



SAN MIGUEL CORPORATION

April 25, 2011

The Philippine Stock Exchange, Inc.
Disclosure Department
3rd Floor, Tower One and Exchange Plaza
Ayala Triangle, Ayala Avenue
Makati City

Attention: **Ms. Janet A. Encarnacion**
Head - Disclosure Department

Re: **Offering Circular**

Gentlemen:

San Miguel Corporation (the "Company") is submitting herewith a Final Offering Circular in relation to the offering of registered common shares in the capital of the Company by the Company, together with its stockholder Top Frontier Investment Holdings Inc.

Very truly yours,


FERDINAND K. CONSTANTINO
Corporate Information Officer



SAN MIGUEL CORPORATION

(a corporation incorporated under the laws of the Republic of the Philippines)

**Offer of 110,320,000 Common Shares
consisting of 27,580,000 Common Shares from SMC and
82,740,000 Common Shares from Top Frontier**

Offer Price: ₱110 per share

This Offering Circular relates to the offer and sale of common shares (the "Offer Shares") of San Miguel Corporation ("SMC" or the "Company"), with a par value of ₱5.00 per share (the "Common Shares"). The Offer Shares are being offered by SMC and Top Frontier Investment Holdings, Inc. (the "Selling Shareholder" or "Top Frontier"), each a corporation organized under the laws of the Republic of the Philippines, at the offer price of ₱110 per share (the "Offer Price"). The offer of the Offer Shares is referred to as the "Offer". The Offer will consist of (i) the international offer (the "International Offer") of 78,800,000 Offer Shares being offered outside the United States to non-U.S. persons in compliance with Regulation S ("Regulation S") under the U.S. Securities Act of 1933, as amended (the "Securities Act"), and (ii) the domestic offer of 31,520,000 Offer Shares being offered and sold at the Offer Price to investors in the Philippines following the pricing of the International Offer (the "Domestic Offer"). The Selling Shareholder has granted ATR KimEng Capital Partners, Inc., BDO Capital & Investment Corporation and SB Capital Investment Corporation (the "Domestic Joint Bookrunners") an option (the "Domestic Option") to sell up to 27,580,000 additional Offer Shares in the event that demand in the Domestic Offer exceeds the number of Offer Shares offered in the Domestic Offer. See "Plan of Distribution". The Offer Shares are subject to reallocation between the International Offer and the Domestic Offer in certain circumstances described in this Offering Circular.

The Common Shares (including the Offer Shares) are listed on the Philippine Stock Exchange, Inc. ("PSE") under the symbol "SMC". The Offer Shares have been registered with the Philippine Securities and Exchange Commission ("Philippine SEC"). In connection with the Offer, the PSE approved a suspension of trading in the Common Shares and SMC's Series 1 preferred shares from April 13, 2011 to May 5, 2011. On April 12, 2011, the last reported sale price of the Common Shares on the PSE was ₱153 per share. The Offer Shares are expected to be ready for delivery in book-entry form through the Philippine Depository & Trust Corporation against payment on or about May 5, 2011 (the "Closing Date").

See "Risk Factors" beginning on page 15 for factors that investors should consider before making an investment in the Offer Shares.

In connection with the Offer, SMC has granted Credit Suisse (Singapore) Limited, Standard Chartered Securities (Singapore) Pte. Limited, Goldman Sachs (Singapore) Pte., and UBS AG (the "International Joint Bookrunners") an option, exercisable in whole or in part for 30 days from the date of allotment of Offer Shares in the International Offer, to procure purchasers for or purchase up to 7,880,000 additional Common Shares (being 10.0% of the total number of International Offer Shares), solely to cover over-allotments under the Offer (the "Over-Allotment Option"), if any. In connection with the Offer, Credit Suisse (Hong Kong) Limited (the "Stabilizing Agent") may, but is not required to, engage in stabilization activities for a limited time. The stabilization arrangements were approved by the Philippine SEC on April 19, 2011. See "Plan of Distribution".

The Offer Shares have not been and will not be registered under the Securities Act and are being offered and sold only outside the United States to non-U.S. persons in compliance with Regulation S.

Joint Global Coordinators



International Joint Bookrunners



International Co-Bookrunner



Domestic Joint Bookrunners



The date of this Offering Circular is April 20, 2011.

If you are in any doubt about this Offering Circular, you should consult your stockbroker, bank manager, legal counsel, professional accountant or other professional advisor. This Offering Circular is confidential. You are authorized to use this Offering Circular solely for the purpose of considering the purchase of the Offer Shares offered pursuant to this Offering Circular. By purchasing the Offer Shares offered by this Offering Circular, you will be deemed to have acknowledged that you have reviewed this Offering Circular. You may not reproduce or distribute this Offering Circular, in whole or in part, and you may not disclose any of the contents of this Offering Circular or use any information herein for any purpose other than considering an investment in the Offer Shares offered hereby. You hereby agree to the foregoing by accepting delivery of this Offering Circular.

No representation is made by SMC or the Selling Shareholder regarding the legality of an investment in the Offer Shares under any legal, investment or similar laws or regulations. The contents of this Offering Circular are not investment, legal or tax advice. You should consult your own counsel, accountant and other advisors as to legal, tax, business, financial and related aspects of a purchase of the Offer Shares. In making any investment decision regarding the Offer Shares, you must rely on your own examination of SMC and the terms of the Offer, including the merits and risks involved.

THE OFFER SHARES ARE BEING OFFERED ON THE BASIS OF THIS OFFERING CIRCULAR ONLY. ANY DECISION TO PURCHASE THE OFFER SHARES MUST BE BASED ONLY ON THE INFORMATION CONTAINED HEREIN.

The Offer Shares have not been and will not be registered under the Securities Act and are not being offered or sold in the United States. The Offer Shares may be subject to certain transfer restrictions as described herein.

No person has been authorized to give any information or to make any representations other than those contained in this Offering Circular and, if given or made, such information or representations must not be relied upon as having been authorized by SMC or the Selling Shareholder. This Offering Circular does not constitute an offer to sell or the solicitation of an offer to purchase any securities other than the Offer Shares or an offer to sell or the solicitation of an offer to purchase such securities by any person in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this Offering Circular nor any sale of the Offer Shares offered hereby shall, under any circumstances, create any implication that there has been no change in the affairs of SMC since the date hereof or that the information contained herein is correct as of any time subsequent to the date hereof.

The distribution of this Offering Circular and the offer and sale of the Offer Shares in certain jurisdictions may be restricted by law. SMC, the Selling Shareholder, the International Joint Bookrunners, the International Co-Bookrunner and the Domestic Joint Bookrunners require persons into whose possession this Offering Circular comes to inform themselves about and to observe any such restrictions. This Offering Circular does not constitute an offer of, or an invitation to purchase, any of the Offer Shares in any jurisdiction in which such offer or invitation would be unlawful. Each prospective purchaser of the Offer Shares must comply with all applicable laws and regulations in force in any jurisdiction in which it purchases, offers, sells or resells the Offer Shares or possesses and distributes this Offering Circular and must obtain any consents, approvals or permissions required for the purchase, offer, sale or resale by it of the Offer Shares under the laws, rules and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or resales, and none of SMC, the Selling Shareholder, the International Joint Bookrunners, the International Co-Bookrunner and the Domestic Joint Bookrunners shall have any responsibility therefor.

IN CONNECTION WITH THE OFFER, THE STABILIZING AGENT OR ANY PERSON ACTING ON ITS BEHALF MAY OVER-ALLOT OFFER SHARES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE OFFER SHARES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD AFTER THE CLOSING DATE. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILIZING AGENT (OR ANY PERSON ACTING ON BEHALF OF THE STABILIZING AGENT) WILL UNDERTAKE STABILIZATION ACTIVITIES. ANY STABILIZATION ACTIVITIES MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE FINAL PRICE OF THE OFFER SHARES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT MUST END NO LATER THAN 30 CALENDAR DAYS AFTER THE DATE OF ALLOTMENT OF THE

OFFER SHARES. ANY STABILIZATION ACTIVITIES SHALL BE DONE IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND RULES. THE TOTAL NUMBER OF OFFER SHARES WHICH THE STABILIZING AGENT OR ANY AGENT OF IT MAY BUY TO UNDERTAKE ANY STABILIZING ACTIVITIES SHALL NOT EXCEED 15.0% OF THE AGGREGATE NUMBER OF THE OFFER SHARES.

This Offering Circular is only being distributed to and is only directed at (i) persons who are outside the United Kingdom or (ii) investment professionals falling within Article 19(5) of the FSMA (Financial Promotion) Order 2005 or (iii) high net worth companies, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the FSMA (Financial Promotion) Order 2005 Order (all such persons together being referred to as “relevant persons”). The Offer Shares are only available to, and any invitation, offer or agreement to purchase or otherwise acquire such Offer Shares will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this Offering Circular or any of its contents.

