



MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL POSITION AND FINANCIAL PERFORMANCE

This discussion summarizes the significant factors affecting the consolidated financial performance, financial position and cash flows of San Miguel Corporation ("SMC" or the "Parent Company") and its subsidiaries (collectively referred to as the "Group") for the three-year period ended December 31, 2017. The following discussion should be read in conjunction with the attached audited consolidated statements of financial position of the Group as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2017. All necessary adjustments to present fairly the Group's consolidated financial position as of December 31, 2017 and the financial performance and cash flows for the year ended December 31, 2017 and for all the other periods presented, have been made.

I. BASIS OF PREPARATION

Statement of Compliance

The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards issued by the International Accounting Standards Board. PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine interpretations issued by the Philippine Financial Reporting Standards Council (FRSC).

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis except for the following items which are measured on an alternative basis at each reporting date:

Items	Measurement Basis
Derivative financial instruments	Fair value
Financial assets at fair value through profit or loss (FVPL)	Fair value
Available-for-sale (AFS) financial assets	Fair value
Defined benefit retirement asset (liability)	Fair value of the plan assets less the present value of the defined benefit retirement obligation
Agricultural produce	Fair value less estimated costs to sell at the point of harvest

Functional and Presentation Currency

The consolidated financial statements are presented in Philippine peso, which is the functional currency of the Parent Company. All financial information are rounded off to the nearest million (000,000), except when otherwise indicated.

Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards and Interpretation

The FRSC approved the adoption of a number of new and amended standards and interpretation as part of PFRS.

Amendments to Standards Adopted in 2017

The Group has adopted the following amendments to PFRS starting January 1, 2017 and accordingly, changed its accounting policies in the following areas:

- Disclosure Initiative (*Amendments to PAS 7, Statement of Cash Flows*). The amendments resulted in improved disclosures about the net debt of an entity relevant to the understanding of its cash flows. The amendments require entities to provide disclosures that enable users of the consolidated financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g., by providing a reconciliation between the opening and closing balances in the consolidated statements of financial position for liabilities arising from financing activities.
- Recognition of Deferred Tax Assets for Unrealized Losses (*Amendments to PAS 12, Income Taxes*). The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.
- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which only the *Amendments to PFRS 12, Disclosure of Interests in Other Entities* on clarification of the scope of the standard is applicable to the Group. The amendments clarify that the disclosure requirements for interests in other entities also apply to interests that are classified as held for sale or distribution.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the consolidated financial statements.

II. FINANCIAL PERFORMANCE

Comparisons of key financial performance for the last three years are summarized in the following tables.

	Years Ended December 31		
	2017	2016	2015
		<i>(In Millions)</i>	
Sales	P826,086	P685,314	P672,243
Cost of Sales	644,221	514,021	532,067
Gross Profit	181,865	171,293	140,176
Selling and Administrative Expenses	(70,823)	(71,639)	(59,627)
Operating Income	111,042	99,654	80,549
Financing Charges - net	(31,189)	(31,110)	(28,232)
Equity in Net Earnings (Losses) of Associates and Joint Ventures	297	203	(120)
Gain (Loss) on Sale of Investments and Property and Equipment	879	154	(79)
Other (Charges) - net	154	(11,426)	(6,506)
Income from Continuing Operations	54,814	40,422	28,831
Income after Income Tax from Discontinued Operations	-	11,818	162
Net Income	54,814	52,240	28,993
Net Income Attributable to Equity Holders of the Parent Company	28,225	29,289	12,448
Net Income Attributable to Non-controlling interests	26,589	22,951	16,545

2017 vs. 2016

The Group's consolidated sales revenue for the year 2017 amounted to P826,086 million, 21% higher than 2016, on the back of robust, double-digit growth across its fuels and petrochemicals, infrastructure, and beer, liquor, and packaging businesses.

The higher cost of sales resulted from the increase in crude prices of Petron Corporation (Petron), increase in sales volume of Petron and San Miguel Brewery Inc. (SMB), higher excise tax of SMB domestic operations, and the higher coal prices and energy fees of SMC Global Power Holdings Corp. (SMC Global).

Sustained sales growth, coupled with effective fixed cost management, brought consolidated operating income to P111,042 million, 11% higher than last year.

The increase in equity in net earnings in 2017 primarily represents the share of SMC Global on the net income of Angat Hydropower Corporation (Angat Hydro) vs net loss in 2016 offset by the decrease in net income of Northern Cement Corporation (NCC).

The gain on sale of investments and property and equipment in 2017 pertains to the sale of service stations by Petron Malaysia to the Malaysian government. Certain service stations of Petron Malaysia were closed to give way to the Mass Rail Transit project of Malaysia.

The decrease in other charges was primarily due to the recognition of lower foreign exchange loss on the translation of the United States (US) Dollar denominated long-term debt of the Parent Company, Petron, and SMC Global, and finance lease liabilities of SMC Global, partly offset by the lower gain on foreign exchange from foreign currency denominated cash and cash equivalents of the Parent Company.

Income from continuing operations amounted to P54,814 million, 36% higher compared to 2016.

Consolidated recurring net income, excluding the effect of forex translation and one-time gain from the sale of the telecommunications business last year, was up 11% to P54,654 million, compared to the previous year's P49,350 million.

Share of non-controlling interests in the Group's net income increased in 2017 compared to 2016 mainly due to the higher net income of Petron and SMB.

The following are the highlights of the performance of the individual business segments:

BEVERAGE

Beer

Consolidated volume of SMB reached almost 260 million cases, surpassing last year's volume by 13%. Strong volume growth was driven mainly by favorable economic conditions, along with effective marketing campaigns and integrated sales initiatives. Consolidated revenues rose 17% to P113,255 million.

Strong domestic operations, coupled with the contributions of international operations, pushed operating income up 15% to P31,161 million, while net income rose 17% to P20,711 million.

Beer Domestic

With favorable economic conditions, domestic beer volumes rose 15%, boosted by strong marketing campaigns and integrated sales initiatives. Revenues grew 18% to P99,999 million, partly reflecting a price increase implemented on October 1, 2017, as a result of the increase in excise tax. This significant improvement in volumes partly made up for the impact of higher excise taxes and operating costs and resulted to a 14% improvement in operating income to P30,139 million.

Red Horse Extra Strong Beer and San Miguel Pale Pilsen remained the top selling brands, with San Mig Light, Gold Eagle Beer, and San Miguel Flavored Beer turning in strong contributions as well.

SMB implemented new marketing campaigns and consumer and trade programs to sustain volume growth, strengthen brand equity, and increase consumption. New digital video campaigns featuring actress Ina Raymundo and rapper Curtsmith, as well as the "MBC Bagong Taon, Bagong Milyon" crown collection promo, strengthened Pale Pilsen's position. Meanwhile, Red Horse's "Pambansang Muziklaban" and "Pasiklaban" events continued to enable the brand to assert its position as "The No. 1 beer". San Mig Light also continued to push its "Mahaba-habang inuman" campaign through a new television commercial dubbed "5 Signs", while San Miguel Flavoured Beer utilized digital and social media advertising to boost penetration of the 'millennial' market.

Beer International

San Miguel Brewing International Limited's (SMBIL) operating income in 2017 grew 18% to US\$24 million. SMBIL continued to intensify efforts to sustain profit growth and accelerate the growth of San Miguel Brands, including Red Horse. San Miguel brands grew 6% versus last year on the back of strong results from South and North China, Thailand, Vietnam and the Exports markets. However, due to lower sales from some local brands in Indonesia and North China, overall volume declined 2%. Revenues ended at US\$263 million, at par with last year.

SMBIL continues to implement volume expansion initiatives for San Miguel brands by increasing trade coverage as well as pursuing cost reduction and efficiency improvements.

Spirits

For the fourth consecutive year, Ginebra San Miguel Inc. (GSMI) registered continued growth. Sales volumes rose 10% to 27.7 million cases, on the back of effective campaigns and below-the-line promotions, which led to higher consumption of flagship brand Ginebra San Miguel and Vino Kulafu. Both brands posted double digit growth. Consumers' strong affinity to the Barangay Ginebra Gin Kings basketball team was a key contributor to growth, as was Vino Kulafu's 60th year anniversary, which was hyped all-year-round via radio commercials anchored on its "Dosenang Lakas" proposition.

Expansion of consumer market reach, particularly the millennial generation, also contributed to strong volumes. Based on the Nielsen Retail Audit as of December 2017, market share is now at 32%.

Revenues rose 12% to P20,892 million, the result of higher volumes and price increase implemented last April 1, 2017. Operating income reached P1,397 million, 43% higher than the previous year while net income significantly rose 67% to P602 million.

FOOD

San Miguel Pure Foods Company Inc. (SMPFC) posted consolidated revenues of P117,449 million, 5% higher than 2016, on the sustained strong performance of the Poultry & Fresh Meats and Processed Meats businesses.

Operating Income rose 11% to P9,926 million, the result of favorable selling prices for poultry, fresh and processed meats products; a better sales mix, and lower costs of some major raw materials.

Net income ended 16% higher at P6,906 million.

Poultry & Meats and Feeds

The Poultry & Meats and Feeds businesses ended 2017 with revenues reaching P80,803 million, up 6% from 2016. This mainly was the result of better sales mix, favorable selling prices of chicken and fresh Meats products and aggressive marketing and promotion activities for feeds.

Milling

Milling business revenues declined by 3% to P9,506 million due to flat volumes and continued price pressures, including stiff competition and lower global wheat prices. Nevertheless, the Milling business remained profitable despite the margin squeeze.

Branded Value-Added

SMPFC's Branded Value-Added Business benefitted from the continued growth of its core products. The robust performance of processed meats, coupled with new product launches and intensified brand-building efforts, resulted to revenues of P29,405 million, 6% higher than 2016.

In a bid to further strengthen market leadership, a number of new products were introduced. Among these products are Purefoods Pulled Pork, Purefoods flavored luncheon meat (Cheese and Bacon); La Pacita Graham Cracker sandwiches and Oat Cookies, dual-flavored popsies and Avocado classic ice cream made with carabao milk.

SMPFC grew its value-added products and launched new offerings under the easy-to-cook and easy-to-heat lines. These include pre-marinated chicken cut-ups in three flavors (ginger, gata and tomato) and fully cooked *lechon kawali* and *crispy pata*.

SMPFC also started implementing its capacity expansion program in 2017. This includes the construction of five feed mills and at least one flour mill; a new hotdog plant, and the first ready-to-eat manufacturing plant, located in Santa Rosa Laguna, which will serve the growing consumer demand for convenient and nutritious meals. Construction of these facilities is progressing according to schedule.

PACKAGING

In 2017, the San Miguel Packaging Group continued to work to broaden its market presence in the region, posting very encouraging growth in Australia. The group achieved total year revenue of P32,099 million, 17% higher than the previous year, driven by the continued growth of Australian operations and higher sales to various beverage companies of glass, metal and plastics products.

With continuous implementation of cost management efforts and programs to increase productivity, operating income grew 16% to P2,994 million.

The Packaging group continued to grow its business in Australia, completing the acquisition of three major companies: Portavin Holdings Pty. Ltd. (Portavin) early in the year; Barrosa Bottling Services Pty. Ltd. - a specialist and independent contract wine bottling and packaging facility serving artisan wineries in South Australia – in June, and by November, Best Bottlers Pty. Ltd. Best Bottlers is a wine bottling and packaging facility specializing in various formats of contract-filling, including still and sparkling wines, cider, ready-to-drink and non-alcoholic beverages, such as fruit juices.

ENERGY

SMC Global's consolidated revenues for year 2017 grew 6% to P82,791 million, the result of higher realization prices from both bilateral and spot sales. Consolidated off-take volume however ended slightly lower at 17,227 gigawatt hours (Gwh) due to lower bilateral volumes from Ilijan and San Roque power plants. Ilijan Power Plant's Block 1 underwent an annual maintenance shutdown as did the Malampaya gas facility, from January 28 to February 16. Block 2 experienced a temporary shutdown due to series of earthquakes that hit Batangas at the beginning of the year. Sual Power Plant's Unit 2 likewise experienced a shutdown from June 14 to November 10, due to a main generator transformer failure. San Roque power plant also recorded lower power dispatch due to lower water level.

Operating income ended 9% lower than the previous year at P24,276 million, the result of higher energy fees, coal consumption costs; higher natural gas prices; replacement power purchases, lower bilateral volumes from Ilijan, and the sale of the Limay Cogen plant in 2016.

Net income amounted to P8,217 million, significantly higher than 2016 due to lower unrealized forex losses.

In 2017, SMC Global's total generating capacity reached 3,213 megawatts (MW), with the addition of 450 MW from the Malita and Limay power plants, which finally started commercial operation.

FUEL AND OIL

Petron reported a net income of P14,087 million, 30% higher than last year's P10,822 million as a result of its continued focus on high-value segments and strong sales volumes from both Philippine and Malaysian operations.

Consolidated volumes reached 107.8 million barrels, up 2% from 105.7 million barrels in the previous year. Sales in the retail segment grew 8%, on the back of the continued aggressive expansion of its service station network. By the end of the year, Petron breached the 3,000-service station mark. Sales of high-margin products such as gasoline, Jet A-1 and lubricants grew double digits while Petrochemicals provided good margins and additional revenue as volumes grew by 9%.

Petron's consolidated revenues reached P434,624 million, a 26% improvement from the P343,840 million recorded in 2016. Operating income grew 16% to P27,638 million. This would have been much higher if not for the scheduled maintenance turnarounds at both the 180,000 barrel-per-day Bataan refinery and the 88,000 barrel-per-day Port Dickson refinery in Malaysia.

Philippines

Petron's domestic performance was driven by higher sales of high-margin products such as gasoline, Jet A-1, and lubricants. Earlier in the year, Petron launched the first and only Euro 6 fuel, Blaze 100 Euro 6, considered the best gasoline in the country. Sales of lubricants such as Blaze Racing also contributed to overall growth. These new products, together with better efficiencies and higher production capability at the upgraded Petron Bataan refinery, all helped boost Philippine operations for the year.

Malaysia

The performance of Petron's Malaysia operations was also remarkable, driven by strong volume growth which resulted to increased market share. Petron Malaysia also continues to pursue its retail outlet expansion program.

INFRASTRUCTURE

SMC Infrastructure posted consolidated revenues of P22,497 million for 2017, a 13% increase from the previous year. Growth is attributed to higher vehicular volume at all operating toll roads namely the: South Luzon Expressway (SLEX), Skyway 1 and 2, Southern Tagalog Arterial Road (STAR), Tarlac-Pangasinan-La Union Toll Expressway (TPLEX), and the Ninoy Aquino International Airport Expressway (NAIAx). Operating income grew 6% to P10,440 million.

Tollroads

All operating toll roads – the SLEX, Skyway 1 and 2, STAR, TPLEX and NAIAx continue to record strong growth in average daily traffic, delivering combined revenues amounting to P18,683 million, 11% higher vs. 2016.

In December 2017, the Pozorrubio exit of TPLEX was completed and opened to the public which now brings to 77.4 km the length of the total commercially operational toll road out of the 89.21 kms total length of the expressway.

The construction of Skyway Stage 3's Sections 1 and 2 from Buendia to Aurora, as well as Sections 3 and 4 from Araneta Avenue to Balintawak, Quezon City, is ongoing and progressing well. The Toll Regulatory Board (TRB) has already issued a Notice of Approval for the San Juan River alignment proposal.

Construction for SLEX - Toll Road 4 (SLEX-TR4) (Sto. Tomas, Batangas to Lucena City) is set to begin. Final engineering plans and drawings has been approved and signed by the TRB. The Dept. of Public Works and Highways (DPWH) is working on right-of-way (ROW) acquisitions.

Preparations for the construction of Skyway Stage 4 are also underway. This is 58.09 km roadway will start at Skyway 1 and will go all the way to Batasan Complex in Quezon City. Once operational, this vital expressway will help decongest EDSA, C5 and other major roads. It will also serve as a faster alternative route for motorists coming from the Rizal and Calabarzon area.

