

Philip Morris International (PMI), LTG's partner in PMFTC, has disclosed that volume reached 17.8 billion sticks in 3Q13, 20.7% lower y-o-y, compared to the 42.5% y-o-y volume drop in 1Q13 and 16.5% decline in 2Q13. Share of the tax-paid market was at 77.2% in 3Q13, 13.6%points lower than the year-ago level. PMI has also disclosed that it started lowering prices at the end of 1Q13, and started to move up prices and reduced pricing support of the lowest-priced brands towards the end of 3Q13. It is tactically balancing the volume and profitability of its operation.

The increases in the prices of premium and mid-low priced cigarettes brought about by the rise in excise taxes from Php12 to Php25, starting January 1, 2013, resulted in the down-trading of consumers to the more affordable Php1/stick super-low priced cigarettes. The industry share of super low priced cigarettes increased to 44% (including PMFTC's brands) in the quarter May to July 2013, from 24% in 1Q13 and only 15% in 2012.

The excise tax for super-low cigarettes is Php12/pack (starting 2013, from Php2.72 previously), which together with the 12% VAT, amounts to close to Php14 in taxes alone. For retailers to sell cigarettes at Php1/stick (or Php20/pack), the truck price of the cigarette has to be around Php15/pack. This leaves only Php1 to cover the cost of manufacturing and distribution.

PMI believes that selling the super-low cigarettes at a retail price of Php1/stick or Php20/pack is economically unsustainable when paying full taxes.

According to the Philippine News Agency (PNA) of the Presidential Communications Operations Office, the Department of Finance (DoF) is investigating the alleged technical smuggling (undervaluation of raw materials, i.e. imported leaf at US$0.68/kilogram vs. US$4.37-6.75/kilogram by other manufacturers, and allegedly using imported materials intended for warehousing or for export, but used for local distribution) and tax evasion (selling low-priced cigarettes at Php14.70/pack while industry estimates that it should be around Php19.70/pack if full taxes are paid) of Mighty Corporation. DoF Secretary Cesar Purisima has issued a memorandum ordering the Bureau of Customs (BoC) and Bureau of Internal Revenue (BIR) to investigate the situation of Mighty. The BIR has deployed 24-hour monitoring team in the manufacturing site of Mighty to monitor the volume and capacity of the manufacturer.

LTG, PMFTC and PMI will continue to work closely with the Philippine Government to try to stem the illicit trade of cigarettes.

We have confirmed reports that Mightly has raised prices, within Metro Maniila, from Php147/carton of 10 packs (truck price) to Php183/carton (up 24%) and is now retailing for Php1.25 to Php1.50/stick. This is a positive development, although small, but indicates that our efforts to get the attention of Government towards the illicit trade, has resulted to some pressure towards Mighty. Mightly's selling price of Php183/carton is now closer to the current price of Php194/carton of our low-end segment brands.

Asia Brewery, Inc. (ABI)

ABI's net income for 9M13 reached Php626 million for the first nine months of 2013, 13.6% more than the Php551 million reported in 9M12. Revenues were slightly lower at Php9.699 billion from Php9.830 billion, as the softdrink/soda war among the more popular cola brands adversely affected demand for ABI's carbonated energy drink, Cobra, which experienced a 5% drop in sales volume, which was more than offset by the 10% increase in selling prices.

The increase in selling prices of ABI's products improved the overall GPM to 30% from 29% previously, while operating expenses were generally flat.

ABI's water brands, Absolute and Summit, remain market leaders, with sales volume increasing 15% y-o-y in 9M13 to 12 million cases, with around a 30% market share.

Currently with the broadest portfolio of beverage products in the Philippines, ABI has sustained its growth by introducing its own products (Cobra, Tanduay Ice, water) or by forming strategic partnerships with well-known brands. ABI's partnership with Grupo Leche Pascual of Spain introduced long-life pasteurized yogurt in the Philippines in 4Q12 under the Creamy Delight brand, and is suitable for nationwide distribution, especially to the "sari-sari" stores (small neighborhood retail stores) as it does not require refrigeration. ABI also partnered with Nestle for ready to drink Nestea, and has recently started to manufacture Sunkist carbonated softdrinks in two flavors, orange and apple. The Company plans to introduce other flavors in time for the summer season next year.

Vitamilk, ABI's soymilk drink under an exclusive distribution agreement with Green Spot of Thailand, is the country's leading soymilk brand, with around 60% market share. With sales volumes reaching significant levels, ABI is putting up its own plant to manufacture the soymilk in the Philippines, and expects commercial operations in 1Q15.

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

Tanduay Distillers, Inc. (TDI)

TDI's earnings were adversely affected by the one-time expenses amounting to Php105 million arising from closure of the old plant in Quiapo, Manila, and the Php115 million fair value adjustment on the claims for refund of excess taxes paid, or a total of Php220 million. This resulted in a loss of Php41 million in 9M13, from an income of Php489 million in 9M12. On a core income basis, TDI's profit dropped by 63% to Php179 million.

Revenues of TDI reached Php7.556 billion, 8.9% lower than 9M12's Php8.294 billion, due to the 20% y-o-y drop in volume due to the adverse effect of higher excise taxes and stiff competition. TDI was able to increase selling prices by an average of 14%, but higher alcohol prices likewise caused GPM to slightly decline to 21% from 23%.

TDI's sales volume dropped 20% y-o-y, and based on Nielsen, our overall market share dropped to 26% as of end-September 2013, from 29% in 2012.

The Visayas-Mindanao area is the traditional market for TDI's products, and accounts for 95% of TDI's sales volume, with Metro Manila and the rest of Luzon only accounting for 5% of total volume. TDI only accounts for less than 3% of the total market in Metro Manila and the rest of Luzon. The planned launch of new products, targeted for the younger generation, should increase TDI's market share in Metro Manila and the rest of Luzon, and would have a significant impact in TDI's overall market share.

This month, TDI is launching Compañero Brandy, in time for the Christmas season, and is expected to compete with other brandy blends in the market. With its more superior taste, this brandy is targeted to appeal to a wider range of consumers.

In August of this year, TDI launched a premium product, Tanduay Asian Rum, in Florida and Connecticut in the United States, with at least 4 more states targeted for 2014. Tanduay Asian Rum comes in two variants, white and gold, which won the Best in Class Award in the Gold Rum Category by the International Rum Expert Panel in the 2013 Miami Rum Renaissance Festival. The product will soon be offered in duty free shops and hotels in the Philippines. The Asian Rum is expected to further enhance the image of the "Tanduay" brand.

Eton Properties

Eton's net income for the first nine months of 2013 reached Php196 million, a significant jump from 9M12's Php12 million, on the back of a 51.5% increase in revenues to Php3.081 billion, largely due to the completion of ongoing residential projects. Revenues from real estate development amounted to Php2.704 billion or 88% of total revenues, while rental income contributed Php378 million or 12%.