SMC and the Selling Shareholder reserve the right to withdraw the offer and sale of Offer Shares at any time, and the International Joint Bookrunners, the International Co-Bookrunner and the Domestic Joint Bookrunners (collectively, the “Bookrunners”) reserve the right to reject any commitment to subscribe for the Offer Shares in whole or in part and to allot to any prospective purchaser less than the full amount of the Offer Shares sought by such purchaser. The Joint Bookrunners and certain related entities may acquire for their own account a portion of the Offer Shares.

The information contained in this Offering Circular relating to SMC, its operations and its affiliates has been supplied by SMC, unless otherwise stated herein. To the best of its knowledge and belief, SMC (which has taken all reasonable care to ensure that such is the case) confirms that the information contained in this Offering Circular relating to it, its operations and those of its affiliates is correct, and that there is no material misstatement or omission of fact which would make any statement in this Offering Circular misleading in any material respect, and SMC hereby accepts responsibility for the accuracy of the information contained in this Offering Circular. To the fullest extent permitted by law, none of the Bookrunners accepts any responsibility for the contents of this Offering Circular or for any other statement, made or purported to be made by a Bookrunner or on its behalf in connection with SMC, or the Offer of the Offer Shares. Each Bookrunner accordingly disclaims all and any liability whether arising in tort or contract or otherwise which it might otherwise have in respect of this Offering Circular or any such statement. Unless otherwise indicated, all information in this Offering Circular is as of the date of this Offering Circular.

CONVENTIONS WHICH APPLY TO THIS OFFERING CIRCULAR

In this Offering Circular, unless otherwise specified or the context otherwise requires, all references to the “Philippines” are references to the Republic of the Philippines. All references to the “BSP” are references to Bangko Sentral ng Pilipinas, the central bank of the Philippines. All references to “United States” or “U.S.” are to the United States of America. All references to “Pesos” and “P” are to the lawful currency of the Philippines, and all references to “U.S. dollars” and “US\$” are to the lawful currency of the United States.

BASIS FOR CERTAIN MARKET DATA

Market data and certain industry forecasts and other data used throughout this Offering Circular were obtained or derived from internal surveys, market research, governmental data, publicly available information and/or industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but the accuracy and completeness of such information are not guaranteed and have not been independently verified by SMC, the Selling Shareholder or the Bookrunners. Similarly, internal surveys, industry forecasts and market research, while believed to be reliable, have not been independently verified, and none of SMC, the Selling Shareholder and the Bookrunners make any representation or warranty, express or implied, as to the accuracy or completeness of such information. In addition, such information may not be consistent with other information compiled within or outside the Philippines.

PRESENTATION

SMC's consolidated financial statements are reported in Pesos and are prepared based on its accounting policies, which are in accordance with the Philippine Financial Reporting Standards ("PFRS") issued by the Financial Reporting Standards Council of the Philippines. PFRS include statements named PFRS and Philippine Accounting Standards, and Philippine Interpretations from International Financial Reporting Interpretations Committee.

Certain Peso amounts have been translated into U.S. dollar amounts, based on the prevailing exchange rate on December 31, 2010 of ₱43.885 = US\$1.00, being the weighted average rate for that date for the purchase of U.S. dollars with Pesos under the Philippine Dealing System (the "PDS") and published in the Reference Exchange Rate Bulletin by the BSP (the "BSP Rate"). Such translations should not be construed as representations that the Peso or U.S. dollar amounts referred to could have been, or could be, converted into Pesos or U.S. dollars, as the case may be, at that or any other rate, or at all. For further information regarding rates of exchange between the Peso and the U.S. dollar, see "Exchange Rates". Figures in this Offering Circular have been subjected to rounding adjustments. Accordingly, figures shown for the same item of information may vary, and figures which are totals may not be an arithmetic aggregate of their components. On April 20, 2011, the BSP Rate was ₱43.366 = US\$1.00.

ENFORCEABILITY OF CIVIL LIABILITIES

Each of SMC and the Selling Shareholder is organized under the laws of the Republic of the Philippines, and a substantial portion of the assets of each of SMC and the Selling Shareholder are located in the Philippines. It may be difficult for investors to effect service of process outside the Philippines upon SMC or the Selling Shareholder, with respect to claims pertaining to the Offer or the Offer Shares. Moreover, it may be difficult for investors to enforce in the Philippines judgments against SMC or the Selling Shareholder obtained outside the Philippines, in any action pertaining to the Offer Shares, particularly with respect to actions for claims to which SMC or the Selling Shareholder has not consented to service of process outside the Philippines. In addition, most of the directors and officers of each of SMC and the Selling Shareholder are residents of the Philippines, and all or a substantial portion of the assets of such persons are or may be located in the Philippines. As a result, it may be difficult for investors to effect service of process upon such persons outside the Philippines or enforce against such persons judgments obtained in courts outside the Philippines.

The Philippines is not a party to any international treaty in relation to the recognition or enforcement of foreign judgments. A judgment obtained against SMC or the Selling Shareholder in any foreign court may be recognized and enforced by the courts of the Philippines in an independent action brought in accordance with the relevant procedures set forth in the Rules of Court of the Philippines to enforce such judgment. However, such foreign judgment or final order may be rejected in the following instances: (i) such judgment was obtained by collusion or fraud, (ii) the foreign court rendering such judgment did not have jurisdiction over the subject matter of the action in accordance with its jurisdictional rules, (iii) such order or judgment is contrary to Philippine laws that have as their object good customs, public order or public policy, (iv) the defendant did not have notice of the proceedings before the foreign court, or (v) such judgment was based upon a clear mistake of law or fact. In addition, Article 17 of the Civil Code of the Philippines provides that the judgment must not be contrary to laws, public order, public policy and good customs in the Philippines. Furthermore, Philippine courts have held that a foreign judgment is presumed to be valid and binding in the country from which it issues, until the contrary is shown, and the party contesting the foreign judgment has the burden of overcoming the presumption of its validity.

FORWARD-LOOKING STATEMENTS

This Offering Circular contains forward-looking statements that are, by their nature, subject to significant risks and uncertainties. These forward-looking statements include, without limitation, statements relating to:

- known and unknown risks;
- uncertainties and other factors which may cause SMC's actual results, performance or achievements to be materially different from any future results; and

- performance or achievements expressed or implied by forward-looking statements.

Such forward-looking statements are based on numerous assumptions regarding SMC's present and future business strategies and the environment in which SMC will operate in the future. Important factors that could cause some or all of the assumptions not to occur or cause actual results, performance or achievements to differ materially from those in the forward-looking statements include, among other things:

- SMC's ability to successfully implement its strategies;
- SMC's ability to anticipate and respond to consumer trends;
- changes in availability and prices of raw materials used in SMC's production processes;
- SMC's ability to successfully manage its growth;
- the condition and changes in the Philippine, Asian or global economies;
- any future political instability in the Philippines;
- changes in interest rates, inflation rates and the value of the Peso against the U.S. dollar and other currencies;
- changes in laws, rules and regulations, including tax laws and licensing requirements, in the Philippines; and
- competition in the industries in which SMC operates in the Philippines and globally.

Additional factors that could cause SMC's actual results, performance or achievements to differ materially from forward-looking statements include, but are not limited to, those disclosed under "Risk Factors" and elsewhere in this Offering Circular. These forward-looking statements speak only as of the date of this Offering Circular. SMC, the Selling Shareholder and the Bookrunners expressly disclaim any obligation or undertaking to release, publicly or otherwise, any updates or revisions to any forward-looking statement contained herein to reflect any change in SMC's expectations with regard thereto or any change in events, conditions, assumptions or circumstances on which any statement is based.

This Offering Circular includes statements regarding SMC's expectations and projections for future operating performance and business prospects. The words "believe", "expect", "anticipate", "estimate", "project", "intend" and similar words identify forward-looking statements. In addition, all statements other than statements of historical facts included in this Offering Circular are forward-looking statements. Statements in the Offering Circular as to the opinions, beliefs and intentions of SMC accurately reflect in all material respects the opinions, beliefs and intentions of its management as to such matters as of the date of this Offering Circular, although SMC gives no assurance that such opinions or beliefs will prove to be correct or that such intentions will not change. This Offering Circular discloses, under the section "Risk Factors" and elsewhere, important factors that could cause actual results to differ materially from SMC's expectations. All subsequent written and oral forward-looking statements attributable to SMC or persons acting on behalf of SMC are expressly qualified in their entirety by the above cautionary statements.

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GLOSSARY OF TERMS

In this Offering Circular, unless the context otherwise requires, the following terms shall have the meanings set forth below.