Airport

Volumes and revenues from Boracay Airport in Caticlan grew in 2017, following the completion of runway expansion and the installation of navigation lights. These upgrades now allow the airport to accommodate larger aircraft as well as night flights. Meanwhile, the interim arrival hall is complete and is now being used, as the construction for the new passenger terminal is being completed. Plans to further extend the runway from 1.8km to 2.1km, is also underway.

Mass Rail

Construction of the Mass Rail Transit Line 7 (MRT 7) project remains on-track. Currently, work is focused at the area between Quezon Memorial Circle to SM Fairview, traversing Commonwealth Ave. and Regalado Ave. Civil works, rolling stocks, and electromechanical works and acquisition of subject lands are also ongoing.

Bulk Water

SMC Infrastructure is currently constructing the Water Treatment and Pipe Conveyance facilities for the Bulacan Bulk Water project. Environmental Compliance Certificate for the water treatment and pipe conveyance facilities have been issued. Discussions with DPWH, the Department of Transportation and the Bulacan local government units on the ROW of pipe conveyance facilities, are ongoing.

REAL ESTATE

San Miguel Properties, Inc. (SMPI), posted revenues of P2,394 million, a 39% rise from the previous year, as it continued to see growth in its real estate, hotel, and leasing operations.

2016 vs. 2015

As a result of completion of the sale of 100% ownership interest of the Parent Company in Vega Telecom, Inc. (Vega) and its subsidiaries on May 30, 2016, the financial performance of Vega and its subsidiaries for the period from January 1 to May 30, 2016 and for the period ended December 31, 2015, were presented as a separate item under "Income after income tax from discontinued operations" account in the consolidated statements of income.

The Group's consolidated revenues for year 2016 amounted to P685,314 million, 2% higher than 2015. Its core Beverage, Food and Packaging businesses continued to perform very well, delivering a combined revenue growth of 10% for 2016, together with the Power and Infrastructure businesses which also registered higher revenues. Petron on the other hand posted lower revenues due to the effect of lower crude oil prices in 2016.

The decrease in cost of sales resulted from the drop in crude prices of Petron, partly offset by the increase in cost of sales due to higher sales volume of Petron and SMB and higher excise tax of SMB domestic operations.

Consolidated operating income grew 24% to P99,654 million from P80,549 million in 2015. This was mainly driven by higher revenues and better margins from most of the businesses which brought in double-digit income growth.

The higher net financing charges resulted from the absence of capitalized interest in 2016, tempered by lower borrowing level and bank charges of Petron.

The increase in equity in net earnings in 2016 primarily represents the share of SMPI and San Miguel Yamamura Packaging Corp. (SMYPC) in the higher net income of Bank of Commerce and NCC, respectively, and the share of SMC Global in the lower net loss of Angat Hydro. The increase was partly reduced by the recognition of the Group's share in the net income of Atlantic Aurum Investments B.V. (AAIBV) Group from January 1 to March 5, 2015, and Manila North Harbour Port, Inc. (MNHPI) from January 1 to December 15, 2015, prior to consolidation.

The gain on sale of investments and property and equipment in 2016 pertains to the gain on sale by San Miguel Equity Investments Inc. of its investment in the shares of stock of South Western Cement Corporation and the gain on sale by SMPFC of investment property located in Sta. Maria, Bulacan. The balance in 2015 pertains mainly to the loss on the sale of heavy equipment in Bataan Refinery and the loss on rebranding of service stations of Petron.

The increase in other charges was primarily due to the recognition by Petron of commodity hedging loss in 2016 compared to a gain in 2015.

Income after income tax from discontinued operations pertains to the one-time gain on sale of the Telecommunications business in the second quarter of 2016, which represents the recovery of losses, costs, interest expense and provisions recognized in the previous periods.

The net income from discontinued operations in 2015 pertains to the consolidated net income of Vega and its subsidiaries.

Consolidated net income for 2016 is P52,240 million 80% higher than the P28,993 million in 2015. The increase was primarily due to the increase in the income from operations of Petron, SMB, Energy, Infrastructure and Food businesses, and the recognition of the one-time gain on sale of the Telecommunications business.

The increase in share of non-controlling interests in the Group's net income in 2016 compared to 2015 is mainly attributable to the additional issuance by SMC Global of undated subordinated capital securities in August 2015, higher net income of SMB, Petron, and of the various tollway companies namely: Citra Metro Manila Tollways Corporation (CMMTC), Manila Toll Expressway Systems, Inc. and South Luzon Tollways Corporation (SLTC) which were consolidated to the Group starting March 5, 2015.

The following are the highlights of the performance of the individual business segments:

BEVERAGE

Beer

SMB delivered outstanding results in 2016, with consolidated revenues amounting to P97,160 million, 18% higher than 2015. Consolidated sales volume reached 230.4 million cases, 12% higher than 2015.

Boosted by the strong performance from its Philippine operations and significant improvements from International Operations, SMB's operating income of P27,188 million and net income of P17,658 million are 20% and 31% higher than 2015, respectively.

Beer Domestic

Sales volume reflected a growth of 15% versus 2015 level supported by its continuous strong marketing campaigns focused on increasing demand, alongside favorable economic conditions. Revenue grew 20% to P84,723 million.

SMB's major brands posted impressive sales in 2016 led by Red Horse, Pale Pilsen and San Mig Light while San Miguel Flavored Beer continued its growth trajectory. As a result, SMB reinforced its leadership in the beer market.

Setting the tone for SMB's beer segment, thematic ads "True Love", "*Bakit Nga Ba Type Kita*", and "Sincere" were developed to strengthen love for beer. Red Horse asserted its position as "The No. 1 Beer" by capitalizing on its "Astig" equity while consumer interest in San Miguel Pale Pilsen was revived by reinforcing its image as the original beer via the "*Sarap ng Orig, Sarap ng Totoo*" thematic campaign.

San Mig Light further cornered the bar channel and resonated with upscale drinkers using its nationwide "Alarm" and "Let's Bar" advertising campaigns and on-ground activations such as "Bucket Nights" and "Party All Night DJ Spin Off".

San Miguel Flavored Beer sustained its robust expansion by building on its fresh and youthful equity. Brand awareness was further improved and demand soared as a result of its "Proposal" and "Proximity" ad materials. The brand also used digital campaigns to reach tech-savvy consumers.

Beer International

SMBIL posted a strong recovery in 2016, surmounting challenges encountered in 2015. SMB's international arm increased its revenue to US\$261 million. All units registered better financial results in 2016, led by the sustained growth in Thailand and Exports, rebound in Indonesia and improvements in China, Hong Kong and Vietnam.

SMBIL further strengthened its presence in both existing and new markets by implementing various sales initiatives aided by marketing activities as well as introduction of new products, variants and packaging design in selected markets.

Thailand's operating income for 2016 was higher on account of higher exports contribution, incremental profit of partner brands as well as higher margins from domestic operations coupled with more efficient advertising and promotion spending.

Exports' profits grew steadily as San Miguel and Red Horse volumes increased, led by higher sales to the United Arab Emirates, Malaysia, Korea and Oman. New markets in Europe and Africa helped improve volumes and better margins also contributed to Export's double-digit growth in operating income.

In Indonesia, 2016 volumes were flat due to the continuing instability brought about by the government regulation, banning the sale of alcohol in provision and convenience stores. Despite this, operating income for the year ended higher compared to 2015 due to improved margins as a result of the price increases implemented in mid-2016.

Operations in China continued to face tough market conditions in 2016, with beer consumption adversely affected by the economic slowdown in the country. However, operating results significantly improved owing to higher margins following the purposive shift to more profitable products and lower production cost.

Hong Kong operations continued to recover from the challenges it faced in 2015. Overall volumes still remained lower than 2015 but volumes of San Mig Light and partner brands posted growth for 2016. Operating results significantly improved - the result of distribution and warehouse restructuring, price adjustments and exports.

Vietnam sustained volume and profit improvements in 2016. San Mig Light continued its strong expansion driven by awareness programs, consumer promotions and trade incentives. Operating results were favorable versus 2015 on the back of higher domestic volumes, improved margins as well as the increase in exports production.

Spirits

GSMI grew volumes for a third successive year, to 25.2 million cases, driven by flagship brand Ginebra San Miguel and Vino Kulafu. GSMI reclaimed market leadership of the North and South Luzon areas as a result, based on the Nielsen Retail Audit December 2016 report. Revenues reached P18,572 million, 12% higher than 2015 while operating income jumped 58% to P978 million. Net income amounted to P361 million, a turnaround from P386 million net loss in 2015.

FOOD

SMPFC delivered another stellar performance in 2016, registering a net income of P5,976 million, 26% higher than 2015, boosted by the Agro-industrial and Branded Value-added businesses. Operating income reached P8,931 million, 17% higher compared to P7,644 million in 2015, due to improved margins brought about by better selling prices, lower costs and improved efficiencies.

SMPFC continued its strategic thrust to shift to offering more branded value-added products, improving efficiencies, strengthening distribution network and aggressive capacity expansion.

Agro-Industrial

Revenues from the Agro-Industrial business, consisting of B-Meg feeds, Magnolia chicken and Monterey fresh meats, posted a 5% growth on the back of robust volumes and better selling prices of poultry, coupled by the strong performance of the Feeds business.

Milling

The Flour business continued to be affected by the downward pressure of selling prices due to the continuous decline of global wheat prices, coupled with intense competition, resulting in a 4% decline in revenues.

The Grain Terminal business continued to provide support to the Feeds and Flour businesses which generated 10% growth in revenue, partly offsetting the setback in the results of the Flour business.

Value-Added

The Branded Value-added business sustained its momentum, bringing 2016 revenues 7% higher compared to 2015. This is attributed to the broad-based growth in sales for processed meats, cheese, spreads, biscuits and ice cream, underpinned by effective brand building campaigns and strong innovations in product development.

The Processed Meats business registered revenue growth in all food service channels mainly driven by higher consumer demand for Chicken nuggets, *Purefoods* corned beef and Star corned beef which were supported by new product launches and the successful advertising campaigns top billed by celebrity endorser Alden Richards for Tender Juicy hotdog.

Dairy and Others

The effective marketing campaigns boosted the performance of the dairy, spreads and biscuit segments with margarine maintaining its dominance in the market. New Magnolia Ice Cream flavors such as the Avocado Macchiato, Mango Salted Caramel, Strawberry Crumble Pie and Banoffee Pie of the Best of the Philippines were launched, further expanding the market of the ice cream category. The San Mig Coffee 3-in-1 likewise launched the Barako and Essenso variants.

The Food Service business also reported stronger sales across its primary channels, aided by more aggressive customized product offerings in the quick-service restaurant channel and by the growing consumer preference for convenience products sold in convenience stores.

PACKAGING

The San Miguel Packaging Group's sales revenue for the full year reached P27,386 million, 9% higher than 2015 mainly driven by solid sales performance from the Glass and Plastic businesses and the growing contribution from its Australian business operations.

Operating income amounted to P2,584 million, 10% higher compared to same period in 2015.

The Packaging Group has expanded its presence in Australia and New Zealand. In February 2017, the Group acquired Portavin, the leading wine bottling service provider in Australia. This acquisition fully complements the existing packaging operations in Australia and New Zealand through Cospak Pty. Limited and Vinocor Worldwide Direct Pty. Ltd. (Vinocor).

Glass

The Glass business, the Packaging Group's largest business, posted revenue growth of 10% in 2016. This was the result of the strong domestic demand from the beverage customers and growth in the export market. All facilities, including China and Vietnam have also shown outstanding performance achieving the highest efficiencies.

Metal

Higher sales of metal crowns and two-piece aluminum cans from the beverage companies resulted in 6% revenue growth during 2016.

Plastics

The Plastic business' revenue grew 16% from 2015 due to the surge in sales of crates and buckets for Beer and Coca-Cola products. Its leasing operations also saw growth in its revenue as a result of the lease-to-own purchase of pallets and revenues generated from the trucking services.

Paper

Despite the adverse weather conditions that affected crop harvest in southern Philippines in 2016, the Paper business managed to bring revenue slightly higher than 2015 as demand from its major customers increased and cost of raw materials and utilities were lower during 2016.

Malaysia

Malaysia operations revenue slightly rose compared to 2015 that have been affected by stiff competition and slowdown in demand from local customers.

Australia

The Australian operations' sales grew by 18% due to strong sales of wine bottles, corks, screwcaps, hoods and capsules from Cospak Group and the Vinocor. The Australia operations revenue now accounts to about 19% of the Packaging Group.

ENERGY

SMC Global registered consolidated offtake volume of 17,346 GWh for 2016, 5% higher than 2015 with both the Sual and Ilijan power plants posting higher bilateral volumes. There were also lower outages and maintenance shutdown experienced during 2016 compared to 2015. As a result, power revenues increased to P77,972 million, slightly higher than 2015. Combined with a 9% decline in generation cost, operating income reached P26,730 million, 13% higher than 2015. Net income amounted to P4,151 million, significantly higher than 2015.

The two greenfield coal power projects located in Malita, Davao and Limay, Bataan (Phase 1 and 2) will have a total capacity of 900 MW. These power plants will be using the circulating fluidized bed technology which limits the effect to the environment.

Sual

Sual power plant's revenue grew 3% compared to 2015 mainly driven by the 5% increase in offtake volumes despite the decline in average bilateral and Philippine Wholesale Electricity Spot Market (WESM) prices.

Ilijan

Ilijan power plant's offtake volume grew 10% with lower outages in 2016. Revenue however declined by 2% due to lower bilateral and WESM prices.

San Roque

The San Roque power plant posted lower offtake volumes by 10% due to low dam reservoir level during 2016. Revenue likewise ended lower by 11% due to lower spot market prices.

FUEL AND OIL

Petron ended 2016 with strong results as consolidated net income reached P10,822 million, 73% higher than the P6,270 million in 2015. The solid performance was fueled by sales volume growth, better efficiencies from both the Philippine and Malaysian operations and effective risk management.

With better margins, Petron's operating income grew 31% to P23,797 million in 2016.

Combined volumes from both the Philippine and Malaysian operations reached all-time high of 105.7 million barrels, 6% higher than the 99.1 million barrels sold in 2015. Both markets saw robust growth across its major business segments in reseller, industrial, liquefied petroleum gas and lubricants, with nearly all sectors experiencing double digit growth.

The surge in sales volume and the recovery of crude prices during the last quarter of 2016 helped mitigate the overall effect of lower crude oil prices throughout 2016. Benchmark Dubai crude averaged US\$41.27 per barrel in 2016, 19% lower than the full year 2015 average of US\$50.91 per barrel. Sales revenue ended lower by 5% at P343,840 million, compared to P360,178 million in 2015.

Philippines

Philippine domestic volumes grew by 10% reaching 48.2 million barrels in 2016. This is better than the industry growth of 8.8%. Combined sales of high-value products of gasoline, diesel and Jet A-1 or kerosene grew 14%, further strengthening its market leadership.

2016 also marked the first full year of commercial operations for Petron's US\$2,000 million refinery upgrade. This has enabled Petron to produce more high-margin fuels and petrochemicals supporting the substantial growth in sales. Costs have likewise gone down since its 180,000 barrel-per-day Bataan refinery can now process cheaper crudes.

At the end of 2016, Petron acquired the 140MW co-generation plant from sister company SMC PowerGen Inc. (SPI). The solid fuel-fired plant located beside Petron's refinery is expected to lower steam and power costs at the facility. The plant can utilize the pet coke from the refinery's delayed coker unit. The power plant is equipped with the latest clean technologies (e.g., circulating fluidized bed) and exceeds local and international environmental standards.

Petron also continued to expand its retail network that will enable Petron to channel increased production from its refinery to its service stations.

Malaysia

Total volumes grew 7% in 2016 fueled by strong sales in both the retail and commercial sectors. The launch of innovative fuels, namely the Blaze 100 Euro IV-M and the Turbo Diesel Euro V helped drive volumes.

Petron built more service stations – more than any other player in Malaysia – bringing its total station count to about 580 in 2016. The ongoing retail network expansion program enabled Petron to increase its presence, especially in underserved markets.