ASEAN	The Association of Southeast Asian Nations, including Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam
BellTel	Bell Telecommunication Philippines, Inc.
BIR	Bureau of Internal Revenue of the Philippines
Board	Board of directors of SMC
BOC	Bank of Commerce
Bonanza	Bonanza Energy Resources, Inc.
bpd	Barrels per day
BSP	Bangko Sentral ng Pilipinas, the Central Bank of the Philippines
BSP Rate	The weighted average rate for the purchase of U.S. dollars with Pesos, as published by the BSP
Bumi Resources	PT Bumi Resources TBK
CAAP	Civil Aviation Authority of the Philippines
CAGR	Compound annual growth rate
Captive Market	A market of end-users who do not have a choice of their supplier of electricity, as determined by the ERC
CCCS	Central Clearing and Central Settlement
CIIF	Coconut Industry Investment Fund
CIIP	Comprehensive and Integrated Infrastructure Program
CIP	Continuous Improvement Program
CNC	Certificate of Non-Coverage
COCO	Company-owned-company-operated service stations
CODO	Company-owned-dealer-operated service stations
Contestable Market	A market of end-users who have a choice on their supplier of electricity
CPCN	Certificate of Public Convenience and Necessity
DA	Department of Agriculture of the Philippines
Daguma	Daguma Agro-Minerals, Inc.
DENR	Department of Environment and Natural Resources of the Philippines
Distribution Code	The Philippine Distribution Code
DODO	Dealer-owned-dealer-operated service stations
DOE	Department of Energy of the Philippines
DOH	Department of Health of the Philippines, including the FDA

DOLE.....	Department of Labor and Employment of the Philippines
DSO.....	Dairy, spreads and oils
DSOAR.....	Distribution Services and Open Access Rules
DTI.....	Department of Trade and Industry of the Philippines
ECA.....	Energy conversion agreement
ECC.....	Environmental Compliance Certificate
EIS.....	Environmental Impact Statement
EPIRA.....	Philippine Republic Act No. 9136, otherwise known as the Electric Power Industry Reform Act of 2001
ERC.....	Energy Regulatory Commission of the Philippines
ETPI.....	Eastern Telecommunications Philippines, Inc.
FDA.....	Food and Drug Administration of the Philippines
Ginebra.....	Ginebra San Miguel Inc., including, as the context requires, its subsidiaries
Grid Code.....	The Philippine Grid Code
GWh.....	Giga-watt hours
Ilijan ECA.....	NPC's ECA with KILCO pertaining to the Ilijan Power Plant
Ilijan Power Plant.....	Natural gas fired combined cycle power plant with installed capacity of 2 x 600 MW located in Ilijan, Batangas
IMF.....	International Monetary Fund
IMS.....	Integrated Management System
IPP.....	Independent power producer
IPPA.....	Independent power producer administrator
IPPA Agreement.....	Independent power producer administration agreement
ISO.....	International Organization for Standardization
KILCO.....	KEPCO Ilijan Corporation
Kirin.....	Kirin Holding Company, Limited
Liberty.....	Liberty Telecoms Holdings, Inc. including, as the context requires, its subsidiaries
Limay Power Plant.....	620 MW combined cycle power plant located in Limay, Bataan
LPG.....	Liquefied petroleum gas
LSFO.....	Low sulfur fuel oil
Magnolia.....	Magnolia Inc.
MARINA.....	Maritime Industry Authority of the Philippines
MEQ.....	Minimum energy quantity
Meralco.....	Manila Electric Company
Monetary Board.....	The Monetary Board of the BSP

MRT-7	Metro Rail Transit Line 7
Must Pay Volume	The monthly generation payments SMCGP “must pay” for electricity sold up to a given volume
MW	megawatt
NEA	National Electrification Administration of the Philippines
Negative List	Eighth Regular Foreign Investment Negative List issued by the Office of the President of the Philippines on February 5, 2010
NMIS	National Meat Inspection Service of the Philippines
Non Delivering Day	Any day that a power plant is unable to produce power for an entire day, for reasons not attributable to SMCGP
NPC	National Power Corporation of the Philippines
NSCB	National Statistical Coordination Board of the Philippines
NSO	National Statistics Office of the Republic of the Philippines
NTC	National Telecommunications Commission of the Philippines
NVRC	New Ventures Realty Corporation
NYG	Nihon Yamamura Glass Co. Ltd.
Open Access	System of allowing qualified persons to use the transmission and/or distribution systems and associated facilities of distribution utilities subject to the payment of transmission and/or distribution wheeling rates approved by the ERC
Packaging Group	SMYPC, SMYPIL and its subsidiaries, SMYAC and Mincorr
PAHL	Petrochemical Asia (Hong Kong) Ltd
Panasia	Panasia Energy Holdings Inc.
PBR	Performance-based regulation
PCGG	Philippine Presidential Commission on Good Government
PDS	Philippine Dealing System
PDTC	Philippine Depository & Trust Corporation
PEMC	Philippine Electricity Market Corporation
Peso or ₱	Philippine Peso, the lawful currency of the Republic of the Philippines
PET	Polyethylene terephthalate
Petron	Petron Corporation
PFRS	Philippine Financial Reporting Standards
PhilHealth	Philippine Health Insurance Corporation
Philippine SEC	The Philippine Securities and Exchange Commission
PIDC	Private Infra Dev Corporation
PIP	Profit Improvement Program
PMC	Petron Marketing Corporation

PNOC.....	Philippine National Oil Company
PPA	Power purchase agreement
PPP	Public-Private Partnership
PSALM	Power Sector Assets and Liabilities Management Corporation
PSC	Power supply contract
PSCL	Power Smart Capital Limited
PSE	The Philippine Stock Exchange, Inc.
Q-Tech	Q-Tech Alliance Holdings Inc.
RAM	Reliability, Availability and Maintenance program
RMP-2	Phase 2 of the Refinery Master Plan of Petron
San Roque Power Plant	Hydroelectric multipurpose power plant with installed capacity of 345 MW located in San Manuel, Pangasinan
San Roque PPA.....	NPC's PPA with SRPC pertaining to the San Roque Power Plant
Saudi Aramco	Saudi Arabian Oil Company
SCCP	The Securities Clearing Corporation of the Philippines
SEPC	Sultan Energy Phils. Corp.
SMB.....	San Miguel Brewery Inc. including, as the context requires, its subsidiaries
SMBIL	San Miguel Brewing International Ltd.
SMC or the Company	San Miguel Corporation including, as the context requires, its subsidiaries
SMCGP	SMC Global Power Holdings Corp. including, as the context requires, its subsidiaries
SMEC.....	San Miguel Energy Corporation
SMPFC.....	San Miguel Pure Foods Company Inc., including, as the context requires, its subsidiaries
SMPI	San Miguel Properties, Inc. including, as the context requires, its subsidiaries
SMYAC	San Miguel Yamamura Asia Corporation
SMYPC	San Miguel Yamamura Packaging Corporation including, as the context requires, its subsidiaries
SPDC	Strategic Power Devt. Corp.
SPPC	South Premiere Power Corp.
SRPC	San Roque Power Corporation
SMC Retirement Fund.....	San Miguel Corporation Retirement Plan
Sual ECA	NPC's ECA with TeaM Energy pertaining to the Sual Power Plant
Sual Power Plant.....	2 x 500 MW Coal-fired power plant located in Sual, Pangasinan

T1 Volume	80% of the statutory rate SMCGP charges Meralco for supplying electrical power under the offtake agreement between SMCGP and Meralco for the given month multiplied by a factor equal to the volume sold
TeaM Energy	Team Sual Corporation
TPLEX	Tarlac — Pangasinan — La Union Expressway
TRB	Toll Regulatory Board of the Philippines
TransCo	National Transmission Corporation
Universal LRT	Universal LRT Corporation (BVI) Limited
U.S. dollar or US\$	The lawful currency of the United States of America
Vega	Vega Telecom, Inc.
WESM	Wholesale Electricity Spot Market

SUMMARY

The following summary is qualified in its entirety by the more detailed information presented in this Offering Circular, including SMC's consolidated financial statements, pro forma financial statements and related notes included elsewhere in this Offering Circular. For a discussion of certain matters that should be considered in evaluating an investment in the Shares, see "Risk Factors". Investors should read this Offering Circular carefully and in its entirety. Capitalized terms not defined in this summary are defined in the "Glossary of Terms" or elsewhere in this Offering Circular.

OVERVIEW

SMC is one of the largest companies in the Philippines in terms of market capitalization and is a highly diversified conglomerate, with revenues equal to approximately 3% of the Philippine gross domestic product in 2010. Originally founded in 1890 as a single brewery in the Philippines, SMC has transformed itself from a market-leading beverages, food and packaging business with a globally recognized beer brand, into a large and diversified conglomerate with additional market-leading businesses and investments in the Philippines' fuel and oil, power, infrastructure, telecommunications, banking and mining industries. As of the date of this Offering Circular, SMC had a portfolio of companies that is interwoven into the economic fabric of the Philippines, benefiting from, as well as contributing to, the development and economic progress of the Philippines.

SMC's Common Shares were listed on the PSE on November 5, 1948, and SMC had a market capitalization of ₱468.97 billion as of December 31, 2010. SMC's sales, gross profit and Adjusted EBITDA were ₱246,109 million, ₱72,203 million and ₱52,536 million, respectively, in 2010. SMC's pro forma sales, gross profit and Adjusted EBITDA, including the results of Petron from January 1, 2010 to December 14, 2010 and the results of SMCGRP from January 1, 2010 to July 31, 2010, were ₱474,609 million, ₱97,515 million and ₱71,646 million, respectively, in 2010.

SMC's Corporate Transformation

Established in 1890 as a single brewery in the Philippines, SMC has become a Philippine market leader in its established businesses in the beverages, food and packaging industries with over 16,800 employees and more than 100 production facilities in the Asia-Pacific region as of December 31, 2010. SMC's extensive portfolio of products has grown to include fuel and oil, power, beer, liquor, non-alcoholic beverages, poultry, animal feeds, flour, meat, dairy products, coffee and various packaging products.

In 2007, in light of the opportunities presented by the global financial crisis, the Philippine government's ongoing program of asset and industry privatizations, and SMC's strong cash position enhanced by recent divestments and the strong cash flow generated by its established businesses, SMC adopted a business diversification program. The program channeled SMC's resources into what it believes were attractive growth sectors, aligned with the development and growth of the Philippine economy. SMC believes this strategy will achieve a more diverse mix of revenue and operating income, better position the company to access capital, present different growth opportunities and mitigate the impact of downturns and business cycles.

SMC's Businesses

SMC is one of the largest and most diverse companies in the Philippines. SMC's new portfolio encompasses the following businesses, which are market leaders in their respective industries:

Beverages — SMC's beverages business consists of brewing, distilling, selling, marketing and distributing beer, liquor and non-alcoholic beverages. SMC sells well recognized beer brands in the Philippines, with a total market share of approximately 94% in terms of volume. Its products include *San Miguel Pale Pilsen*, which is San Miguel Brewery, Inc.'s ("SMB") flagship beer and is sold throughout the world, *San Miguel Super Dry*, *San Mig Light*, *San Mig Strong Ice* and *San Miguel Premium All-Malt*. Other SMC beers include *Cerveza Negra*, *Red Horse*, *Gold Eagle* and *Oktoberfest Brew*. In addition to its Philippine beer operations, SMB has brewery and sales operations in China, Hong

Kong, Thailand, Vietnam and Indonesia and exports to 40 countries. According to Drinks International (UK), SMC is the world's largest gin seller and the world's third largest distilled spirit seller by volume with some of the most recognizable brands in the Philippine liquor market, including *Ginebra San Miguel*, *GSM Blue*, *Vino Kulafu* and *Gran Matador Brandy*. SMC also has a growing non-alcoholic beverages business which produces non-carbonated, ready-to-drink tea and fruit juice products, primarily under the *Magnolia* brand. SMC conducts its beverages business through majority owned subsidiaries: SMB for beer and Ginebra San Miguel Inc. ("Ginebra") for liquor and non-alcoholic beverages.

Food — SMC's food business holds numerous market leading positions in the Philippine food industry, offering a broad range of high-quality food products and services to both household and food service customers. The business is organized into business clusters: Agro-Industrial (poultry, feeds and fresh meats); Value-Added Meats (processed meats); Milling (flour and flour-based products); DSO (dairy products, spreads, oils and ice cream); and food service, retail and miscellaneous businesses. SMC has some of the best known brands in the Philippine food industry, such as *Magnolia*, *Star*, *Dari Crème*, *Purefoods*, *B-Meg Feeds* and *Monterey*. The food business is conducted through SMC's subsidiary San Miguel Pure Foods Company Inc. ("SMPFC").

Packaging — SMC's packaging business has one of the largest packaging operations in the Philippines, producing glass, metal, plastic, aluminum cans, paper, flexibles, PET and other packaging products. SMC's packaging business is the major source for packaging products for SMC's other businesses. Over the last five years, external sales have grown. SMC's packaging business supplies its products to major multinational corporations in the Philippines and customers across the Asia-Pacific region, the United States, Africa, Australia and the Middle East. The packaging business is conducted through San Miguel Yamamura Packaging Corporation ("SMYPC"), San Miguel Yamamura Packaging International Limited ("SMYPIL") and its subsidiaries, San Miguel Yamamura Asia Corporation ("SMYAC") and Mindanao Corrugated Fibreboard Inc. ("Mincorr"). SMYPC and SMYPIL are joint venture companies in which SMC holds a 65% equity interest, while SMC holds a 60% equity interest in SMYAC. Mincorr is a wholly-owned subsidiary of SMC.

Fuel and Oil — SMC operates its fuel and oil business through Petron Corporation ("Petron") in which SMC holds a 68.3% equity interest. Petron is the largest integrated oil refining and marketing company in the Philippines, supplying more than a third of the country's refined oil requirements and is the largest liquefied petroleum gas ("LPG") distributor, with a 33.3% market share in the six months ended June 30, 2010, according to the Department of Energy of the Philippines (the "DOE"). Petron's core business involves the refining of crude oil and the marketing and distribution of refined petroleum products, mainly for the Philippine market. Petron possesses the most extensive oil distribution infrastructure in the country with more than 30 depots and terminals and over 1,700 service stations in the Philippines. Petron also exports various petroleum products and petrochemical feedstock, including high sulfur fuel oil, naphtha, mixed xylene, benzene, toluene and propylene, to customers in the Asia-Pacific region.

Power — SMC's power business is a leader in the Philippine power generation industry in terms of installed capacity. SMC administers three power plants, namely, the Sual Power Plant (coal), the Ilijan Power Plant (natural gas) and the San Roque Power Plant (hydroelectric), with a combined capacity of 2,545 MWs, pursuant to independent power producer administration agreements ("IPPA Agreements") with Power Sector Assets and Liabilities Management Corporation ("PSALM") and NPC. SMC also owns and operates a fourth power plant, the Limay Power Plant (diesel oil), with a capacity of 620 MW. As of December 31, 2010, SMC was one of the largest electricity suppliers in the Philippines and held a 29.2% market share of the total installed power generation capacity for the Luzon power grid and a 21.7% market share of the national grid. SMC also owns a 33.2% equity interest in Manila Electric Company ("Meralco"), the biggest power distributor and private sector utility in the Philippines, which accounted for almost half of all electricity sales in the Philippines in 2010. SMC's power business is conducted through its wholly-owned subsidiary SMC Global Power Holdings Corp. ("SMCGP").

Infrastructure — SMC's infrastructure business consists of investments in companies which hold long-term concessions in the Philippines' infrastructure industry. Current projects include an 88.58 km two-lane expressway from Tarlac, through Pangasinan to La Union ("TPLEX"), Caticlan Airport and Manila's MRT-7 rail and road project. SMC operates with partners in its investments in most of these infrastructure concessions.

Other Operations and Investments — SMC's other operations and investments business consist principally of interests and investments in coal mining, telecommunications, banking and property development.

The following table sets forth the contribution of each of SMC's businesses to its revenues for the periods indicated and the pro forma contribution of each of SMC's business, assuming in each case the business had been held for all of 2010:

	2008		2009		2010		2010 Pro Forma	
	Revenues	%	Revenues	%	Revenues	%	Revenues	%
	(In millions)		(In millions)		(In millions)		(In millions)	
Beverages	₱ 78,599	46.8%	₱ 82,735	47.5%	₱ 90,407	36.7%	₱ 90,407	19.0%
Food	73,830	43.9	77,220	44.3	80,415	32.7	80,415	16.9
Power	—	—	—	—	45,636	18.5	65,937	13.9
Packaging	15,612	9.3	14,258	8.2	19,268	7.8	19,268	4.1
Fuel and Oil	—	—	—	—	10,383	4.2	218,582	46.1
Infrastructure	—	—	—	—	—	—	—	—
Other Operations and Investments	—	—	—	—	—	—	—	—
Total	<u>₱168,041</u>	<u>100.0%</u>	<u>₱174,213</u>	<u>100.0%</u>	<u>₱246,109</u>	<u>100.0%</u>	<u>₱474,609</u>	<u>100.0%</u>

Strengths

In addition to having market leading positions in key industries in the Philippines as discussed above, SMC believes that its principal strengths include the following:

- *Broad exposure to the growing Philippine economy.*

The Philippines is the fifth largest economy in Southeast Asia in terms of GDP as of 2009, with an average real GDP growth of 4.9% over the last five years. According to the World Bank, real GDP growth is expected to continue over the next two years at a rate of 4.5% per annum. In addition, the Philippine population is young, comparably literate and growing, which provides the Philippine economy with favorable demographics for further growth.