INFRASTRUCTURE

The Infrastructure business through San Miguel Holdings Corp. (SMHC), continued to increase its contribution to the Group. Revenues in 2016 reached P19,866 million, 13% higher than full year 2015 result. This was mainly driven by the continuous growth in traffic volume from all the operating tollroads – SLEX, Skyway Stages 1 and 2, STAR and TPLEX.

Operating income amounted to P9,849 million, up by 6% compared to 2015.

Tollroads

SLEX recorded a 13% growth in average daily traffic volume which registered revenues of P5,454 million, 12% higher than 2015. The Skyway Stages 1 and 2, generated P8,854 million of revenue with average daily traffic volume growth of 4%. Star Tollway, on the other hand, posted a 15% growth in revenue at P702 million, the result of increase in average daily traffic volume by 17%. TPLEX continued to post improvements in average daily traffic which grew 31% resulting in revenues of P978 million, up by 29%.

TPLEX's Carmen and Binalonan Exits have been opened to vehicular traffic last July and September 2016, respectively.

The NAIAX Sections 1 and 2 are now open. Section 2 opened on December 21, 2016 and started collecting toll fees on January 31, 2017 - more than one month from its opening date. Average daily traffic has been growing since the time the tollway has been completely opened to the commuters.

The construction of Skyway Stage 3, particularly Sections 1 and 2 from Buendia to Aurora Boulevard is ongoing and progressing well. Skyway Stage 3 involves the construction of a 14.2 kilometer elevated expressway from Buendia in Makati up to Balintawak, Quezon City.

Airport

The expansion of the runway to 1.8 kilometers has been completed including navigational equipment that enabled night flights. The first A320 flight has successfully landed on November 18, 2016.

Mass Rail

On July 1, 2016, the Parent Company also took full control of MRT 7 Project, through its wholly-owned subsidiary, SMHC. The remaining 49% equity interest in Universal LRT Corporation BVI (ULC BVI) and 100% in ULCOM Company, Inc. (ULCOM) was acquired for a total consideration of US\$100 million. ULC BVI holds the exclusive right, obligation and privilege to finance, design, construct, supply, complete and commission the MRT 7 project. ULCOM is the designated facility operator of the MRT 7 Project.

SMC Mass Rail Transit 7, Inc. (SMC-MRT 7) was incorporated on April 15, 2016 under SMHC which is the corporate vehicle for the implementation of MRT 7 project. This involves the construction of a 22 kilometer light rail transit from North EDSA to San Jose Del Monte, Bulacan, with a 22 kilometer road component that will connect to the North Luzon Expressway at the Bocaue exit. A groundbreaking ceremony was held on April 20, 2016 at the Quezon Memorial Circle.

Bulk Water

The Bulacan Bulk Water project involves the construction and operations and maintenance of water treatment facilities that will supply potable water to up to 24 different water districts in Bulacan. The Parent Company, through SMHC and partner Korea Water Resources Corporation won the public bidding for this project and concession agreement was signed on January 15, 2016. Commencement of site works such as clearing and grubbing started in September 2016 at the water treatment plant location.

REAL ESTATE

SMPI, the property arm of SMC, delivered higher sales from its residential projects, rental income and hotel revenues. Total revenues amounted to P1,716 million, a 53% growth over 2015.

Makati Diamond Residences achieved a significant rise in average occupancy in 2016 which grew 61.2% compared to the 2015 growth of 36%.

SMPI's income from operations of P210 million in 2016, increased by 83% from 2015.

III. FINANCIAL POSITION

A. The following are the major developments in 2017:

INVESTMENT IN SUBSIDIARIES

- *Consolidation of Food and Beverage Businesses of the Parent Company*

On November 3, 2017, the Board of Directors (BOD) of the Parent Company approved the subscription to additional 4,242,549,130 common shares of stock of SMPFC (the “New Shares”).

The additional subscription to the common shares of stock of SMPFC by the Parent Company will be issued out of the increase in authorized capital stock of SMPFC after the reduction of the par value of SMPFC common shares from P10.00 to P1.00 per share, and the corresponding amendment of the Articles of Incorporation of SMPFC. The New Shares will be listed at the Philippine Stock Exchange (PSE).

The subscription amount for the New Shares is P336,349 million which is the transaction value based on the independent valuation expert report of ING Bank N.V.

The subscription to the New Shares shall be paid in full through the execution of a Deed of Exchange between the Parent Company and SMPFC to convey 7,859,319,270 common shares of SMB and 216,972,000 common shares of GSMI held by the Parent Company (the “Exchange Shares”). This will result in the consolidation of the Food and Beverage Business units of the Parent Company under SMPFC to be renamed as San Miguel Food and Beverage, Inc. (SMFB).

The above corporate actions were approved by the stockholders of SMPFC in a special meeting held on January 18, 2018.

On March 23, 2018, the SEC approved the amendment to the articles of incorporation of SMPFC to (a) change of the corporate name of SMPFC to “San Miguel Food and Beverage, Inc.”, (b) change the par value of the common shares from P10.00 per share to P1.00 per share, and (c) denial of pre-emptive rights on the common shares of SMFB.

On April 5, 2018, the Parent Company and SMFB signed the Deed of Exchange to transfer the Exchange Shares to SMFB which will be effected upon the approval by the SEC of the increase in the authorized capital stock of SMFB, which application is pending with the SEC.

- *Sale of 34.83% Equity Interest in MNHPI*

On September 21, 2017, Petron signed the Share Purchase Agreement with International Container Terminal Services, Inc. for the sale of 10,449,000 shares of stocks or 34.83% equity interest in MNHPI for a total consideration of P1,750 million.

On October 30, 2017, all conditions for the completion of the sale had been complied with and the purchase price had been paid.

The Group retained the 43.33% ownership and control through SMHC’s stake in MNHPI.

LONG-TERM DEBT

▪ REDENOMINATION OF FOREIGN CURRENCY LOANS/DEBT

In 2017, the Group redenominated certain foreign currency loans to reduce exposure to changes in the peso-dollar exchange rates.

Parent Company

- *Shelf Registration of P60,000 Million worth of Fixed Rate Peso-denominated Bonds by the Parent Company and Issuance of P30,000 Million Bonds*

On February 14, 2017, the Philippine Securities and Exchange Commission (SEC) approved the shelf registration of up to P60,000 million worth of Fixed Rate Bonds of the Parent Company.

On March 1, 2017, the Parent Company issued and listed in the Philippine Dealing & Exchange Corp. (PDEX) the first tranche of the fixed rate bonds amounting to P20,000 million.

The Bonds are comprised of five-year Series A Bonds due 2022, seven-year Series B Bonds due 2024, and 10-year Series C Bonds due 2027. The Series A, Series B and Series C Bonds have interest rate per annum equivalent to 4.8243%, 5.2840% and 5.7613%, respectively. Interests are payable on March 1, June 1, September 1, and December 1 of each year.

Proceeds from the issuance were used by the Parent Company to partially pay the P25,000 million short-term bridge loan which was availed to partially redenominate the US\$500 million out of the US\$1,500 million long-term debt of the Parent Company.

On April 7, 2017, the Parent Company issued and listed in the PDEX the second tranche of the fixed rate bonds amounting to P10,000 million. The Bonds comprised of five-year Series D Bonds due 2022 with interest rate per annum equivalent to 5.1923%.

Proceeds from the issuance were used by the Parent Company to refinance the US\$200 million short-term bridge loan which was availed to partially redenominate the US\$200 million obligation, under the US\$300 million Facility Agreement.

SMC Global

- *Availment of P15,000 Million Term Loan*

On April 26, 2017, SMC Global availed of a P15,000 million fixed-rate, seven-year term loan to fund the payment of the US\$300 million out of the US\$700 million, five-year term loan drawn to refinance existing indebtedness and to fund the construction of the power plants in Malita, Davao and Limay, Bataan, investments in power-related assets, and for general corporate purposes.

- *Shelf Registration of P35,000 Million worth of Fixed Rate Peso-denominated Bonds and Issuance of P20,000 Million Bonds*

On December 8, 2017, the SEC approved the shelf registration of up to P35,000 million worth of Fixed Rate Bonds of SMC Global.

On December 22, 2017, SMC Global issued and listed in the PDEx the first tranche of P20,000 million Fixed Rate Bonds comprising of five-year Series D Bonds due 2022, seven-year Series E Bonds due 2024, and 10-year Series F Bonds due 2027.

The Series D, Series E and Series F Bonds have fixed interest rate per annum equivalent to 5.375%, 6.25% and 6.625%, respectively. Interests are payable on March 22, June 22, September 22, and December 22 of each year.

Proceeds from the issuance were used by SMC Global to pay the short-term bridge loans availed in March and September 2017, used to redenominate the US\$400 million out of the US\$700 million term loan.

SMC Consolidated Power Corporation (SCPC)

– Availment of P42,000 Million Term Loan

On June 22, 2017, SCPC entered into a P44,000 million Omnibus Loan and Security Agreement (OLSA), with various banks, of which P42,000 million has been drawn on June 28, 2017. Proceeds from the loan was used primarily for the payment of the US\$360 million short-term bridge financing loan availed in May 2017, to redenominate the US\$359 million loan drawn in 2016 to finance the acquisition and ongoing construction of the 2x150 MW Limay Coal-fired Power Plant.

■ REFINANCING OF LOANS

Parent Company

– Availment of US\$300 million Medium Term Loan

On October 24, 2017, the Parent Company drew US\$300 million from the medium-term loan facility subject to a floating interest rate plus spread and with maturities up to October 24, 2024. The proceeds were used to refinance the US\$287 million term loan drawn in 2015. The interest rate per annum of the US\$300 million loan is lower than the interest rate of the US\$287 million loan.

– Availment of US\$100 Million Medium Term Loan

On November 21, 2017, the Parent Company drew US\$100 million from its amended revolving facility agreement dated November 6, 2016. The loan is subject to a floating interest rate per annum of LIBOR + a spread and maturing on May 6, 2019. The proceeds were used to refinance the US\$100 million short-term loan. The refinancing extended the term of the loan from short-term loan to long-term debt.

Petron

– US\$1,000 Million Term Loan

On June 16, 2017, Petron signed and executed a US\$1,000 million term loan facility to be amortized over five years with a two-year grace period and is subject to a floating interest rate plus a spread. On June 28 and October 10, 2017, Petron drew US\$600 million and US\$400 million, respectively from the loan facility.

The proceeds from the US\$600 million loan were used to fully pay the outstanding balances of US\$115 million and US\$470 million under the US\$475 million and US\$550 million term loan facilities, respectively.

The proceeds of the US\$400 million loan were used to settle the P20,000 million Peso-denominated Notes which matured on November 10, 2017. The interest rate per annum of the new loan is lower than the fixed interest rate per annum of the P20,000 million loan.

The previous loans were prepaid to benefit from the lower interest rate of the new facility.

▪ **AVAILMENT OF LOANS TO FINANCE CAPEX/PROJECTS**

Petron

– *P15,000 Million Term Loan*

On July 25, 2017, Petron drew P15,000 million from its term loan facility. The loan is amortized over seven years and is subject to a fixed interest rate of 5.5276% per annum payable quarterly. The proceeds were used to refinance the short-term loan availed on December 23, 2016 for the acquisition of the 140MW Power Plant in Limay, Bataan.

– *P10,000 Million Term Loan*

On December 29, 2017, Petron drew P10,000 million from its term loan facility. The loan is amortized over five years and is subject to a fixed interest rate of 5.7584% per annum payable quarterly. The proceeds were used to finance permanent working capital requirements.

Citra Central Expressway Corp. (CCEC)

On December 15, 2017, CCEC drew P3,200 million from the P31,000 million OLSA dated December 15, 2014. The loan was used to partially finance the design, construction and the operation and maintenance of the Stage 3 of Metro Manila Skyway Project.

As of December 31, 2017, P200 million was spent for the construction of Skyway Stage 3 Project.

SCPC

– *Availment of P42,000 Million Term Loan*

Part of the balance of the P42,000 million loan proceeds amounting to P20,050 million were used for the ongoing construction of the Limay Greenfield power plant projects and for payment of transaction costs, interest and shareholder advances previously used by SCPC to defray its capex requirements.

▪ **PAYMENT OF MATURING OBLIGATIONS**

Infrastructure Group

In 2017, the SMC Infrastructure Group paid a total of P10,473 million of its maturing long-term debt.

SMB

On April 3, 2017, SMB completed the redemption of the P3,000 million Series “D” fixed rate bonds. The Series D bonds was part of the P20,000 million Series “D, E and F” fixed rate bonds issued by SMB in 2012. The payment was funded by cash generated from operations of SMB.

Petron

Petron Group paid a total of P3,400 million of its maturing long-term debt in 2017.

Other Subsidiaries

In 2017, SMYPC, East Pacific Star Bottlers Phils Inc., and Can Asia, Inc. paid their maturing long-term debt amounting to P1,056 million.

B. The following are the major developments in 2016:

DIVESTMENT

- *Sale of Telecommunications Business to Philippine Long Distance Telephone Company (PLDT) and Globe Telecom, Inc. (Globe)*

On May 30, 2016, the Parent Company entered into agreements with PLDT and Globe for the sale of 100% ownership interest of the Parent Company in Vega for total amount of P30,004 million. Vega, through its subsidiaries holds the telecommunications assets of the Parent Company. In addition, advances by the Parent Company to Vega was also assigned to PLDT and Globe in the total amount of P22,077 million. The Parent Company received P39,061 million or 75% of the proceeds from the sale of shares and assignment of advances. The remaining balance of P13,020 million was paid on May 30, 2017.

INVESTMENT IN SUBSIDIARIES

- *Additional 49% Equity Interest in ULC BVI and Acquisition of 100% Equity Interest in ULCOM by SMHC*

On June 16, 2016, the Parent Company through its wholly-owned subsidiary, SMHC, executed an Amended and Restated Share Sale and Purchase Agreement with Universal LRT Corporation Limited (ULC HK) and Mr. Salvador B. Zamora II and various parties, for the purchase of: (i) an additional 49% equity interest in ULC BVI; and (ii) 100% equity interest in ULCOM.

The total consideration for the acquisition of ULC BVI and ULCOM is US\$100 million, which amount consists of payment for the shares as well as the outstanding shareholder advances made by each of ULC HK and Mr. Zamora to ULC BVI and ULCOM, respectively. The amount of the shareholder advances is approximately US\$3.8 million.

ULC BVI holds the exclusive right, obligation and privilege to finance, design, construct, supply, complete and commission the MRT 7 Project by virtue of the Concession Agreement dated, June 18, 2008 with the Republic of the Philippines, through the Department of Transportation and Communications, now the Department of Transportation or the DOTr. ULCOM is the designated Facility Operator and Maintenance Provider of the MRT 7 Project.

The additional investment in ULC BVI and the acquisition of ULCOM was completed on July 1, 2016. With the completion of such acquisition, SMHC now owns 100% interest in ULC BVI and ULCOM.

LONG-TERM DEBT

▪ *AVAILMENT OF LONG-TERM LOANS TO FINANCE CAPITAL PROJECTS*

SCPC

In 2016, SCPC drew a total of US\$359 million from the US\$400 million, term loan facility with various banks. The loan is payable within seven years up to 2022 and bears interest rate of LIBOR plus margin per annum.

Proceeds of the loan is earmarked for the financing of the construction of the 2x150MW Limay Power Plant (Phase I), in Bataan.

Vertex Tollway Devt. Inc. - NAIAX

On January 29 and February 1, 2016, Vertex has drawn a total of P1,100 million loan, to complete the P7,500 million OLSA dated July 8, 2014 for the financing of the construction of the NAIAX.

▪ *REFINANCING AND DEBT LIABILITY MANAGEMENT*

– *Issuance of P15,000 Million Fixed Rate Peso-denominated Bonds by SMC Global*

On July 11, 2016, SMC Global issued fixed rate Philippine Peso-denominated bonds with an aggregate principal amount of P15,000 million. The Bonds consist of Series A Bonds due 2021 with an interest rate of 4.3458% per annum, Series B Bonds due 2023 with an interest rate of 4.7575% per annum and Series C Bonds due 2026 with an interest rate of 5.1792% per annum. Interests are payable on January 11, April 11, July 11 and October 11 of each year thereafter.