As one of the Philippines' largest companies in terms of market capitalization and a highly diversified conglomerate, with revenues equal to approximately 3% of the Philippine GDP in 2010, SMC is broadly exposed to the Philippine economy through its diverse range of businesses spanning the beverages, food, packaging, fuel and oil, power, infrastructure, telecommunications, property, mining, banking and other industries. SMC's recent acquisitions in the fuel and oil, power, infrastructure and telecommunications industries align it to key sectors that it believes will benefit from the forecast growth of the Philippine economy.

- *Operating businesses provide sustainable stream of income and cash flows.*

SMC's beverages, food and packaging businesses provide SMC with a sustainable stream of income and cash flows. These businesses demonstrated resilience during the global financial crisis in 2008 and provided SMC with a strong financial base from which to pursue its recent diversification strategy.

In 2008, these established businesses generated ₱19.9 billion of Adjusted EBITDA and ₱7.2 billion of net income and had ₱6.4 billion of capital expenditures. In 2009, they generated ₱30.0 billion of

Adjusted EBITDA and ₱8.5 billion of net income with ₱6.2 billion of capital expenditures. In 2010, they generated ₱34.6 billion of Adjusted EBITDA and ₱9.3 billion of net income and had ₱4.3 billion of capital expenditures. Many of SMC's operating businesses have demonstrated their ability to fund their operations with internally generated operating cash flows.

Some of SMC's newly acquired businesses, such as Petron and the power business, are cash flow positive and are accretive to the revenues and Adjusted EBITDA of SMC. Assuming Petron and the power business were consolidated from January 1, 2010, SMC had pro forma sales and Adjusted EBITDA of ₱474.6 billion and ₱71.6 billion, respectively.

- *Platform for significant future growth.*

SMC is well-positioned for significant future growth. In particular, SMC's established businesses in beverages, food and packaging provide for stable growth annually, while its new businesses are expected to contribute further to this growth.

- *Beverages:* SMC's beverages business is well-positioned to benefit from increasing affluence and population growth in the Philippines. SMC believes there are significant opportunities in the premium beer market as the Philippine population becomes more affluent. In addition, SMC's international beer business is experiencing increased sales through increasing brand recognition in selected overseas markets such as Indonesia, Thailand, Singapore and Hong Kong.
- *Food:* SMC aims to become the lowest cost producer by securing a stable raw material supply and developing alternative raw materials. SMC also plans to streamline its operations to improve profitability of its established business segments, such as poultry, feeds, meat and flour, maximize synergies across operations, and improve margins through outsourcing non-core activities.
- *Packaging:* SMC's packaging business aims to benefit from trade liberalization and globalization in the Asian region and increase its exports to new markets. Furthermore, rising environmental awareness provides opportunities for the production of more environmentally friendly products such as heavy metal-free paint glass and recycled PET resin. SMC plans to improve margins by developing alternative sources of raw materials and optimizing recycling efforts to lower its material costs.
- *Fuel and oil:* The Philippines is a net importer of refined petroleum products and is expected to remain dependent on imports. SMC believes that the less urbanized areas in the Philippines are underserved, and that there are significant growth opportunities in a growing domestic economy. Petron's focus on the Philippine market and its leading position as the largest refinery operator by sales volume with the largest number of service stations present good growth opportunities. SMC plans to continue its service station network expansion and seek growth in complementary non-fuel businesses. SMC also plans to increase the production of higher margin products. Petron is currently embarking on Phase 2 of its refinery master plan ("RMP-2"), which includes further enhancements to the refinery's operational efficiencies, an increase in conversion capability and the minimizing of the production of lower value fuel oils.
- *Power:* SMC is planning to double its power generating capacity over the next five years, and believes its power business will benefit from both growing demand for electricity in the Philippines, which is forecast to exceed the growth rates of the Philippine GDP, and a shortage in electricity supply, with the industry constrained by aging power generation assets and minimal new capacity. Furthermore, if spot electricity rates move higher as a result of increased demand, SMC's margins are expected to increase.
- *Infrastructure:* SMC believes there are significant opportunities in building or purchasing infrastructure assets in a growing economy that has historically under-invested in its infrastructure. In addition, SMC believes its operating licenses will provide strong and stable long-term income streams, as well as serve as a barrier to entry to new entrants to the business.

- *Telecommunications:* SMC believes its recent acquisitions in the telecommunications industry provide it with exposure to an industry that is expecting high growth as the Philippine population becomes more affluent and spends more on higher margin services. Moreover, companies recently acquired by SMC have a wide bandwidth of spectrum that would enable SMC to be competitive in both current (2G/3G) and future technologies.
- *Potential to extract synergies across businesses.*

SMC believes there are significant opportunities to develop and increase synergies across many of its businesses, including:

- *Ancillary business opportunities:* SMC believes it has opportunities within its existing businesses to secure new growth opportunities along the routes of its infrastructure projects by using the relevant land area to conduct business and activities. Potential initiatives of this type include installing SMC-related billboards and advertisements, as well as building service stations, retail outlets, rest stops and kiosks along toll roads.
- *Effective distribution channel:* SMC's extensive retail distribution network provides an effective platform for roll-out of new products and services. For example, Petron's network of over 1,700 service stations provides an effective distribution channel for retail sales for SMC products.
- *Economies of scale:* SMC believes the size and scale of its distribution network operations will provide significant economies of scale and synergies in production, research and development, distribution, management and marketing. SMC's size and scale should also result in substantial leverage and bargaining power with suppliers and retailers.
- *Integration:* SMC plans to continue pursuing vertical integration across its established and strategic businesses, such as supplying the fuel and oil and power requirements of its businesses internally.
- *Strong and experienced management team with an in-depth understanding of the Philippines.*

SMC has an extensive pool of experienced managers, and many senior managers have been with SMC for more than 20 years. In particular, the management team has a deep understanding and extensive knowledge of the Philippine operating environment and has managed SMC through periods of crisis and instability in the Philippines. The management team has recently successfully directed SMC's diversification strategy, including retaining key management personnel from acquired companies, such as Petron, in order to retain their expertise and leverage their industry experience.

Business Strategies

SMC's principal strategies include the following:

- *Enhance value of established businesses.* SMC aims to enhance the value of its established businesses through pursuing operational excellence, brand enhancement, improving product visibility, targeting regions where SMC has lower market share, implementing pricing strategies and pursuing efficiencies.
- *Continue to diversify into industries that underpin the development and growth of the Philippine economy.* In addition to organic growth, SMC intends to continue seeking strategic acquisition and greenfield opportunities to position itself for the economic growth and industrial development of the Philippines.
- *Identify and pursue synergies across businesses through vertical integration, platform matching and channel management.* SMC is pursuing plans to further expand and integrate its production and distribution facilities for its established and newly acquired businesses to enable additional cost savings and efficiencies.
- *Invest in and develop businesses with market leading positions.* SMC intends to further enhance its market position in the Philippines by leveraging its financial resources and experience to continue introducing new products and services, including constructing new power plants and expanding its

power generation portfolio, building additional service and micro-filling stations and expanding food distribution networks. SMC believes its strong domestic market position provides an effective platform to develop markets for its expanding product portfolio.

- *Adopt world-leading practices and jointly develop businesses.* SMC has strategic partnerships with global industry leaders, including Kirin Holdings Company, Limited (“Kirin”) in the beverages business and Nihon Yamamura Glass Co. Ltd. (“NYG”) in the packaging business. These partnerships provide marketing and expansion opportunities, and they also potentially provide liquidity and opportunities for SMC to divest minority stakes in its businesses as other opportunities arise. SMC intends to develop additional strategic partnerships.

RECENT DEVELOPMENTS

On January 13, 2011, SMPI agreed to acquire a 7.2% equity interest in Bank of Commerce (“BOC”). Upon completion of the acquisition, SMC will hold a 39.9% equity interest in BOC.

On January 25, 2011, SMCGP completed a US\$300 million bond offering. The 5-year bonds have an interest rate of 7% per annum. The proceeds from the bond offering will be applied towards: (i) financing investments in power-related assets; (ii) financing payment or, subject to negotiations with PSALM, prepayment of SMCGP’s payment obligations to PSALM under its IPPA Agreements; and/or (iii) general corporate purposes.

On February 2, 2011, Petron acquired a 35% equity interest in Manila North Harbour Port Inc., which holds a 25-year concession from the Philippine Ports Authority to operate the Manila North Harbour, Philippines’ busiest domestic cargo port in terms of volume. SMC plans to use the facilities to establish fuel tanks to serve Petron’s requirements, as well as grain terminals and bulk cement silos for the needs of other SMC entities.

On February 21, 2011, SMC confirmed that San Miguel Electric Corp. would, together with the other power generation subsidiaries of the Company, engage in the business of producing electricity and processing alternative fuels for power generation.

On March 3, 2011, SMPFC raised ₱15 billion in a public offering of 15 million preferred shares on the PSE for ₱1,000.00 per share. SMPFC’s intended use of proceeds from the offering include (i) repayment of a payable to SMC in the amount of ₱3.6 billion relating to SMPFC’s acquisition from SMC of food-related brands and intellectual property rights as well as SMC’s food business in Vietnam; (ii) investment in opportunities and areas that the board of SMPFC may identify; and (iii) general corporate purposes.

On March 16, 2011, the Selling Shareholder exercised its option to purchase from Q-Tech Alliance Holdings, Inc. (“Q-Tech”) a 12.9% equity interest in SMC held by Q-Tech, which increased the Selling Shareholder’s equity interest in SMC to 67.2%.

On March 31, 2011, SMCGP signed a US\$200 million 3-year term loan with a syndicate of banks. SMCGP’s intended use of proceeds from the loan include: (i) financing payment or, subject to negotiations with PSALM, prepayment of SMCGP’s payment obligations to PSALM under its IPPA Agreements; (ii) financing additional capital expenditures to support expansion of existing power generation assets; and/or (iii) financing new investment in power-related assets.

SUMMARY OF THE OFFERING

Offer	A total offering of 110,320,000 Offer Shares, consisting of 27,580,000 Common Shares from the treasury stock of SMC to be offered by SMC and 82,740,000 Common Shares to be offered by the Selling Shareholder.
Offer Price	₱110 per Offer Share.
International Offer	78,800,000 of the Offer Shares (the “International Offer Shares”) are being offered only outside the United States to non-U.S. persons in compliance with Regulation S under the Securities Act.
Domestic Offer	31,520,000 of the Offer Shares (the “Domestic Offer Shares”) are being offered in the Philippines. SMC is giving applicants who are both (i) holders of Common Shares as of the date of this Offering Circular and (ii) resident in the Philippines (as reflected on the share register of SMC) priority in the distribution and sale of the Domestic Offer Shares so that applications from such applicants will be allocated in full in preference to other applications (the “Domestic Shareholder Allocation”). In case of over-subscription of the Domestic Offer, the number of Domestic Offer Shares to be sold to applicants entitled to the benefit of the Domestic Shareholder Allocation will be reduced <i>pro rata</i> in proportion to the respective shareholdings of such applicants as of the date of this Offering Circular, with such reductions made in the sole discretion of SMC. Only stock transactions up to April 12, 2011, which was the last trading day prior to the voluntary suspension of trading in the Common Shares on the PSE, will be reflected in the stock and transfer book of the Company.
Domestic Option	The Selling Shareholder has granted the Domestic Joint Bookrunners an option to sell up to 27,580,000 additional Offer Shares (the “Additional Domestic Offer Shares”) in the event that demand in the Domestic Offer exceeds the number of Domestic Offer Shares.
Closing Date	The Offer Shares are expected to be ready for delivery in book-entry form through the Philippine Depository & Trust Corporation against payment on or about May 5, 2011.
Reallocation	The Offer Shares are subject to reallocation between the International Offer and the Domestic Offer. In the event of an under-application in the International Offer and an over-application in the Domestic Offer, Offer Shares may (upon the agreement of the Domestic Joint Bookrunners and International Joint Bookrunners) be reallocated from the International Offer to the Domestic Offer. In the event of an under-application in the Domestic Offer and an over-application in the International Offer, Offer Shares may (upon the agreement of the International Joint Bookrunners and Domestic Joint Bookrunners) be reallocated from the Domestic Offer to the International Offer. There will not be a reallocation in the event of an over-application in both the International Offer and the Domestic Offer.
Over-Allotment Option	SMC has granted the International Joint Bookrunners an option, exercisable in whole or in part, to procure purchasers for or

purchase up to 7,880,000 additional Common Shares from the treasury stock of SMC (being 10.0% of the total number of International Offer Shares) at the Offer Price, on the same terms and conditions as the sale of the Offer Shares in the International Offer, solely to cover over-allotments, if any. The Over-Allotment Option is exercisable within 30 days from the date of allotment of Offer Shares in the International Offer.

Stabilization	In connection with the Offer, the Stabilizing Agent or any person acting on its behalf may over-allot Offer Shares or effect transactions with a view to supporting the market price of the Offer Shares at a level higher than that which might otherwise prevail for a limited period after the Closing Date. However, there is no assurance that the Stabilizing Agent (or any person acting on behalf of the Stabilizing Agent) will undertake stabilization activities. Any stabilization activities may begin on or after the date on which adequate public disclosure of the final price of the Offer Shares is made and, if begun, may be ended at any time, but must end no later than 30 calendar days after the date of allotment of the Offer Shares. Any stabilization activities shall be done in compliance with all applicable laws, rules and regulations. The total number of Offer Shares which the Stabilizing Agent or any agent of it may buy to undertake any stabilizing activities shall not exceed 15.0% of the aggregate number of the Offer Shares. The stabilization arrangements were approved by the Philippine SEC on April 19, 2011.
Transfer Restrictions	The International Offer Shares are being offered only outside the United States to non-U.S. persons in compliance with Regulation S under the Securities Act. The Offer Shares have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the benefit of, U.S. persons.
Use of Proceeds	See “Use of Proceeds”.
Brokerage Fee and Transaction Fees ...	The Offer Price does not include any brokerage fees, transaction fees, taxes or other expenses that investors must pay to their brokers, Philippine or other relevant tax authorities or any other persons.
Concurrent Offer	Concurrently with the pricing of the Offer, SMC has priced a separate offer of US\$600,000,000 2.0% Exchangeable Bonds due 2014. The exchangeable bonds will be exchangeable for Common Shares from the treasury stock of SMC. The initial exchange price for the exchange of the exchangeable bonds into Common Shares is ₱137.50.
Lock-up	SMC has agreed with the International Joint Bookrunners that, except in connection with: (i) the sale of the Offer Shares as contemplated by this Offering Circular; (ii) the sale of up to US\$600 million aggregate principal amount of exchangeable bonds in the Concurrent Offer and the delivery of Common Shares upon exchange of the exchangeable bonds; and (iii) any issuance, offer, sale, contract to sell, pledge or other disposal pursuant to existing management incentive programs, neither SMC nor any of its

affiliates over which SMC exercises management or voting control will, for a period of 180 days from the Closing Date, without the prior written consent of the International Joint Bookrunners, issue, offer, sell, contract to sell, pledge or otherwise dispose of (or publicly announce any such issuance, offer, sale or disposal of) any Common Shares or any shares of SMC or securities convertible or exchangeable into or exercisable for shares of SMC or warrants or other rights to purchase shares of SMC or any security or financial product whose value is determined directly or indirectly by reference to the price of the Common Shares, including equity swaps, forward sales and options.

The Selling Shareholder has agreed with the International Joint Bookrunners that, except in connection with the sale of the Offer Shares as contemplated by this Offering Circular, neither the Selling Shareholder nor any of its affiliates over which the Selling Shareholder exercises management or voting control will, for a period of 180 days from the Closing Date, without the prior written consent of the International Joint Bookrunners, issue, offer, sell, contract to sell, pledge or otherwise dispose of (or publicly announce any such issuance, offer, sale or disposal of) any Common Shares or any shares of SMC or securities convertible or exchangeable into or exercisable for shares of SMC or warrants or other rights to purchase shares of SMC or any security or financial product whose value is determined directly or indirectly by reference to the price of the Common Shares, including equity swaps, forward sales and options.

Dividend Policy	Dividends on Common Shares may be declared at the discretion of the board of directors of SMC (the “Board”) and will depend upon SMC’s future results of operations and general financial condition, capital requirements, ability to receive dividends and other distributions and payments from its subsidiaries, foreign exchange rates, legal, regulatory and contractual restrictions, loan obligations, and other factors the Board may deem relevant.
Registration of Foreign Investments	Bangko Sentral ng Pilipinas (the “BSP”) requires that investments in shares of stock funded by an inward remittance of foreign currency be registered with the BSP if the foreign exchange needed to service capital repatriation or dividend remittance will be sourced from the Philippine banking system. The registration with the BSP of all foreign investments in the Offer Shares will be the responsibility of the foreign investor.
Listing and Trading	The Offer Shares are listed and traded on the PSE under the symbol “SMC”.
Tax Considerations	See “Philippine Taxation”.
Risk Factors	Prospective investors should carefully consider the risks connected with an investment in the Offer Shares, some of which are discussed in “Risk Factors”.

SUMMARY FINANCIAL AND OPERATING INFORMATION

SMC's summary financial and operating information presented below as of and for the years ended December 31, 2008, 2009 and 2010 are derived from SMC's consolidated financial statements, audited by Manabat Sanagustin & Co., CPAs, and prepared in compliance with PFRS. The information below should be read in conjunction with SMC's consolidated financial statements and related notes included elsewhere in this Offering Circular and also the section "Management's Discussion and Analysis of Financial Condition and Results of Operations". SMC's historical financial condition, results of operations and cash flows are no guarantee of its future operating and financial performance.