The net proceeds were used to refinance the US\$300 million short-term loan that matured on July 25, 2016.

The Series A Bonds, Series B Bonds and Series C Bonds, were listed on the PDEX on July 11, 2016.

– *Refinancing of the US\$340 million Loan of AAIBV*

On March 14, 2016, Atlantic Aurum Investments Philippines Corporation (AAIPC) entered into a Corporate Notes Facility Agreement with various banks amounting to P16,700 million to finance its acquisition of the shares of stock of Stage 3 Connector Tollways Holding Corporation from AAIBV. The loan is payable semi-annually maturing in 2021 and 2026 with a fixed interest rate of 6.52% and 6.7394% per annum, respectively.

On March 15, 2016, AAIBV used the proceeds from the sale of the shares to prepay its existing US\$340 million loan with an interest rate per annum of 5.7989%, from the loan facility agreement it has entered into with Standard Chartered Bank on September 17, 2014. The refinanced loan was redenominated to minimize the exposure to foreign exchange rate changes.

– *Refinancing of US\$1,500 million Long-term Debt by the Parent Company*

On various dates in 2016, the Parent Company refinanced the US\$1,500 million long-term debt through the availment of: a) P25,000 million short-term bridge loan from local banks, which was partially refinanced by the issuance of the P20,000 million bonds on March 1, 2017; b) US\$420 million short-term loans; and c) US\$580 million medium-term loans from foreign banks. The redenomination and refinancing of the long-term debt, minimized the exposure to foreign exchange rate changes and lowered the interest margin, respectively.

– *Issuance of P20,000 Million Fixed Rate Peso-denominated Retail Bonds by Petron*

On October 27, 2016, Petron issued and listed in the PDEX P20,000 million fixed rate Philippine Peso-denominated retail bonds, the first tranche of Petron's shelf registration of P40,000 million fixed rate bonds. The fixed rate bonds consist of Series A Bonds (P13,000 million) due on October 27, 2021 with fixed interest rate of 4.0032% per annum and Series B Bonds (P7,000 million) due on October 27, 2023 with fixed interest rate of 4.5219% per annum. Interests are payable on January 27, April 27, July 27 and October 27 of each year. The proceeds from the issuance were used to partially settle the \$475 million and \$550 million Term Loan facilities, to repay short-term loans and for general corporate requirements.

▪ *PAYMENT OF LONG-TERM DEBT*

SPI

On December 23, 2016, SPI pre-settled the remaining balance of the P13,800 million, 10-year term loan drawn in 2013 and 2014, for the acquisition of the 2 x 35 MW Co-Generation Coal Fuel-Fired Power Plant and all other pertinent machinery, equipment, facilities and structures for the expansion of the capacity.

The payment of the loan was funded by the proceeds from the sale of power plant to Petron.

Infrastructure Group

In 2016, the Infrastructure Group paid a total of P9,009 million of its maturing long-term debt.

Petron

In 2016, Petron paid US\$205 million, from the US\$475 million loan drawn in 2014, obtained for the refinancing of an existing loan.

Petron Malaysia

In 2016, Petron Malaysia paid MYR96 million, from the MYR300 million loan availed in 2014 to finance the refurbishment of the retail stations in Malaysia.

EQUITY

▪ *PREFERRED SHARES*

- *Issuance of 400,000,000 Series “2” Preferred Shares - Subseries G, H and I by the Parent Company*

On February 24, 2016, the BOD of the PSE approved the listing application of the Parent Company of up to 975,571,800 shares of Series “2” preferred shares under shelf registration (the Shelf Registered Shares) and the offering of up to 400,000,000 shares of Series “2” preferred shares (the First Tranche) with a par value of P5.00 per share and an offer price of P75.00 per share. The SEC approved the Shelf Registered Shares and issued a permit to sell on March 8, 2016.

The Parent Company offered the “First Tranche” of up to: (i) 280,000,000 shares of Series “2” preferred shares consisting of Subseries “2-G”, “2-H” and “2-I” and (ii) 120,000,000 shares of Series “2” preferred shares to cover the oversubscription option. The First Tranche was re-issued and offered from the Series “2” preferred shares Subseries held in treasury. The offer period was from March 14 to March 18, 2016. The First Tranche was issued on March 30, 2016 which was also the listing date of the Shelf Registered Shares.

The remaining 575,571,800 Shelf Registered Shares will be issued within a period of three years. The offer shares shall be issued from the remaining Series “2” preferred shares Subseries “2-A” held in treasury and unissued Series “2” preferred shares.

Dividend rates are 6.5793%, 6.3222% and 6.3355% per annum for Subseries “2-G”, “2-H” and “2-I”, respectively.

Following the completion of the Parent Company’s follow-on offering of 280,000,000 Series “2” preferred shares, with an oversubscription option of 120,000,000 Series “2” preferred shares, the Parent Company re-issued the Series “2” preferred shares held in treasury as follows: (i) 244,432,686 Series “2” preferred shares; and (ii) 155,567,314 Subseries “2-A” preferred shares (collectively, the “Offer Shares”). The Series “2” preferred shares were Series “1” preferred shares held in treasury that were reclassified to Series “2” preferred shares on June 9, 2015.

After reissuance of the Offer Shares on March 30, 2016, the Parent Company shall have a remaining 565,445,086 Subseries “2-A” preferred shares held in treasury. There are no more Series “2” preferred shares held in treasury.

The net proceeds from the issuance of the shares amounting to P29,707 million were used for the refinancing of the existing US\$170 million long-term debt and for investments by way of equity in the Infrastructure business.

C. MATERIAL CHANGES PER LINE OF ACCOUNT

2017 vs. 2016

The Group's consolidated total assets as of December 31, 2017 amounted to P1,379,643 million, P72,819 million higher than last year. The increase was primarily due to the increase in inventories, biological assets, property, plant and equipment, other intangible assets and other noncurrent assets.

Inventories increased by P19,334 million primarily due to the higher prices of crude oil and finished products of Petron and increased importation of certain raw materials to support expected surge in sales volume and in anticipation of further increase in raw material costs in 2018 of SMPFC.

Current and noncurrent portion of biological assets increased by P300 million and P432 million, respectively, mainly due to expansion of Poultry farms' capacities to support increasing supply requirement.

Assets held for sale decreased by P184 million due to the sale of certain machinery and equipment to NCC by SMC Powergen Inc. in 2017.

The increase in investments and advances by P3,025 million was mainly due to advances for investment made by San Miguel Holdings Limited to Bryce Canyon Investments Limited.

Other intangible assets increased by P9,273 million mainly due to the additional concession rights for the various infrastructure projects of SMC Infrastructure, such as: Skyway Stages 3 and 4, Bulacan Bulk Water, Manila North Harbour, TPLEX, Boracay Airport, NAIAx, STAR and SLEX-TR4 in 2017, net of the recognition of amortization during the period.

Deferred tax assets decreased by P1,855 million mainly due to the temporary difference on the higher actual monthly fixed payments to PSALM over the finance lease interest expense accrued in 2017.

The increase in other noncurrent assets by P14,279 million was mainly due to the a) capitalized project costs incurred for the MRT 7 Project, advances to contractors of the Skyway Stage 3 Project and increase in noncurrent portion of the subsidy receivable from DPWH for the construction costs incurred in Section 3A-2 (Binalonan to Pozzorubio) of TPLEX Project; b) higher restricted cash to cover SCPC's debt servicing and capex requirements and higher prepaid input VAT recognized on additional purchases for the construction of Limay Phase II.

The decrease in loans payable by P39,414 million was mainly due to the net payments made by the Parent Company and settlement by Petron of the P15,000 million bridge loan, offset by availments made by San Miguel Consolidated Power Corporation for Malita, Davao capex requirements.

Accounts payable and accrued expenses increased by P15,391 million mainly due to higher liabilities for crude and other products of Petron, and higher volume of transactions with third party suppliers in the last quarter of 2017 of SMPFC.

Dividends payable increased by P437 million mainly due to unclaimed dividends payable to common stockholders of the Parent Company.

The higher amount of long-term debt by P70,892 million resulted from the P42,000 million term loan availed by SCPC; issuance by the Parent Company of P30,000 million fixed rate - bonds on March 1 and April 7, 2017; availment by Petron of the P15,000 million and P10,000 million term loans; and availment by CCEC of the P3,200 million term loan for the construction of the Skyway Stage 3 project. The increase was partially offset by the payments made by the Infrastructure Group, and prepayment of Petron Malaysia of its long-term debt and the redemption of SMB of the Series D Bonds.

Deferred tax liabilities increased by P3,445 million mainly due to the temporary differences arising from the: a) different method of depreciation used for tax reporting (accelerated method) and financial accounting (straight-line method) for power plant acquired by Petron in December 2016 and RMP-2, and realization of forex loss of Petron; and b) actual monthly payments to the PSALM over the finance lease liability-related expenses of South Premier Power Corp. (SPPC).

The decrease in finance lease liabilities by P15,343 million was mainly due to payments, net of interest and the effect of foreign exchange rate changes.

The P3,444 million increase in other noncurrent liabilities was primarily due to higher retirement liabilities caused mainly by the recognition of re-measurement losses on plan assets and increase in asset retirement obligation of Petron, retention payable to the contractors of MRT 7 and Luzon Clean Water Development Corporation and additional long term liability of MNHPI for the purchase of certain equipment in relation to the expansion project.

Equity reserves increased by P2,901 million mainly due to the translation adjustment on the net assets of foreign subsidiaries of Petron, Packaging Group International and SMB.

The increase in appropriated retained earnings by P9,984 was mainly due to the increase in appropriation by SMC Global for monthly fixed payments and energy fees to PSALM and SMB for the payment of Series C & E bonds due in 2019 partially offset by the reversal of SMC Shipping and Lighterage Corporation (SMCSLC) of appropriations for completed projects.

Unappropriated retained earnings increased by P7,351 million mainly due to the net income attributable to the equity holders of the Parent Company, net of additional appropriations and dividends declared by the Parent Company.

Non-controlling interests increased by P13,926 million primarily due to the share of non-controlling stockholders in the higher net income of SMB, Petron, SMPFC and Infrastructure and translation adjustments, net of dividends declared to the non-controlling stockholders of SMB and Petron.

Equity

The increase in equity in 2017 is due to:

<i>(In millions)</i>	2017
Income during the period	P54,814
Other comprehensive income	3,440
Net addition to non-controlling interests and others	3,368
Issuance of capital stock	119
Cash dividends and distributions	(27,460)
	P34,281

2016 vs. 2015

The Group's consolidated total assets as of December 31, 2016 amounted to P1,306,824 million, P60,802 million higher than 2015. The increase was primarily due to the: a) higher amount of cash and cash equivalents; b) the recognition of receivables for the unpaid balance on the sale of the Telecommunications business, and c) the increase in inventories of Petron.

Cash and cash equivalents increased by P22,395 million mainly due to proceeds from the sale of the Telecommunications business and from the issuance of preferred shares by the Parent Company.

Trade and other receivables increased by P13,798 million primarily due to the recognition of receivables for the unpaid balance on the sale of the Telecommunications business due on May 30, 2017.

Inventories increased by P19,093 million mainly due to increase in inventories of: Petron as a result of higher volume and price of crude and higher cost of finished products, SMPFC due to higher importation of major raw materials to take advantage of lower prices, and increased cassava harvest, and the higher inventory of full goods and purchase of new bottles and shells of the domestic operations of SMB in anticipation of higher sales volume.

Current portion of biological assets decreased by P197 million due to lower production of marketable hogs and decrease in volume of hatching eggs.

The balance of assets held for sale in 2016 pertains to roller press and elevators for sale by SPI to NCC and Eagle Cement. The sale was completed in 2017.

Investments and advances increased by P5,583 million in 2016 mainly due to additional investments made by SMC Global in Angat Hydro.

Investment property increased by P2,549 million mainly due to the acquisition by a subsidiary of SMPI of parcels of land in Mariveles, Bataan for the construction of an industrial park.

Other intangible assets decreased by P14,804 million primarily due to the deconsolidation of the licenses attributed to the subsidiaries of Vega, net of the recognition of additional concession rights for the various infrastructure project, namely: Skyway Stage 3, NAIAx, Boracay Airport, Manila North Harbour and TPLEX in 2016.

Deferred tax assets increased by P3,826 million mainly due to the recognition by the Parent Company of deferred tax asset on: NOLCO, provision for doubtful accounts, unrealized loss on foreign exchange and loss on derivatives.

The increase in loans payable of P42,418 million in 2016 was primarily due to net availment made by the Parent Company to refinance the payment of its US\$ denominated - long-term debt.

Accounts payable and accrued expenses increased by P18,766 million mainly due to higher liabilities of Petron for crude and finished product importation, as a result of the increase in volume and price of crude oil and petroleum products, and increase in payable to contractors in relation to the power plant projects of SMC Global and the various infrastructure projects of SMHC, net of the deconsolidation of Vega's balance, as a result of the sale of the investment.

The increase in income and other taxes payable of P3,060 million in 2016 was mainly due to higher Value-added Tax (VAT) payable of SPI and higher withholding tax payable of Petron attributable to the sale of power plant by SPI; and higher income tax payable of SMB, Petron and SMCSLC due to higher taxable income, net of the deconsolidation of Vega's balance, as a result of the sale of the investment.

Dividends payable increased by P1,996 million mainly due to the dividend declared by the Parent Company to its preferred stockholders on November 10, 2016, which was subsequently paid on January 5, 2017. The Parent Company has no outstanding dividends payable to its preferred stockholders as of December 31, 2015.

The decrease in long-term debt was mainly due to the net payments made by the Parent Company of its US Dollar denominated-loans and payments made by, SPI, Infrastructure Group, and SMYPC of their maturing long-term debt. The decrease was partially offset by the: (a) availments by SCPC and Vertex to finance the construction of the Limay Power Plant (Phase I), in Bataan and the NAIAX Project, respectively; (b) issuance of P20,000 million bonds by Petron, and (c) the effect of foreign exchange rate changes on the translation of foreign currency denominated-long-term debt.

Deferred tax liabilities increased by P1,900 million due largely to the recognition of deferred income tax expense on the actuarial gain on remeasurement of the plan assets of Petron.

The decrease in finance lease liabilities was mainly due to payments, net of interest and the effect of foreign exchange rate changes.

Other noncurrent liabilities decreased by P10,425 million mainly due to the deconsolidation of Vega's balance, as a result of the sale of the investment, and the lower net retirement benefit liability due to higher value of plan assets of Petron and SMB.

Equity reserve decreased by P4,081 million primarily due to the acquisition of the remaining non-controlling interest in ULCBVI and Petrochemical Asia (HK) Limited (PAHL) by SMHC and Petron, respectively.

Additional appropriations on retained earnings were made by Petron, SMB, SMCSLC and SMITS, Inc. mainly to finance future capital expenditures. The appropriations in 2016 were partly reduced by the reversals made by San Miguel Mills, Inc. and PF-Hormel upon approval by the SEC of the increase in authorized capital stock.

The decrease in treasury stock pertains to the re-issuance on March 30, 2016 of Series 2 Subseries G, H and I preferred shares from the Series "2" preferred shares subseries held in treasury by the Parent Company.

Non-controlling interests increased by P10,099 million mainly due to the share of non-controlling stockholders in the higher net income of SMB, Petron, SMPFC and the Infra Group, net of dividends declared to the non-controlling stockholders of SMB, Petron, SMPFC, SLTC and CMMTC.