SMC's consolidated financial statements are reported in Pesos and are presented in accordance with PFRS. All conversions of amounts in Pesos into U.S. dollars are provided for convenience only.

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
CONSOLIDATED STATEMENT OF INCOME DATA				
Sales	₱168,041	₱174,213	₱ 246,109	US\$ 5,608
Cost of sales	<u>124,072</u>	<u>124,295</u>	<u>173,906</u>	<u>3,963</u>
Gross profit	43,969	49,918	72,203	1,645
Selling and administrative expenses	(29,151)	(30,249)	(37,426)	(853)
Interest expense and other financing charges	(6,032)	(7,926)	(16,578)	(378)
Interest income	6,630	5,989	3,023	69
Equity in net earnings (losses) of associates	(1,132)	2,816	6,817	155
Gain on sale of investments and property and equipment	8,746	50,630	529	12
Other income (charges) — net	<u>(2,262)</u>	<u>(6,843)</u>	<u>6,926</u>	<u>158</u>
Income before income tax from continuing operations . . .	₱ 20,768	₱ 64,335	₱ 35,494	US\$ 809
Income tax expense	<u>(6,098)</u>	<u>(3,706)</u>	<u>(11,438)</u>	<u>(261)</u>
Income from continuing operations	14,670	60,629	24,056	548
Income after income tax from discontinued operations . . .	<u>5,413</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	<u>₱ 20,083</u>	<u>₱ 60,629</u>	<u>₱ 24,056</u>	<u>US\$ 548</u>
Attributable to:				
Equity holders of SMC	₱ 19,348	₱ 57,799	₱ 20,091	US\$ 458
Non-controlling interests	<u>735</u>	<u>2,830</u>	<u>3,965</u>	<u>90</u>
	<u>₱ 20,083</u>	<u>₱ 60,629</u>	<u>₱ 24,056</u>	<u>US\$ 548</u>
CONSOLIDATED STATEMENT OF FINANCIAL POSITION DATA				
ASSETS				
Current Assets				
Cash and cash equivalents	₱116,939	₱209,411	₱ 125,188	US\$ 2,853
Trade and other receivables — net	50,814	49,082	75,904	1,730
Inventories	25,836	25,458	57,442	1,309
Current portion of biological assets — net	2,932	2,525	3,267	74
Prepaid expenses and other current assets	<u>7,742</u>	<u>8,891</u>	<u>16,914</u>	<u>385</u>
	204,263	295,367	278,715	6,351
Assets held for sale	<u>—</u>	<u>2,746</u>	<u>823</u>	<u>19</u>
Total Current Assets	<u>204,263</u>	<u>298,113</u>	<u>279,538</u>	<u>6,370</u>

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Noncurrent Assets				
Investments and advances — net	₱ 32,253	₱ 39,005	₱ 152,814	US\$ 3,482
Available-for-sale financial assets	—	351	3,597	82
Property, plant and equipment — net	68,313	65,919	308,073	7,020
Investment properties — net	1,838	1,867	2,133	49
Biological assets — net of current portion	1,814	1,847	1,479	34
Goodwill — net	5,201	6,408	30,251	689
Other intangible assets — net	3,812	3,630	10,980	250
Deferred tax assets	7,638	8,883	7,134	163
Other noncurrent assets — net	14,241	12,468	33,801	770
Total Noncurrent Assets	<u>135,110</u>	<u>140,378</u>	<u>550,262</u>	<u>12,539</u>
Total Assets	<u>₱339,373</u>	<u>₱438,491</u>	<u>₱ 829,800</u>	<u>US\$18,909</u>
LIABILITIES AND EQUITY				
Current Liabilities				
Drafts and loans payable	₱ 48,560	₱ 56,789	₱ 74,128	US\$ 1,689
Accounts payable and accrued expenses	23,292	31,391	69,774	1,590
Finance lease liabilities — current portion	—	13	10,946	249
Income and other taxes payable	4,429	4,186	10,001	228
Dividends payable	1,563	573	826	19
Current maturities of long-term debt — net of debt issue costs	9,044	1,077	12,549	286
Total Current Liabilities	<u>86,888</u>	<u>94,029</u>	<u>178,224</u>	<u>4,061</u>
Noncurrent Liabilities				
Long-term debt — net of current maturities and debt issue costs	₱ 40,719	₱ 71,885	₱ 156,378	US\$ 3,563
Deferred tax liabilities	17,851	12,037	13,752	313
Finance lease liabilities — net of current portion	—	17	197,461	4,500
Other noncurrent liabilities	25,691	19,585	17,160	391
Total Noncurrent Liabilities	<u>84,261</u>	<u>103,524</u>	<u>384,751</u>	<u>8,767</u>
Equity				
Equity Attributable to Equity Holders of SMC				
Capital stock — common	₱ 16,112	₱ 16,150	₱ 16,343	US\$ 372
Capital stock — preferred	—	4,852	4,852	111
Additional paid-in-capital	31,183	99,085	101,406	2,311
Revaluation increment	18	18	1,391	32
Cumulative translation adjustments	4,837	5,845	5,365	122
Retained earnings:				
Appropriated	5,522	5,497	5,671	129
Unappropriated	96,298	151,911	150,544	3,430
Treasury Stock	(4,053)	(69,541)	(69,541)	(1,585)
Total Equity Attributable to Equity Holders of SMC	<u>149,917</u>	<u>213,817</u>	<u>216,031</u>	<u>4,923</u>

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Non-controlling Interests	18,307	27,121	50,794	1,157
Total Equity	168,224	240,938	266,825	6,080
	<u>₱339,373</u>	<u>₱438,491</u>	<u>₱ 829,800</u>	<u>US\$18,909</u>

SUMMARY CONSOLIDATED STATEMENT OF CASH FLOWS

Net cash flows provided by operating activities	₱ 7,049	₱ 13,368	₱ 45,314	US\$ 1,033
Net cash flows provided by (used in) investing activities . .	31,898	49,155	(126,931)	(2,892)
Net cash flows provided by (used in) financing activities	(13,865)	32,550	(2,226)	(51)
Effect of exchange rate changes on cash and cash equivalents	(1,424)	(2,601)	(380)	(9)
Net increase (decrease) in cash and cash equivalents	23,658	92,472	(84,223)	(1,919)
Cash and cash equivalents at beginning of year	93,281	116,939	209,411	4,772
Cash and cash equivalents at end of year	<u>₱116,939</u>	<u>₱209,411</u>	<u>₱ 125,188</u>	<u>US\$ 2,853</u>

OTHER FINANCIAL DATA

Calculation of Adjusted EBIT and Adjusted EBITDA⁽¹⁾

	Years Ended December 31			
	2008	2009	2010	2010
	(in millions)			
Net income	₱20,083	₱ 60,629	₱24,056	US\$548
Add (deduct)				
Income tax expense	9,012	3,706	11,438	261
Net financing charges				
Interest Expense	6,032	7,926	16,578	378
Interest Income	(6,630)	(5,989)	(3,023)	(69)
Gain on sale of Investments	(7,477)	(50,831)	—	—
Other charges (income)	321	—	(4,490)	(102)
Foreign exchange losses (gains)	(8,684)	3,364	(6,097)	(139)
Marked-to-market losses (gains)	8,836	(399)	(122)	(3)
Adjusted EBIT	<u>₱21,493</u>	<u>₱ 18,406</u>	<u>₱38,340</u>	<u>US\$874</u>
Depreciation and amortization and impairment	6,767	11,607	14,196	324
Adjusted EBITDA	<u>₱28,260</u>	<u>₱ 30,013</u>	<u>₱52,536</u>	<u>US\$1,197</u>

⁽¹⁾ Adjusted EBIT and Adjusted EBITDA are measures used by SMC's management to internally evaluate the performance of its businesses. Adjusted EBIT is calculated as net income plus the following: income tax expense, net financing charges (interest income net of interest expense), gain on sale of investments, other income (charges), foreign exchange losses (gains) and marked-to-market losses (gains). Adjusted EBITDA is calculated as Adjusted EBIT plus depreciation and amortization and impairment losses. Adjusted EBIT and Adjusted EBITDA are not measures determined in accordance with PFRS, and prospective investors should not consider Adjusted EBIT or Adjusted EBITDA as an alternative to net income as a measure of operating performance or to cash flow as a measure of free cash flow for management's discretionary use, as they do not reflect certain cash requirements such as interest payments, tax payments and capital expenditures. SMC's calculation of Adjusted EBIT and Adjusted EBITDA may be different from the calculations used by other companies, and, as a result, SMC's Adjusted EBIT and Adjusted EBITDA may not be comparable to other similarly titled measures of other companies.

CONSOLIDATED PRO FORMA FINANCIAL INFORMATION

SMC's consolidated pro forma financial information presented below as of and for the year ended December 31, 2010 was prepared by SMC. The information presented below should be read in conjunction with the assumptions set forth below. See "Management's discussion and analysis of financial condition and results of operations" and the consolidated financial information included elsewhere in this Offering Circular for more detailed information regarding the acquisitions underlying the financial information presented below.