Equity

The increase in equity in 2016 is due to:

<i>(In millions)</i>	2016
Income during the period	P52,240
Reissuance of treasury shares	29,707
Other comprehensive income	2,950
Issuance of capital stock	71
Cash dividends and distributions	(26,334)
Net reduction to non-controlling interests and others	(6,730)
	P51,904

IV. CASH FLOW

SOURCES AND USES OF CASH

A brief summary of cash flow movements is shown below:

	December 31		
	2017	2016	2015
		<i>(In Millions)</i>	
Net cash flows provided by operating activities	P79,228	P79,193	P65,441
Net cash flows used in investing activities	(53,624)	(23,257)	(58,729)
Net cash flows used in financing activities	(22,386)	(34,147)	(88,253)

Net cash from operations basically consists of income for the period and changes in noncash current assets, certain current liabilities and others.

Net cash flows provided by (used in) investing activities are as follows:

	December 31		
	2017	2016	2015
		<i>(In Millions)</i>	
Additions to property, plant and equipment	(P38,693)	(P40,649)	(P59,973)
Increase in other noncurrent assets and others	(30,023)	(15,515)	(8,833)
Additions to investments and advances and available-for-sale financial assets	(2,908)	(8,038)	(3,544)
Acquisition of subsidiaries, net of cash and cash equivalents acquired	(2,568)	(1,905)	(7,633)
Proceeds from disposal of discontinued operations, net of cash and cash equivalents disposed of	13,020	37,175	-
Interest received	4,263	3,480	4,136
Proceeds from sale of investments and property and equipment	1,930	1,114	2,607
Dividend received from associates and available-for-sale financial assets	1,355	1,081	96
Cash and cash equivalents acquired from business combination, net of cash paid	-	-	14,415

Net cash flows provided by (used in) financing activities are as follows:

	December 31		
	2017	2016	2015
	<i>(In Millions)</i>		
Net proceeds from (payments of) long-term borrowings	P67,740	(P52,325)	P3,978
Net proceeds from (payments of) short-term borrowings	(40,058)	42,160	(34,135)
Cash dividends paid	(27,023)	(24,338)	(23,649)
Payments of finance lease liabilities	(24,924)	(23,907)	(22,296)
Increase (decrease) in non-controlling interests	1,760	(5,515)	(369)
Proceeds from issuance of capital stock	119	71	27
Proceeds from reissuance of treasury shares	-	29,707	54,201
Redemption of preferred shares	-	-	(94,718)
Net proceeds from issuance of preferred shares and undated subordinated capital securities of subsidiaries	-	-	28,708

The effect of exchange rate changes on cash and cash equivalents amounted to (P298) million, P606 million and P3,693 million on December 31, 2017, 2016 and 2015, respectively.

V. ADDITIONAL INFORMATION ON UNAPPROPRIATED RETAINED EARNINGS

The unappropriated retained earnings of the Parent Company is restricted in the amount of P67,093 million in 2017, 2016 and 2015, representing the cost of common shares held in treasury.

The unappropriated retained earnings of the Group include the accumulated earnings in subsidiaries and equity in net earnings of associates and joint ventures not available for declaration as dividends until declared by the respective investees.

VI. KEY PERFORMANCE INDICATORS

The following are the major performance measures that the Group uses. Analyses are employed by comparisons and measurements based on the financial data of the current period against the same period of previous year. Please refer to Item II “Financial Performance” of the MD&A for the discussion of certain Key Performance Indicators.

	December 31	
	2017	2016
Liquidity:		
Current Ratio	1.40	1.26
Solvency:		
Debt to Equity Ratio	1.93	1.99
Asset to Equity Ratio	2.93	2.99
Profitability:		
Return on Average Equity Attributable to Equity Holders of the Parent Company	9.73%	11.31%
Interest Rate Coverage Ratio	3.27	2.99

	December 31	
	2017	2016
Operating Efficiency:		
Volume Growth	4%	7%
Revenue Growth	21%	2%
Operating Margin	13%	15%

The manner by which the Group calculates the key performance indicators is as follows:

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities (Current + Noncurrent)}}{\text{Equity + Non-controlling Interests}}$
Asset to Equity Ratio	$\frac{\text{Total Assets (Current + Noncurrent)}}{\text{Equity + Non-controlling Interests}}$
Return on Average Equity	$\frac{\text{Net Income Attributable to Equity Holders of the Parent Company}}{\text{Average Equity Attributable to Equity Holders of the Parent Company}}$
Interest Rate Coverage Ratio	$\frac{\text{Earnings Before Interests and Taxes}}{\text{Interest Expense and Other Financing Charges}}$
Volume Growth	$\left(\frac{\text{Sum of all Businesses' Revenue at Prior Period Prices}}{\text{Prior Period Net Sales}} \right) - 1$
Revenue Growth	$\left(\frac{\text{Current Period Net Sales}}{\text{Prior Period Net Sales}} \right) - 1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

VII. OTHER MATTERS

▪ Events After the Reporting Date

Parent Company

On March 2, 2018, the SEC issued to the Parent Company the Permit to Sell for the third tranche, consisting of P20,000 million peso denominated fixed rate bonds with an oversubscription option of up to P10,000 million, to be issued out of the P60,000 million shelf registered Peso bonds of the Parent Company.

A total of P20,000 million bonds were issued and listed in the PDEX on March 19, 2018. The bonds comprised of the five-year Series E Bonds due 2023, seven-year Series F Bonds due 2025 and ten-year Series G Bonds due 2028.

The Series E Bonds, Series F Bonds and Series G Bonds have fixed interest rate equivalent to 6.2500% per annum, 6.6250% per annum and 7.1250% per annum, respectively.

On March 9, 2018, the BOD of SMC Global approved the issuance of Redeemable Perpetual Securities (RPS) amounting to US\$650 million in favor of the Parent Company, to be used to partially finance the acquisition of the Masinloc power assets.

On March 15, 2018, the BOD of the Parent Company approved the subscription to the US\$650 million RPS to be issued by SMC Global.

On March 15, 2018, the Parent Company subscribed to the US\$650 million RPS. Proceeds from the RPS will be used by SMC Global to partially finance its acquisition of the Masinloc power plant.

SMC Global

On December 17, 2017, SMC Global executed a Share Purchase Agreement with AES Phil Investment Pte. Ltd. (AES Phil) and Gen Plus B. V. (Gen Plus) for the purchase by SMC Global of (a) 51% and 49% equity interests of AES Phil and Gen Plus, respectively, in Masin-AES Pte. Ltd. (the “Target Company”); (b) 100% equity interest of The AES Corporation in AES Transpower Private Ltd. (ATPL); and (c) 100% equity interest of AES Phil in AES Philippines Inc. (API), (collectively, “the Transaction”).

The Target Company, through its subsidiaries [including Masinloc Power Partners Co. Ltd. (MPPCL)], owns and/or operates (i) the 2 x 315 MW coal-fired power plant; (ii) the under construction project expansion of the 335 MW unit known as Unit 3; (iii) the 10 MW battery energy storage project, all located in the Province of Zambales, Philippines; and (iv) the 2 x 20 MW battery energy storage facility in Kabankalan, Negros Occidental, which is still at the pre-development stage. ATPL has a Philippine Regional Office and Headquarters which provides the corporate support services to MPPCL, while API provides energy marketing services to MPPCL.

With the acquisition by SMC Global of the Target Company, ATPL and API, SMC Global aims to improve its existing baseload capacity to further ensure its ability to provide affordable and reliable supply of power to its customers. The additional power assets provide an opportunity for SMC Global to increase its footprint in clean coal technology that provides reliable and affordable power, particularly in Luzon. The Transaction will result in the production of electricity in an environmentally responsible way.

The total consideration for the Transaction is US\$1,900 million, subject to a post-closing purchase price adjustment. The total consideration will be paid in cash by SMC Global to be funded through a combination of its (a) availment of US dollar-denominated long-term borrowings from various financial institutions totaling to US\$1,200 million and (b) issuing RPS to, and obtaining advances from, SMC amounting to US\$650 million and US\$150 million, respectively.

On February 23, 2018, the Philippine Competition Commission (PCC) issued its decision which states that the Transaction does not result in a substantial lessening of competition in the relevant markets, and as such, the PCC resolved that it will take no further action with respect to the Transaction (the PCC Decision).

Other than the issuance of the PCC Decision, there are other conditions precedent that are required for the closing and completion of the Transaction.

On March 20, 2018, SMC Global completed the acquisition.

The following summarizes the initial financial information as at December 31, 2017 of assets to be acquired and liabilities to be assumed:

	Provisionary Amount (In Millions)
Assets	
Cash and cash equivalents	P1
Trade and other receivables - net	
Inventories - net	
Prepaid expenses and other current assets	
Property, plant and equipment - net	P1
Other noncurrent assets	
Liabilities	
Loans payable	
Accounts payable and accrued expenses	
Finance lease liabilities - net (including current portion)	
Long-term debt - net (including current maturities)	(P2)
Other noncurrent liabilities	
Total Identifiable Net Assets at Fair Value	P6

Based on the foregoing initial amounts of net assets acquired, the goodwill to be recognized is estimated to be as follows:

	Provisionary Amount (In Millions)
Consideration transferred	P9
Non-controlling interest measured at proportionate interest in identifiable net assets	
Total identifiable net assets at fair value	(P2)
Goodwill	P6

The estimates above will be updated to their fair values as at the date of acquisition when the Transaction is closed for purposes of recognizing the business combination and will involve identification and recognition of identifiable assets or intangible assets and will likely reduce the amount of initial goodwill above.

Acquisition-related Costs

As of December 31, 2017, SMC Global incurred acquisition-related costs of P195 million which have been included in the “Selling and administrative expenses” account in the consolidated statements of income.

Goodwill expected to arise from the Transaction is attributable to the benefit of expected synergies, revenue growth, future development and the assembled workforce. These benefits are not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets.

Petron

On January 8, 2018, Petron announced a tender offer to holders of its US\$750 million Undated Subordinated Capital Securities (USCS) with expiration deadline on January 16, 2018. Tenders amounted to US\$402 million and were settled by Petron on January 22, 2018. The USCS redeemed by Petron pursuant to the Tender Offer were cancelled.

On January 19, 2018, Petron issued US\$500 million Senior Perpetual Capital Securities (the “SPCS”) with an issue price of 100% to partially refinance the redemption of its existing US\$750 million USCS, for the repayment of indebtedness and for general corporate purposes, including capital expenditures. The SPCS were listed with the Singapore Exchange Securities Trading Ltd. on January 22, 2018.

▪ Contingencies

The Group is a party to certain lawsuits or claims (mostly labor related cases) filed by third parties which are either pending decision by the courts or are subject to settlement agreements. The outcome of these lawsuits or claims cannot be presently determined. In the opinion of management and its legal counsel, the eventual liability from these lawsuits or claims, if any, will not have a material effect on the consolidated financial statements of the Group.

a. Penalties for Late Filing

On March 20, 2012, the Parent Company was assessed by the Corporate Finance Department of the SEC (SEC-CFD) for a penalty amounting to P769 million, in connection with the filing of the Statement of Initial Beneficial Ownership and Statement of Changes in the Beneficial Ownership (SEC Form 23-A and B, respectively) relating to the purchase by the Parent Company of the shares in Manila Electric Company (Meralco). The Parent Company filed an appeal from the order of the SEC-CFD to the SEC *En Banc* on April 17, 2012.

On November 21, 2017, the SEC *En Banc* rendered a Decision denying the appeal of the Parent Company.

On December 7, 2017, the Parent Company filed a petition for review of the Decision of the SEC *En Banc* to set aside the imposition of the penalty, with an urgent application for issuance of ex parte temporary restraining order and/or writ of preliminary injunction to enjoin the SEC from enforcing the said Decision.

b. Treasury Shares of the Parent Company

A portion of the total treasury shares of the Parent Company came from 25,450,000 common shares with an acquisition cost of P481 million, [net of the cost of the 1,000,000 shares paid to the Presidential Commission on Good Government (PCGG) as arbitral fee pursuant to the Compromise Agreement, as herein defined] which were reverted to treasury in 1991 upon implementation of the Compromise Agreement and Amicable Settlement (Compromise Agreement) executed by the Parent Company with the United Coconut Planters Bank (UCPB) and the Coconut Industry Investment Fund (CIIF) Holding Companies in connection with the purchase of the common shares of the Parent Company under an agreement executed on March 26, 1986.

Certain parties have opposed the Compromise Agreement. The right of such parties to oppose, as well as the propriety of their opposition, has been the subject matters of cases before the Sandiganbayan and the Supreme Court.

On September 14, 2000, the Supreme Court upheld a Sandiganbayan Resolution requiring the Parent Company to deliver the 25,450,000 common shares that were reverted to treasury in 1991 to the PCGG and to pay the corresponding dividends on the said shares (the “Sandiganbayan Resolution”).

On October 10, 2000, the Parent Company filed a motion for reconsideration with the Supreme Court to be allowed to comply with the delivery and payment of the dividends on the treasury shares only in the event that another party, other than the Parent Company, is declared owner of the said shares in the case for forfeiture (Civil Case) filed by the Philippine government (Government).

On April 17, 2001, the Supreme Court denied the motion for reconsideration.

On September 19, 2003, the PCGG wrote the Parent Company to deliver to the PCGG the stock certificates and cash and stock dividends under the Sandiganbayan Resolution upheld by the Supreme Court. The Parent Company referred the matter to its external financial advisor and external legal counsel for due diligence and advice. The external financial advisor presented to the BOD on December 4, 2003 the financial impact of compliance with the resolution considering “with and without due compensation” scenarios, and applying different rates of return to the original amount paid by the Parent Company. The financial advisor stated that if the Parent Company is not compensated for the conversion of the treasury shares, there will be: (a) a negative one-off EPS impact in 2003 of approximately 17.5%; (b) net debt increase of approximately P2,100 million; and (c) a negative EPS impact of 6.9% in 2004. The external legal counsel at the same meeting advised the BOD that, among others, the facts reviewed showed that: (a) the compromise shares had not been validly sequestered; (b) no timely direct action was filed to nullify the transaction; (c) no rescission can be effected without a return of consideration; and (d) more importantly, requiring the Parent Company to deliver what it acquired from the sellers without a substantive ground to justify it, and a direct action in which the Parent Company is accorded full opportunity to defend its rights, would appear contrary to its basic property and due process rights. The external legal counsel concluded that the Parent Company has “legal and equitable grounds to challenge the enforcement” of the Sandiganbayan Resolution.

On January 29, 2004, the external legal counsel made the additional recommendation that the Parent Company should file a Complaint-in-Intervention in the Civil Case (now particularly identified as SB Civil Case No. 0033-F), the forfeiture case brought by the Government involving the so-called CIIF block of the Parent Company shares of stock of which the treasury shares were no longer a portion. The Complaint-in-Intervention would pray that any judgment in the Civil Case forfeiting the CIIF block of the Parent Company shares of stock should exclude the treasury shares.

At its January 29, 2004 meeting, the BOD of the Parent Company unanimously decided to: (a) deny the PCGG demand of September 19, 2003, and (b) authorize the filing of the Complaint-in-Intervention. Accordingly, the external legal counsel informed the PCGG of the decision of the Parent Company and the Complaint-in-Intervention was filed in the Civil Case.

In a Resolution dated May 6, 2004, the Sandiganbayan denied the Complaint-in-Intervention. The external legal counsel filed a Motion for Reconsideration, which was denied by the Sandiganbayan in its Decision dated November 28, 2007.

The external legal counsel advised that because the Sandiganbayan had disallowed the Parent Company's intervention, the Sandiganbayan's disposition of the so-called CIIF block of the Parent Company shares in favor of the Government cannot bind the Parent Company, and that the Parent Company remains entitled to seek the nullity of that disposition should it be claimed to include the treasury shares.

The external legal counsel also advised that the Government has, in its own court submissions: (i) recognized the Parent Company's right to the treasury shares on the basis that the Compromise Agreement is valid and binding on the parties thereto; and (ii) taken the position that the Parent Company and UCPB had already implemented the Compromise Agreement voluntarily, and that the PCGG had conformed to the Agreement and its implementation. The Executive Committee of the Parent Company approved the recommendation of external legal counsel on January 18, 2008 which was ratified by the BOD on March 6, 2008.

On July 23, 2009, the stockholders of the Parent Company approved the amendment of the Articles of Incorporation to issue Series "1" preferred shares, and the offer to exchange common shares to Series "1" preferred shares. The PCGG, with the approval of the Supreme Court in its Resolution dated September 17, 2009, converted the sequestered common shares in the Parent Company in the name of the CIIF Holding Companies, equivalent to 24% of the outstanding capital stock, into Series "1" preferred shares.

On February 11, 2010, the Supreme Court, amending its Resolution dated September 17, 2009, authorized the PCGG to exercise discretion in depositing in escrow, the net dividend earnings on, and/or redemption proceeds from, the Series "1" preferred shares of the Parent Company, either with the Development Bank of the Philippines/Land Bank of the Philippines or with the UCPB. All dividends accruing to the Series "1" preferred shares are remitted to the escrow account established with UCPB.

On October 5, 2012, the Parent Company redeemed all Series "1" preferred shares including those Series "1" preferred shares in the name of the CIIF Holding Companies. Proceeds of such redemption with respect to Series "1" preferred shares in the name of the CIIF Holding Companies, including all accumulated dividends were paid to the National Treasury. As of October 5, 2012, CIIF Holding Companies are no longer stockholders of the Parent Company.

On June 30, 2011, the PCGG filed with the Supreme Court an Urgent Motion to Direct the Parent Company to comply with the Sandiganbayan Resolution (the "Urgent Motion"). On March 30, 2012, the Parent Company filed a Comment on the Urgent Motion in compliance with the Supreme Court's Resolution dated December 13, 2011 in G.R. Nos. 180705, 177857-58 and 178193, which was received by the Parent Company on February 22, 2012, directing the Parent Company to file its Comment on the Urgent Motion. The Supreme Court, in the Resolution of April 24, 2012 noted the comment of the Parent Company.

Thereafter, the PCGG filed in G.R. Nos. 177857-58 and 178193 a “Manifestation and Omnibus Motion 1) To Amend the Resolution Promulgated on September 4, 2012 to Include the “Treasury Shares” which are Part and Parcel of the 33,133,266 Coconut Industry Investment Fund (CIIF) Block of San Miguel Corporation (SMC) Shares of 1983 Decreed by the Sandiganbayan, and Sustained by the Honorable Court, as Owned by the Government; and 2) To Direct SMC to Comply with the Final and Executory Resolutions Dated October 24, 1991 and March 18, 1992 of the Sandiganbayan Which Were Affirmed by the Honorable Court in G.R. Nos. 104637-38” (“Manifestation and Omnibus Motion”).

The Supreme Court, in the Resolution of November 20, 2012 in G.R. Nos. 177857-58 and 178193, required the Parent Company to comment on COCOFED, et al.’s “Manifestation” dated October 4, 2012 and PCGG’s “Manifestation and Omnibus Motion.” Atty. Estelito P. Mendoza, counsel for Eduardo M. Cojuangco, Jr. in G.R. No. 180705, who is a party in that case, filed a “Manifestation Re: ‘Resolution’ dated November 20, 2012,” dated December 17, 2012, alleging that (a) Mr. Cojuangco, Jr. is not a party in G.R. Nos. 177857-58 and 178193 and he has not appeared as counsel for any party in those cases; (b) the Parent Company is likewise not a party in those cases, and if the Parent Company is indeed being required to comment on the pleadings in the Resolution of November 20, 2012, a copy of the Resolution be furnished the Parent Company; and (c) the Supreme Court had already resolved the motion for reconsideration in G.R. Nos. 177857-58 and 178193 and stated that “no further pleadings shall be entertained, thus, any motion filed in the said cases thereafter would appear to be in violation of the Supreme Court’s directive”.

In its Resolution of June 4, 2013 in G.R. Nos. 177857-58 and 178193, the Supreme Court required the Parent Company to file its comment on the (a) Manifestation, dated October 4, 2012 filed by petitioners COCOFED, et al. and (b) Manifestation and Omnibus Motion dated October 12, 2012 filed by the Office of the Solicitor General for respondent Republic of the Philippines, as required in the Supreme Court Resolution, dated November 20, 2012, within ten (10) days from notice thereof.

In the Resolution, dated September 10, 2013, the Supreme Court directed the Parent Company, through its counsel or representative, to immediately secure from the Office of the Clerk of Court of the Supreme Court *En Banc* photocopies of the (a) Manifestation, dated October 4, 2012 filed by petitioners COCOFED, et al. and (b) Manifestation and Omnibus Motion dated October 12, 2012 filed by the Office of the Solicitor, and granted the Parent Company’s motion for a period of thirty (30) days from receipt of the pleadings within which to file the required comment per resolutions dated November 20, 2012 and June 4, 2013.

The Parent Company, thru external counsel, filed the following comments required in the Supreme Court Resolution of June 4, 2013 in G.R. Nos. 177857-58; (a) “Comment of San Miguel Corporation on the ‘Manifestation’ of Petitioners COCOFED, et al., Dated October 4, 2012” on November 6, 2013; and (b) “Comment of San Miguel Corporation on the ‘Manifestation and Omnibus Motion...’ Dated October 12, 2012 of the Respondent Republic” on December 3, 2013.

In the Entry of Judgment received on January 27, 2015, the Supreme Court entered in the Book of Entries of Judgments the Resolution of September 4, 2012 in G.R. Nos. 177857-58 and G.R. No. 178193 wherein the Supreme Court clarified that the 753,848,312 SMC Series “1” preferred shares of the CIIF companies converted from

the CIIF block of SMC shares, with all the dividend earnings as well as all increments arising therefrom shall now be the subject matter of the January 29, 2012 Decision and declared owned by the Government and used only for the benefit of all coconut farmers and for the development of the coconut industry. Thus, the fallo of the Decision dated January 24, 2012 was accordingly modified.

In the meantime, the Parent Company has available cash and shares of stock for the dividends payable on the treasury shares, in the event of an unfavorable ruling by the Supreme Court.

On October 5, 2016, the Supreme Court of the Philippines in G.R. Nos. 177857-58 and 178193 issued a Judgment denying the “Manifestation and Omnibus Motion” filed by the Presidential Commission on Good Government to amend the Resolution Promulgated on September 4, 2012 to Include the “Treasury Shares” Which are Part and Parcel of the 33,133,266 Coconut Industry Investment Fund (CIIF) Block of San Miguel Corporation (SMC) Shares of 1983 Decreed by the Sandiganbayan, and Sustained by the Honorable Court, as Owned by the Government. The denial of the motion is without prejudice to the right of the Republic of the Philippines to file the appropriate action or proceeding to determine the legal right of the Parent Company to the 25,450,000 treasury shares of the Parent Company. On November 29, 2016, the Supreme Court denied with finality the motion for reconsideration of the Republic of the Philippines.

c. Deficiency Excise Tax

Parent Company

On April 12, 2004 and May 26, 2004, the Parent Company was assessed by the Bureau of Internal Revenue (BIR) for deficiency excise tax on “San Mig Light”, one of its beer products. The Parent Company contested the assessments before the Court of Tax Appeals (CTA) (1st Division) under CTA Case Nos. 7052 and 7053.

In relation to the aforesaid contested assessments, the Parent Company, on January 31, 2006, filed with the CTA (1st Division), under CTA Case No. 7405, a claim for refund of taxes paid in excess of what it believes to be the excise tax rate applicable to it.

The above assessment cases (CTA Case Nos. 7052 and 7053) and claim for refund (CTA Case No. 7405), which involve common questions of fact and law, were subsequently consolidated and jointly tried.

On November 27, 2007, the Parent Company filed with the CTA (3rd Division), under CTA Case No. 7708, a second claim for refund, also in relation to the contested assessments, as it was obliged to continue paying excise taxes in excess of what it believes to be the applicable excise tax rate.

On January 11, 2008, the BIR addressed a letter to the Parent Company, appealing to the Parent Company to settle its alleged tax liabilities subject of CTA Case Nos. 7052 and 7053 “in order to obviate the necessity of issuing a Warrant of Distraint and Garnishment and/or Levy”. The Parent Company’s external legal counsel responded to the aforesaid letter and met with appropriate officials of the BIR and explained to the latter the unfairness of the issuance of a Warrant of Distraint and Garnishment and/or Levy against the Parent Company, especially in view of the Parent Company’s pending claims for refund.

As of December 31, 2017, the BIR has taken no further action on the matter.

On July 24, 2009, the Parent Company filed its third claim for refund with the CTA (3rd Division), under CTA Case No. 7953, also in relation to the contested assessments. This case is still undergoing trial.

On January 7, 2011, the CTA (3rd Division) under CTA Case No. 7708 rendered its decision in this case, granting the Parent Company's petition for review on its claim for refund and ordering respondent Commissioner of Internal Revenue to refund or issue a tax credit certificate in favor of the Parent Company in the amount of P926 million, representing erroneously, excessively and/or illegally collected and overpaid excise taxes on "San Mig Light" during the period from December 1, 2005 up to July 31, 2007. This decision was elevated by the BIR Commissioner to the CTA *En Banc* and the appeal was denied in the case docketed as CTA EB No. 755. The Office of the Solicitor General filed with the Supreme Court a Petition for Review which was docketed as G.R. No. 205045.

On October 18, 2011, the CTA (1st Division) rendered its joint decision in CTA Case Nos. 7052, 7053 and 7405, cancelling and setting aside the deficiency excise tax assessments against the Parent Company, granting the latter's claim for refund and ordering the BIR Commissioner to refund or issue a tax credit certificate in its favor in the amount of P782 million, representing erroneously, excessively and/or illegally collected and overpaid excise taxes on "San Mig Light" during the period from February 1, 2004 to November 30, 2005.

A motion for reconsideration filed by the BIR Commissioner on the aforesaid decision was denied and the Commissioner elevated the decision to CTA *En Banc* for review, which was docketed as CTA EB No. 873, the same was dismissed in a Decision dated October 24, 2012. The subsequent Motion for Reconsideration filed by the Commissioner was likewise denied. The CTA *En Banc* Decision was later elevated by the Office of the Solicitor General to the Supreme Court by Petition for Review, which was docketed as G.R. No. 20573 and raffled to the Third Division. This case was subsequently consolidated with G.R. No. 205045.

In a Resolution dated July 21, 2014, a copy of which was received by the Parent Company's counsel on August 27, 2014, the Third Division of the Supreme Court required the parties to submit memoranda. Both the Parent Company's counsel and the BIR Commissioner, through the Office of the Solicitor General, filed their respective memorandum.

On January 25, 2017, the Supreme Court decided in the consolidated cases of G.R. Nos. 205045 and 205723 to uphold the decision of the CTA requiring the BIR to refund excess taxes erroneously collected in the amount of P926 million for the period of December 1, 2005 to July 31, 2007, and P782 million for the period of February 2, 2004 to November 30, 2005. The Office of the Solicitor General filed motions for reconsideration, which were denied by the Supreme Court with finality on April 19, 2017.

In the meantime, effective October 1, 2007, the Parent Company spun off its domestic beer business into a new company, SMB. SMB continued to pay the excise taxes on "San Mig Light" at the higher rate required by the BIR and in excess of what it believes to be the excise tax rate applicable to it.

SMB

SMB filed nine claims for refund for overpayments of excise taxes with the BIR which were then elevated to the CTA by way of petition for review on the following dates:

- (a) first claim for refund of overpayments for the period from October 1, 2007 to December 31, 2008 - Second Division docketed as CTA Case No. 7973 (September 28, 2009);
- (b) second claim for refund of overpayments for the period of January 1, 2009 to December 31, 2009 - First Division docketed as CTA Case No. 8209 (December 28, 2010);
- (c) third claim for refund of overpayments for the period of January 1, 2010 to December 31, 2010 - Third Division docketed as CTA Case No. 8400 (December 23, 2011);
- (d) fourth claim for refund of overpayments for the period of January 1, 2011 to December 31, 2011 - Second Division docketed as CTA Case No. 8591 (December 21, 2012);
- (e) fifth claim for refund of overpayments for the period of January 1, 2012 to December 31, 2012 - Second Division docketed as CTA Case No. 8748 (December 19, 2013);
- (f) sixth claim for refund of overpayments for the period of January 1, 2013 to December 31, 2013 - docketed as CTA Case No. 8955 (December 2014);
- (g) seventh claim for refund of overpayments for the period of January 1, 2014 to December 31, 2014 - docketed as CTA Case No. 9223 (December 2015);
- (h) eighth claim for refund of overpayments for the period of January 1, 2015 to December 31, 2015 - docketed as CTA Case No. 9513 (December 2016);
and
- (i) ninth claim for refund of overpayments for the period from January 1, 2016 to December 31, 2016 - docketed as CTA Case No. 9743 (December 2017).

CTA Case No. 7973, which was consolidated with CTA Case No. 7953, had been decided in favor of SMB by the Third Division, ordering the BIR in the consolidated cases to refund to SMC SMB the joint amount of P934 million, which decision was appealed by the BIR before the CTA *En Banc*. The CTA *En Banc* affirmed the Decision of the Third Division and, subsequently, the BIR filed a Motion for Reconsideration, which was denied. The BIR elevated the CTA *En Banc* decision to the Supreme Court by way of a petition for review, which was docketed thereat as G.R. No. 232404. The petition was denied by the Supreme Court on September 11, 2017, thereby affirming the decision of the CTA *En Banc*.

CTA Case No. 8209 was decided in favor of SMB by the CTA's First Division, ordering the BIR to refund the amount of P730 million. The case was not appealed by the BIR within the prescribed period, thus, the decision was deemed final and executory. The First Division granted SMB's Motion for Execution, while the BIR filed a petition for certiorari before the Supreme Court, where it was docketed as G.R. No. 221790. The petition was dismissed by the Supreme Court with finality but the BIR still filed an urgent motion for clarification. Subsequently, SMB, through counsel, received a clarificatory resolution dated February 20, 2017 wherein the Supreme Court reiterated its grounds for the denial of the BIR's petition for certiorari.

CTA Case No. 8400 was decided in favor of SMB by both the CTA's Third Division and the CTA *En Banc*, ordering the BIR to refund the amount of P699 million. The BIR filed a motion for reconsideration, which the CTA *En Banc* denied. Subsequently, the BIR elevated the decision of the CTA *En Banc* to the Supreme Court by way of petition for review, where it was docketed as G.R. No. 226768. On March 20, 2017, the Supreme Court denied the petition for review, thereby affirming the CTA *En Banc* decision. The Office of the Solicitor General filed a motion for reconsideration, which was denied on July 24, 2017.

CTA Case No. 8591 was decided in favor of SMB by the Second Division. The BIR was ordered to refund to SMB the amount of P740 million. On appeal to the CTA *En Banc*, the latter affirmed the decision of the division. The BIR filed a motion for reconsideration, which was denied by the CTA *En Banc*. The BIR, through the Office of the Solicitor General, appealed the CTA *En Banc* decision to the Supreme Court by way of petition for review, where it was docketed as G.R. No. 232776. The case is still pending in the Supreme Court.

In CTA Case No. 8748, the Second Division rendered a decision on June 9, 2017, granting SMB's claim for refund of P761 million, which was appealed by the BIR to the CTA *En Banc*, where the case is still pending.

The petition for review in CTA Case No. 8955 was denied by the Third Division on the ground that the same involves a collateral attack on issuances of the BIR, the court ruling that the petition should have been filed in the Regional Trial Court (RTC). SMB through counsel filed a motion for reconsideration, arguing that the case involves a claim for refund and is at the same time a direct attack on the BIR issuances which imposed excise tax rates which are contradictory to, and violative of, the rates imposed in the Tax Code. The motion for reconsideration has been deemed submitted for resolution by the court.

In CTA Case Nos. 9223 and 9513, the trial has been finished and documentary evidence submitted by SMB is still under consideration by the court.

CTA Case No. 9743 will be scheduled for pre-trial after the respondent BIR Commissioner shall have filed his answer to SMB's petition for review.

GSMI

CTA Case Nos. 8953 and 8954: These cases pertain to GSMI's Claims for Refund with the BIR, in the amount of P581million in Case No. 8953, and P133 million in Case No. 8954 representing payments of excise tax erroneously, excessively, illegally, and/or wrongfully assessed on and collected from GSMI by the BIR on removals of its distilled spirits or finished products for the periods from January 1, 2013 up to May 31, 2013 in Case No. 8953, and from January 8, 2013 up to March 31, 2013 in Case No. 8954.

The aforementioned assessment and collection arose from the imposition and collection of excise taxes on GSMI's finished products processed and produced exclusively from its inventory of ethyl alcohol, notwithstanding that excise taxes had already been previously paid by GSMI on said ethyl alcohol. These cases are still pending with the CTA.

CTA Case No. 9059: This case pertains to GSMI's Claim for Refund with the BIR, in the total amount of P26 million, representing payments of excise tax erroneously, excessively, illegally, and/or wrongfully assessed on and collected from GSMI by the BIR on removals of its distilled spirits or finished products for the period from June 1, 2013 up to July 31, 2013.

The aforementioned assessment and collection arose from the imposition and collection of excise taxes on GSMI's finished products processed and produced exclusively from its inventory of ethyl alcohol, notwithstanding that excise taxes had already been previously paid by GSMI on the said ethyl alcohol. This case is still pending with the CTA.

d. Deficiency Tax Liabilities

The BIR issued a Final Assessment Notice dated March 30, 2012 (2009 Assessment), imposing on Iconic Beverages, Inc. (IBI) deficiency tax liabilities, including interest and penalties, for the tax year 2009. IBI treated the royalty income earned from the licensing of its intellectual properties to SMB as passive income, and therefore subject to 20% final tax. However, the BIR is of the position that said royalty income is regular business income subject to the 30% regular corporate income tax.

On May 16, 2012, IBI filed a protest against the 2009 Assessment. In its Final Decision on Disputed Assessment issued on January 7, 2013, the BIR denied IBI's protest and reiterated its demand to pay the deficiency income tax, including interests and penalties. On February 6, 2013, IBI filed a Petition for Review before the CTA contesting the 2009 Assessment. The case was docketed as CTA Case No. 8607 with the First Division. On August 14, 2015, the CTA partially granted the Petition for Review of IBI, by cancelling the compromise penalty assessed by the BIR. However, IBI was still found liable to pay the deficiency income tax, interests and penalties as assessed by the BIR. The Motion for Reconsideration was denied by the CTA's First Division on January 6, 2016. On January 22, 2016, IBI filed its Petition for Review before the CTA *En Banc* and the case was docketed as CTA EB Case No. 1417. The petition is pending before the CTA *En Banc*. To interrupt the running of interests, IBI filed a Motion to Pay without Prejudice, which was granted by the CTA *En Banc*. As a result, IBI paid the amount of P270 million on August 26, 2016.

As of December 31, 2017, the Petition for Review remains pending before the CTA *En Banc*.

On November 17, 2013, IBI received a Formal Letter of Demand with the Final Assessment Notice for tax year 2010 (2010 Assessment) from the BIR with a demand for payment of income tax and VAT deficiencies with administrative penalties. The BIR maintained its position that royalties are business income subject to the 30% regular corporate tax. The 2010 Assessment was protested by IBI before the BIR through a letter dated November 29, 2013. A Petition for Review was filed with the CTA and the case was docketed as CTA Case No. 8813. IBI also filed its Petition for Review before the CTA *En Banc* where it remains pending to date. In 2017, IBI filed an application for abatement where the Company requested for the cancellation of the surcharge and interests. As of December 31, 2017, both the Petition for Review and IBI's application for abatement remain pending for resolution by the CTA *En Banc* and the BIR, respectively.

On December 27, 2016, IBI received a Formal Letter of Demand for tax year 2012 with a demand for payment of income tax, VAT, withholding tax, documentary stamp tax and miscellaneous tax deficiencies with administrative penalties. SMB addressed the assessment of each tax type with factual and legal bases in a Protest filed within the reglementary period. Due to the inaction of the BIR, IBI filed a Petition for Review with the CTA. The case is currently pending while, at the same time, an application for abatement was submitted to the BIR in August 2017. As of December 31, 2017, both the Petition for Review and the application for abatement remain pending for resolution by the CTA and the BIR, respectively.

e. Tax Credit Certificates Cases

In 1998, the BIR issued a deficiency excise tax assessment against Petron relating to its use of P659 million worth of Tax Credit Certificates (TCCs) to pay certain excise tax obligations from 1993 to 1997. The TCCs were transferred to Petron by suppliers as payment for fuel purchases. Petron contested the BIR's assessment before the CTA. In July 1999, the CTA ruled that as a fuel supplier of BOI-registered companies, Petron was a qualified transferee of the TCCs and that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. On March 21, 2012, the Court of Appeals promulgated a decision in favor of Petron and against the BIR affirming the ruling of the CTA striking down the assessment issued by the BIR to Petron. On April 19, 2012, a motion for reconsideration was filed by the BIR, which was denied by the CTA in its Resolution dated October 10, 2012. The BIR elevated the case to the Supreme Court through a petition for review on *certiorari* dated December 5, 2012. On June 17, 2013, Petron filed its comment on the petition for review filed by the BIR. The petition is still pending as of December 31, 2017.

f. Pandacan Terminal Operations

In November 2001, the City of Manila enacted Ordinance No. 8027 reclassifying the areas occupied by the oil terminals of Petron, Pilipinas Shell Petroleum Corporation (Shell) and Chevron Philippines Inc. (Chevron) from industrial to commercial. This reclassification made the operation of the oil terminals in Pandacan, Manila illegal. In December 2002, the Social Justice Society (SJS) filed a petition with the Supreme Court against the Mayor of Manila asking that the latter be ordered to enforce Ordinance No. 8027. In April 2003, Petron filed a petition with the RTC to annul Ordinance No. 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, Mayor of Manila ceased implementation of Ordinance No. 8027.

The City of Manila subsequently issued Ordinance No. 8119, the Comprehensive Land Use Plan and Zoning Ordinance, which applied to the entire City of Manila. Ordinance No. 8119 allowed Petron (and other non-conforming establishments) a seven-year grace period to vacate. As a result of the passage of Ordinance No. 8119, which was thought to effectively repeal Ordinance No. 8027, in April 2007, the RTC dismissed the petition filed by Petron questioning Ordinance No. 8027.

However, on March 7, 2007, in the case filed by SJS, the Supreme Court rendered a decision (the “March 7 Decision”) directing the Mayor of Manila to immediately enforce Ordinance No. 8027. On March 12, 2007, Petron, together with Shell and Chevron, filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision. In the same year, Petron also filed a petition before the RTC of Manila praying for the nullification of Ordinance No. 8119 on the grounds that the reclassification of the oil terminals was arbitrary, oppressive and confiscatory, and thus unconstitutional, and that the said Ordinance contravened the provisions of the Water Code of the Philippines (Presidential Decree No. 1067, the Water Code). On February 13, 2008, Petron, Shell and Chevron were allowed by the Supreme Court to intervene in the case filed by SJS but their motions for reconsideration were denied. The Supreme Court declared Ordinance No. 8027 valid and dissolved all existing injunctions against the implementation of the Ordinance No. 8027.

In May 2009, the Mayor of Manila approved Ordinance No. 8187, which amended Ordinance No. 8027 and Ordinance No. 8119 and permitted the continued operations of the oil terminals in Pandacan.

On August 24, 2012 (the “August 24 Decision”), the RTC of Manila ruled that Section 23 of Ordinance No. 8119 relating to the reclassification of subject oil terminals had already been repealed by Ordinance No. 8187; hence any issue pertaining thereto had become moot and academic. The RTC of Manila also declared Section 55 of Ordinance No. 8119 null and void for being in conflict with the Water Code. Nonetheless, the RTC upheld the validity of all other provisions of Ordinance No. 8119. Petron filed with the RTC a Notice of Appeal to the Court of Appeals on January 23, 2013.

In a decision dated September 19, 2017, the Court of Appeals denied the appeal of Petron, finding that Manila's Comprehensive Land Use Plan was valid, except for Section 55 of Ordinance No. 8119. Section 55, which imposed an easement of ten meters from the riverbank to serve as a linear park, was struck down as invalid because it violated the Water Code which required only a three-meter easement. Petron no longer filed a motion for reconsideration or elevated the matter to the Supreme Court since the issue has already become moot following the cessation by Petron of the operations of its petroleum storage facilities in Pandacan in August 2015.

With regard to Ordinance No. 8187, petitions were filed before the Supreme Court, seeking for its nullification and the enjoinder of its implementation. Petron filed a manifestation on November 30, 2010 informing the Supreme Court that, without prejudice to its position in the cases, it had decided to cease operation of its petroleum product storage facilities in Pandacan within five years or not later than January 2016 due to the many unfounded environmental issues being raised that tarnish the image of Petron and the various amendments being made to the zoning ordinances of the City of Manila when the composition of the local government changes that prevented Petron from making long-term plans. In a letter dated July 6, 2012 (with copies to the offices of the Vice Mayor and the City Council of Manila), Petron reiterated its commitment to cease the operation of its petroleum product storage facilities and transfer them to another location by January 2016.

On November 25, 2014, the Supreme Court issued a Decision (the "November 25 Decision") declaring Ordinance No. 8187 unconstitutional and invalid with respect to the continued stay of the oil terminals in Pandacan. Petron, Shell and Chevron were given 45 days from receipt of the November 25 Decision to submit a comprehensive plan and relocation schedule to the RTC of Manila and implement full relocation of their fuel storage facilities within six months from the submission of the required documents. On March 10, 2015, acting on a Motion for Reconsideration filed by Shell, a Motion for Clarification filed by Chevron, and a Manifestation filed by Petron, the Supreme Court denied Shell's motion with finality and clarified that relocation and transfer necessarily included removal of the facilities in the Pandacan terminals and should be part of the required comprehensive plan and relocation schedule. On May 14, 2015, Petron filed its submission in compliance with the November 25 Decision.

g. Oil Spill Incident in Guimaras

On August 11, 2006, MT Solar I, a third party vessel contracted by Petron to transport approximately two million liters of industrial fuel oil, sank 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the Philippine Department of Justice (DOJ) and the Special Board of Marine Inquiry (SBMI), both agencies found the owners of MT Solar I liable. The DOJ found Petron not criminally liable, but the SBMI found Petron to have overloaded the vessel. Petron has appealed the findings of the SBMI to the DOTr and is awaiting its resolution. Petron believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as Petron, which are charterers.

Other complaints for non-payment of compensation for the clean-up operations during the oil spill were filed by a total of 1,063 plaintiffs who allegedly did not receive any payment of their claims for damages arising from the oil spill. The total claims amounted to P292 million. The cases are still pending as of December 31, 2017.

h. Leases with Philippine National Oil Company (PNOC)

On October 20, 2017, Petron filed with the RTC of Mandaluyong City a complaint against the PNOC for Resolution and Reconveyance, and Damages, with Verified Ex-Parte Application for 72-hour Temporary Restraining Order (TRO) and Verified Applications for 20-day TRO and Writ of Preliminary Injunction. In its complaint, Petron seeks the reconveyance of the various landholdings it conveyed to PNOC in 1993 as a result of the government-mandated privatization of Petron. These landholdings consist of the refinery lots in Limay, Bataan, 23 bulk plant sites and 66 service station lots located in different parts of the country. The Deeds of Conveyance covering the landholdings provide that the transfer of these lots to PNOC was without prejudice to the continued long-term use by Petron of the conveyed lots for its business operation. Thus, PNOC and Petron executed three lease agreements covering the refinery lots, the bulk plants, and the service station sites, all with an initial lease term of 25 years to expire in August 2018, with a provision for automatic renewal for another 25 years. In 2009, Petron, through its realty subsidiary, NVRC, had an early renewal of the lease agreement for the refinery lots with an initial lease term of 30 years, renewable for another 25 years.

The complaint stemmed from PNOC's refusal to honor the automatic renewal clause in the lease agreements for the bulk plants and the service station sites and the renewed lease agreement for the refinery lots on the alleged ground that all such lease agreements were grossly disadvantageous to PNOC, a government-owned-and-controlled corporation.

Petron alleged that by unilaterally setting aside the renewal clauses of the lease agreements and by categorically declaring its refusal to honor them, PNOC committed a fundamental breach of such lease agreements with Petron.

On December 11, 2017, the trial court granted Petron's prayer for a writ of preliminary injunction, enjoining PNOC from committing any act aimed at ousting Petron possession of the subject properties until the case is decided. On December 29, 2017, the trial court mandated the conduct of mediation proceedings on February 5, 2018 before the Philippine Mediation Center. The case was still pending as of December 31, 2017.

The court-mandated mediation conference held at the Philippine Mediation Center in Mandaluyong City on February 5, 2018 was terminated without any agreement between the parties. In an Order dated February 28, 2018, upon motion of Petron, the trial court directed that the case be returned to the Office of the Clerk Court for re-raffle for the judicial dispute resolution proceeding. As of March 13, 2018, Petron is awaiting the notice on the date for the re-raffle.

i. Generation Payments to Power Sector Assets and Liabilities Management Corporation (PSALM)

SPPC and PSALM are parties to the Ilijan Independent Power Producer Administration (IPPA) Agreement covering the appointment of SPPC as the IPP administrator of the Ilijan Power Plant.

SPPC and PSALM have an ongoing dispute arising from differing interpretations of certain provisions related to generation payments under the Ilijan IPPA Agreement. As a result of such dispute, the parties have arrived at different computations regarding the subject payments. In a letter dated August 6, 2015, PSALM has demanded payment of the difference between the generation payments calculated based on its interpretation and the amount which has already been paid by the SPPC, plus interest, covering the period December 26, 2012 to April 25, 2015.

On August 12, 2015, SPPC initiated a dispute resolution process with PSALM as provided under the terms of the Ilijan IPPA Agreement, while continuing to maintain that it has fully paid all of its obligations to PSALM. Notwithstanding the bona fide dispute, PSALM issued a notice terminating the Ilijan IPPA Agreement on September 4, 2015. On the same day, PSALM also called on the Performance Bond posted by SPPC pursuant the Ilijan IPPA Agreement.

On September 8, 2015, SPPC filed a Complaint with the RTC of Mandaluyong City. In its Complaint, SPPC requested the RTC that its interpretation of the relevant provisions of the Ilijan IPPA Agreement be upheld. The Complaint also asked that a 72-hour TRO be issued against PSALM for illegally terminating the Ilijan IPPA Agreement and drawing on the Performance Bond. On even date, the RTC issued a 72-hour TRO which prohibited PSALM from treating SPPC as being in Administrator Default and from performing other acts that would change the status quo ante between the parties before PSALM issued the termination notice and drew on the Performance Bond. The TRO was extended for until September 28, 2015.

On September 28, 2015, the RTC issued an Order granting a Preliminary Injunction enjoining PSALM from proceeding with the termination of the Ilijan IPPA Agreement while the main case is pending.

On October 22, 2015, the RTC also issued an Order granting the Motion for Intervention and Motion to Admit Complaint-in-intervention by Meralco.

In an Order dated June 27, 2016, the RTC denied PSALM's: (1) Motion for Reconsideration of the Order dated September 28, 2015, which issued a writ of preliminary injunction enjoining PSALM from further proceedings with the termination of the IPPA Agreement while the case is pending; (2) Motion for Reconsideration of the Order, which allowed Meralco to intervene in the case; and (3) Motion to Dismiss. In response to this Order, PSALM filed a petition for certiorari with the Court of Appeals seeking to annul the RTC's Orders granting the writ of preliminary injunction, allowing Meralco's intervention, and the Orders denying PSALM's motions for reconsideration of said injunction and intervention orders. PSALM also prayed for the issuance of a TRO and/or writ of preliminary injunction "against public respondent RTC and its assailed Orders". The Court of Appeals, however, denied the petition filed by PSALM in its Decision dated December 19, 2017.

The preliminary conference on the RTC case was suspended to pave way for mediation between the parties. During the last mediation conference on January 6, 2017, mediation between the parties was terminated. Thereafter, the case was referred to judicial dispute resolution. During the dispute conference between the parties on September 28, 2017, the judicial dispute process was terminated. The parties were required to submit their respective position papers on whether or not the case should be re-raffled, in compliance with the Order of the RTC dated October 24, 2017. On December 8, 2017, SPPC filed its Comment and Opposition to the Motion for Inhibition filed by PSALM. On December 18, 2017, the presiding

judge of the RTC who conducted the judicial dispute resolution issued an Order inhibiting himself in the instant case. The case was then re-raffled to another RTC which scheduled the Pre-Trial Conference on May 11, 2018. SPPC filed a Request for Motion for Production of Documents on February 28, 2018, while PSALM filed its Manifestation with Motion to Hear Affirmative Defenses and Objections Ad Cautelam. Both motions are still pending with the court as of March 15, 2018.

Meanwhile, there are no restrictions or limitations on the ability of SPPC to supply power from the Ilijan Power Plant to Meralco under its Power Supply Agreement with the latter.

By virtue of the Preliminary Injunction issued by the RTC, SPPC continues to be the IPP administrator for the Ilijan Power Plant.

j. Intellectual Property Rights

G.R. No. 196372: This case pertains to GSMI's application for the registration of the trademark "GINEBRA" under Class 33 ("gin") with the Intellectual Property Office of the Philippines ("IPOP HL"). The IPOP HL rejected GSMI's application on the ground that "GINEBRA" is a Spanish word for gin, and is a generic term incapable of appropriation.

When the Court of Appeals affirmed the IPOP HL's ruling, GSMI filed a Petition for Review on Certiorari (the "Petition") with the Supreme Court. The Supreme Court denied GSMI's Petition. GSMI moved for a reconsideration thereof, and likewise filed a Motion to Refer its Motion for Reconsideration to the Supreme Court *En Banc*. Unfortunately, the Supreme Court denied GSMI's Motion for Reconsideration "with FINALITY", as well as GSMI's Motion to Refer to Court *En Banc*.

Subsequently, GSMI filed a Manifestation with Motion for Relief from Judgment and invoked the case of "League of Cities vs. Commission of Elections" (G.R. Nos. 176951, 177499 and 178056) to invite the Supreme Court *En Banc* to re-examine the case. This case is still pending with the Supreme Court.

G.R. Nos. 210224 and 219632: These cases pertain to GSMI's complaint for trademark infringement and unfair competition against Tanduy Distillers, Inc. ("TDI") filed with the RTC, arising from TDI's distribution and sale of "Ginebra Kapitan" and use of a bottle design similar to that used by GSMI. The RTC dismissed GSMI's complaint.

When GSMI elevated the case to the Court of Appeals, due to technicalities, two (2) cases were lodged in the Court of Appeals: 1.) Petition for Review (CA-G.R. SP No. 127255), and 2.) Notice of Appeal (CA-G.R. SP No. 100332).

Acting on GSMI's Petition for Review, the Court of Appeals reversed, set aside the RTC's Decision, and ruled that "GINEBRA" is associated by the consuming public with GSMI. Giving probative value to the surveys submitted by GSMI, the Court of Appeals ruled that TDI's use of "GINEBRA" in "Ginebra Kapitan" produces a likelihood of confusion between GSMI's "Ginebra San Miguel" gin product and TDI's "Ginebra Kapitan" gin product. The Court of Appeals likewise ruled that "TDI knew fully well that GSMI has been using the mark/word "GINEBRA" in its gin products and that GSMI's "Ginebra San Miguel" had already obtained, over the years, a considerable number of loyal customers who associate the mark "GINEBRA" with GSMI.

On the other hand, upon GSMI's Appeal, the Court of Appeals also set aside the RTC's Decision and ruled that "GINEBRA" is not a generic term, there being no evidence to show that an ordinary person in the Philippines would know that "GINEBRA" is a Spanish word for "gin". According to the Court of Appeals, because of GSMI's use of the term in the Philippines since the 1800s, the term "GINEBRA" now exclusively refers to GSMI's gin products and to GSMI as a manufacturer. The Court of Appeals added that "the mere use of the word 'GINEBRA' in 'Ginebra Kapitan' is sufficient to incite an average person, even a gin-drinker, to associate it with GSMI's gin product, and that TDI 'has designed its bottle and label to somehow make a colorable similarity with the bottle and label of Ginebra S. Miguel'".

TDI filed separate Petitions for Review with the Supreme Court, docketed as G.R. Nos. 210224 and 219632, which were eventually consolidated by the Supreme Court. These cases are still pending with the Supreme Court.

G.R. No. 216104: This case pertains to TDI's application for the registration of the trademark "GINEBRA KAPITAN" for Class 33 ("gin") with the IPOPHL.

GSMI opposed TDI's application, alleging that it would be damaged by the registration of "GINEBRA KAPITAN" because the term "GINEBRA" has acquired secondary meaning and is now exclusively associated with GSMI's gin products. GSMI argued that the registration of "GINEBRA KAPITAN" for use in TDI's gin products will confuse the public and cause damage to GSMI. TDI countered that "GINEBRA" is generic and incapable of exclusive appropriation, and that "GINEBRA KAPITAN" is not identical or confusingly similar to GSMI's mark.

The IPOPHL ruled in favor of TDI and held that: (a) "GINEBRA" is generic for "gin", (b) GSMI's products are too well known for the purchasing public to be deceived by a new product like Ginebra Kapitan, and (c) TDI's use of "GINEBRA" would supposedly stimulate market competition.

The Court of Appeals reversed and set aside the IPOPHL's ruling and disapproved the registration of "GINEBRA KAPITAN". The Court of Appeals ruled that "GINEBRA" could not be considered as a generic word in the Philippines considering that, to the Filipino gin-drinking public, it does not relate to a class of liquor/alcohol but rather has come to refer specifically and exclusively to the gin products of GSMI.

TDI filed a Petition for Review on Certiorari with the Supreme Court, which was subsequently consolidated with the case of "Tanduay Distillers, Inc. vs. Ginebra San Miguel Inc.", docketed as G.R. No. 210224. This case is still pending with the Supreme Court.

k. Imported Industrial Fuel Oil

SL Harbor Bulk Terminal Corporation (SLHBTC) is a party to an investigation by the Bureau of Customs under Section 1113 (f) of the Customs Modernization and Tariff Act, in relation to an importation of industrial fuel oil which arrived at the Port of Limay, Bataan on December 14, 2016. The said imported fuel is subject to a Decision of Forfeiture issued by the district collector of the Bureau of Customs Limay, Bataan on January 20, 2017. The case was docketed as CTA Case No. 9551.

On February 2, 2017, a Notice of Appeal was filed by SLHBTC with the commissioner of Bureau of Customs.

On April 19, 2017, SLHBTC filed a Motion for Special Order on the necessity of releasing the 44,000 metric tons of fuel seized on January 20, 2017.

On January 23, 2018, the request to release the seized fuel was granted. The CTA directed the Bureau of Customs to release the 44,000 metric tons of imported industrial fuel oil, valued approximately at P759 million, only upon SLHBTC's posting of surety bond equivalent to one and a half times the assessed amount of P82 million or P123 million. SLHBTC complied with the CTA's directive, and on February 6, 2018, it started releasing the seized fuel.

The pre-trial conference is scheduled on April 28, 2018.

1. Criminal Cases

SPPC

On September 29, 2015, SPPC filed a criminal complaint for estafa and for violation of Section 3(e) of RA No. 3019, otherwise known as the Anti-Graft and Corrupt Practices Act, before the DOJ, against certain officers of PSALM, in connection with the termination of SPPC's IPPA Agreement, which was made by PSALM with manifest partiality and evident bad faith. Further, it was alleged that PSALM fraudulently misrepresented its entitlement to draw on the Performance Bond posted by SPPC, resulting in actual injury to SPPC in the amount US\$60 million. The case is still pending with the DOJ as of December 31, 2017.

San Miguel Energy Corporation (SMEC)

On October 21, 2015, SMEC filed a criminal complaint for Plunder and violation of Section 3(e) and 3(f) of RA No. 3019, before the DOJ against a certain officer of PSALM, and certain officers of Team Philippines Energy Corp. (TPEC) and Team Sual Corporation (TSC), relating to the illegal grant of the so-called "excess capacity" of the Sual Power Plant in favor of TPEC which enabled it to receive a certain amount at the expense of the Government and SMEC.

In a Resolution dated July 29, 2016, the DOJ found probable cause to file Information against the respondents for (a) Plunder; (b) Violation of Section 3(e) of the Anti-Graft and Corrupt Practices Act; and (c) Violation of Section 3(f) of the Anti-Graft and Corrupt Practices Act. The DOJ further resolved to forward the entire records of the case to the Office of the Ombudsman for their proper action. Respondents have respectively appealed said DOJ's Resolution of July 29, 2016 with the Secretary of Justice. On October 25, 2017, the DOJ issued a Resolution partially granting the Petition for Review by reversing the July 29, 2016 DOJ Resolution insofar as the conduct of the preliminary investigation. On November 17, 2017, SMEC filed a motion for partial reconsideration of said October 25, 2017 DOJ Resolution.

On June 17, 2016, SMEC filed with the RTC Pasig a civil complaint for consignment against PSALM arising from PSALM's refusal to accept SMEC's remittances corresponding to the proceeds of the sale on the WESM of electricity generated from capacity in excess of the 1000 MW of the Sual Power Plant ("Sale of the Excess Capacity"). With the filing of the complaint, SMEC also consigned with the RTC Pasig, the amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods December 26, 2015 to April 25, 2016.

On October 3, 2016, SMEC filed an Omnibus Motion (To Admit Supplemental Complaint and To Allow Future Consignation without Tender). Together with this Omnibus Motion, SMEC consigned with the RTC Pasig an additional amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods from April 26, 2016 to July 25, 2016.

Pending for resolution are (a) PSALM's Motion for Preliminary Hearing and Special and Affirmative Defenses and (b) SMEC's Omnibus Motion (To Admit Supplemental Complaint and To Allow Future Consignations without Tender).

Further related thereto, on December 1, 2016, SMEC received a copy of a Complaint filed by TPEC and TSC with the Energy Regulatory Commission (ERC) against SMEC and PSALM in relation to the Excess Capacity issues, which issues have already been raised in the abovementioned cases. SMEC filed a Motion to Dismiss and Motion to Suspend Proceeding of the instant case.

On July 5, 2017, SMEC consigned with the RTC the amount representing additional proceeds of Sale of the Excess Capacity for the billing period July 26, 2016 to August 25, 2016. SMEC also filed a Motion to Admit Second Supplemental Complaint in relation to said consignation. With the submission of manifestation from PSALM, the Motion to Admit Second Supplemental Complaint is submitted for resolution.

m. TRO Issued to Meralco

On December 23, 2013, the Supreme Court issued a TRO, effective immediately, preventing Meralco from collecting from its customers the power rate increase pertaining to November 2013 billing. As a result, Meralco was constrained to fix its generation rate to its October 2013 level of P5.67/kWh. Claiming that since the power supplied by generators, including SMEC and SPPC is billed to Meralco's customers on a pass-through basis, Meralco deferred a portion of its payment on the ground that it was not able to collect the full amount of its generation cost. Further, on December 27, 2013, the Department of Energy, ERC, and PEMC, acting as a tripartite committee, issued a joint resolution setting a reduced price cap on the WESM of P32/kWh. The price will be effective for 90 days until a new cap is decided upon.

On January 16, 2014, the Supreme Court granted Meralco's plea to include other power supplier and generation companies, including SMEC and SPPC, as respondents to an inquiry. On February 18, 2014, the Supreme Court extended the period of the TRO until April 22, 2014 and enjoined the respondents (PEMC and the generators) from demanding and collecting the deferred amounts.

On March 3, 2014, the ERC issued an order declaring the November and December 2013 Luzon WESM prices void and imposed the application of regulated prices. Accordingly, SMEC, SPPC and Strategic Power Devt. Corp. (SPDC) recognized a reduction in the sale of power while San Miguel Electric Corp. recognized a reduction in its power purchases. Consequently, a payable and receivable were also recognized for the portion of over-collection or over-payment, the settlement of which shall be covered by a 24-month Special Payment Arrangement with PEMC which was already completed on May 25, 2016.

On June 26, 2014, SMEC, SPPC, SPDC and SPI filed with the Court of Appeals a Petition for Review of these orders.

In a Decision dated November 7, 2017 (“Decision”), the Court of Appeals granted the Petition for Review filed by SMEC, SPPC, SPDC and SPI, declaring the aforesaid ERC Order null and void and set aside the Orders of the ERC dated March 3, 2014, March 27, 2014, May 9, 2014 and October 15, 2014 and accordingly reinstated and declared as valid the WESM prices for Luzon for the supply of months of November to December 2013.

Upon finality of the Decision, a claim for refund may be made by the relevant subsidiaries with PEMC for an amount up to P3 million, plus interest.

n. Electric Power Industry Reform Act (EPIRA)

The EPIRA sets forth the following: (i) Section 49 created PSALM to take ownership and manage the orderly sale, disposition and privatization of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets; (ii) Section 31(c) requires the transfer of the management and control of at least 70% of the total energy output of power plants under contract with NPC to the IPP Administrators as one of the conditions for retail competition and open access; and (iii) Pursuant to Section 51(c), PSALM has the power to take title to and possession of the IPP contracts and to appoint, after a competitive, transparent and public bidding, qualified independent entities who shall act as the IPP Administrators in accordance with the EPIRA. In accordance with the bidding procedures and supplemented bid bulletins thereto to appoint an IPP Administrator relative to the capacity of the IPP contracts, PSALM has conducted a competitive, transparent and open public bidding process following which the Group was selected winning bidder of the IPPA Agreements.

The EPIRA requires generation and distribution utility (DU) companies to undergo public offering within five years from the effective date, and provides cross ownership restrictions between transmission and generation companies. If the holding company of generation and DU companies is already listed with the PSE, the generation company or the DU need not comply with the requirement since such listing of the holding company is deemed already as compliance with the EPIRA.

A DU is allowed to source from an associated company engaged in generation up to 50% of its demand except for contracts entered into prior to the effective date of the EPIRA. Generation companies are restricted from owning more than 30% of the installed generating capacity of a grid and/or 25% of the national installed generating capacity. The Group is in compliance with the restrictions as of December 31, 2017.

▪ Commitments

The outstanding purchase commitments of the Group amounted to P101,881 million as of December 31, 2017.

Amount authorized but not yet disbursed for capital projects is approximately P141,914 million as of December 31, 2017.

▪ Foreign Exchange Rates

The foreign exchange rates used in translating the US Dollar accounts of foreign subsidiaries and associates and joint ventures to Philippine peso were closing rates of P49.93 and P49.72 in 2017 and 2016, respectively, for consolidated statements of financial position accounts; and average rates of P50.40, P47.48 and P45.50 in 2017, 2016 and 2015, respectively, for income and expense accounts.

- Certain accounts in prior years have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported financial performance for any period.
- There are no unusual items as to nature and amount affecting assets, liabilities, equity, net income or cash flows, except those stated in Management's Discussion and Analysis of Financial Position and Financial Performance.
- There were no material changes in estimates of amounts reported in prior interim periods of the current year or changes in estimates of amounts reported in prior financial years.
- There were no known trends, demands, commitments, events or uncertainties that will have a material impact on the Group's liquidity.
- There were no known trends, events or uncertainties that have had or that are reasonably expected to have a favorable or unfavorable impact on net sales or revenues or income from continuing operation.
- There were no known events that will trigger direct or contingent financial obligation that is material to the Group, including any default or acceleration of an obligation and there were no changes in contingent liabilities and contingent assets since the last annual reporting date, except for "Contingencies" of Section VII above that remain outstanding as of December 31, 2017.
- The effects of seasonality or cyclicalities on the interim operations of the Group's businesses are not material.
- There were no material off-statements of financial position transactions, arrangements, obligations (including contingent obligations), and other relationship of the Group with unconsolidated entities or other persons created during the reporting period, except for the outstanding derivative transactions entered by the Group as of and for the period December 31, 2017.