For the Year Ended December 31, 2010					
	Actual	SRC and Petron from January 1 to December 14, 2010	SMCGP from January 1 to July 31, 2010	Other Pro forma adjustments	Pro forma Combined
	(In millions, except per share data)				
Sales	P246,109	P208,199 ⁽¹⁾	P20,301 ⁽²⁾	—	P474,609
Cost of sales	<u>173,906</u>	<u>189,612⁽¹⁾</u>	<u>13,576⁽²⁾</u>	<u>—</u>	<u>377,094</u>
Gross profit	72,203	18,587	6,725	—	97,515
Selling and administrative expenses . . .	(37,426)	(6,825) ⁽¹⁾	(114) ⁽²⁾	—	(44,365)
Interest expense and other financing charges	(16,578)	(4,803) ⁽¹⁾	(4,559) ⁽²⁾	846 ⁽³⁾	(25,094)
Interest income	3,023	739 ⁽¹⁾	23 ⁽²⁾	(1,928) ⁽⁴⁾	1,857
Equity in net earnings of associates . . .	6,817	(151) ⁽¹⁾	—	(4,596) ⁽⁵⁾	2,070
Gain on sale of investments and property and equipment	529	(8) ⁽¹⁾	—	—	521
Other income (charges) — net	<u>6,926</u>	<u>1,620⁽¹⁾</u>	<u>7,421⁽²⁾</u>	<u>(3,832)^(6,7)</u>	<u>12,135</u>
Income before income tax	35,494	9,159	9,496	(9,510)	44,639
Income tax expense (benefit)	<u>11,438</u>	<u>2,160⁽¹⁾</u>	<u>(367)⁽²⁾</u>	<u>(132)⁽⁸⁾</u>	<u>13,099</u>
Net income	<u>P 24,056</u>	<u>P 6,999</u>	<u>P 9,863</u>	<u>P (9,378)</u>	<u>P 31,540</u>
Net income attributable to :					
equity holders of SMC	20,091	7,071	9,376	(11,446)	25,092
Non-controlling interests	<u>3,965</u>	<u>(72)⁽¹⁾</u>	<u>487⁽²⁾</u>	<u>2,068^(9,10)</u>	<u>6,448</u>
	<u>P 24,056</u>	<u>P 6,999</u>	<u>P 9,863</u>	<u>P (9,378)</u>	<u>P 31,540</u>
Basic Earnings Per share	<u>P 6.18</u>	<u>P 3.06</u>	<u>P 4.06</u>	<u>P (4.95)</u>	<u>P 8.34</u>
Adjusted EBITDA ⁽¹¹⁾	<u>P 52,536</u>	<u>P 15,037</u>	<u>P14,821</u>	<u>—</u>	<u>P 71,646</u>

⁽¹⁾ Represents the results of Sea Refinery Corporation ("SRC") and Petron from January 1 to December 14, 2010.

⁽²⁾ Represents results of SMCGP and its subsidiaries SMEC and Strategic Power Devt. Corp ("SPDC") from January 1 to July 31, 2010.

⁽³⁾ Represents adjustment in interest expense of SRC assuming that SRC used a portion of the amount advanced by SMC to pay off SRC's loans payable as of January 1, 2010.

⁽⁴⁾ Represents reduction in interest income assuming:

- a. SMC used P50,277 million in cash on January 1, 2010 in connection with the acquisition of SRC and Petron and that such cash would have generated interest totalling P1,807 million, computed at the prevailing market interest rate for the relevant period.
- b. SMC had used P4,320 million in cash on January 1, 2010 in connection with the acquisition of SMCGP and that such cash would have generated interest totalling P121 million, computed at the prevailing market interest rate for the relevant period.

⁽⁵⁾ Adjustments in equity in net earnings of associates:

- a. Represents reversal of SMC's share in net income of Petron for the period commencing June 15 and ending December 15, 2010 totalling P1,599 million, assuming SMC acquired SRC and Petron on January 1, 2010.
- b. Represents reversal of SMC's 40% share in the net income of SMEC and SPDC for the period commencing January 1 and ending September 30, 2010 totalling P3,361 million, assuming SMC acquired 100% equity interests in SMCGP on January 1, 2010.

- c. Represents adjustment in SMCGP's 6.2% share in the net income of Meralco for the period commencing January 1 and ending July 31, 2010 totalling ₱364 million, assuming that the investment in shares of Meralco was classified as investment in associates from January 1, 2010.
- (6) Represents reversal of SMCGP's (i) dividend income of ₱390 million from Meralco and (ii) unrealized fair value gain of ₱5,762 million from its investment in shares of Meralco, assuming that such investment was classified as investment in associates from January 1, 2010.
- (7) Adjustment for acquisition of SMCGP at less than book value, assuming the acquisition occurred on January 1, 2010.
- (8) Assumes adjustments for (i) interest income in connection with the acquisition of SMCGP, SRC and Petron were subject to a Philippine tax rate of 20.0% and (ii) the reversal in interest expense and other financing charges in connection with the acquisition of SRC and Petron were subject to the Philippine statutory income tax rate of 30.0%.
- (9) Represents reversal of Non-controlling Interests (i) for SMC's 40.0% share in the net income of SMEC and SPDC for the period commencing January 1 and ending Sept 30, 2010 totalling ₱487 million and (ii) for the 25.0% share of other shareholders in the net loss of SMCGP for the month of August 2010 totalling ₱49 million, assuming SMC acquired SMCGP on January 1, 2010.
- (10) Represents the net income attributable to the 31.7% interest held by non-controlling interests in Petron for the period commencing January 1 and ending December 14, 2010 totalling ₱2,506, assuming SMC acquired SRC and Petron on January 1, 2010.
- (11) Adjusted EBITDA is a measure used by SMC's management to internally evaluate the performance of its business. Adjusted EBITDA is calculated as net income plus the following: income tax expense, net financing charges (interest income net of interest expense), gain on sale of investments, other income (charges), foreign exchange losses (gains), marked-to-market losses (gains), plus depreciation and amortization and impairment losses. Adjusted EBITDA is not a measure determined in accordance with PFRS, and prospective investors should not consider Adjusted EBITDA as an alternative to net income as a measure of operating performance or to cash flow as a measure of free cash flow for management's discretionary use, as it does not reflect certain cash requirements such as interest payments, tax payments and capital expenditures. SMC's calculation of Adjusted EBITDA may be different from the calculations used by other companies, and, as a result, SMC's Adjusted EBITDA may not be comparable to other similarly titled measures of other companies.

RISK FACTORS

An investment in the Offer Shares involves a number of risks. Prospective investors should carefully consider the risks described below, in addition to other information contained in this Offering Circular, before making any investment decision relating to the Offer Shares.

Risks Relating to SMC

SMC is subject to risks associated with diversifying its traditional businesses and acquiring new businesses, including the failure to successfully integrate acquired businesses into its existing operations.

SMC's traditional businesses comprise primarily beverage, food and packaging products. SMC recently has embarked on a diversification strategy and has expanded into a number of new businesses, including fuel and oil, power, infrastructure, mining, telecommunications, property development and other businesses outside of its traditional businesses. SMC has implemented this strategy through a series of acquisitions and investments and intends to continue to pursue its diversification strategy. SMC intends to make further acquisitions and investments to enhance its product and brand portfolio and realize other strategic and cost benefits.

SMC's diversification strategy involves a number of risks and challenges, including the substantial financial investments required to implement this strategy, diversion of management's time and resources to focus on implementing the strategy and managing a broader scope of businesses and risks inherent in making new acquisitions and investments. Growth through acquisitions involves business risks, including unforeseen contingent risks, latent business liabilities and other challenges that may only become apparent after the acquisition is finalized, such as the successful integration and management of the acquired business by SMC, retention of key personnel, joint sales and marketing efforts, management of a larger business and diversion of management's attention from other ongoing business matters. In addition, there is no assurance that SMC will achieve the anticipated benefits, expected returns, strategic benefits or synergies of an acquisition, or that SMC will be as successful in new businesses as it has been in its traditional businesses. Failure to successfully implement its diversification strategy, to integrate acquired businesses or to realize the anticipated benefits of acquisitions or investments could materially and adversely affect SMC's business, financial condition, results of operations and prospects.

SMC's largest shareholder has significant ability to influence SMC's corporate actions.

Top Frontier is SMC's single largest shareholder and is expected to hold approximately 63% of SMC's Common Shares and to control approximately 84% of the voting rights of the Common Shares immediately after the closing of the Offer, assuming no exercise of the Over-Allotment Option and no exercise of the Domestic Option. In addition, Top Frontier has an option to acquire an additional 21.2% of the Common Shares from other corporate shareholders of SMC on or prior to November 19, 2012. Top Frontier is able to influence SMC's business through its ability to vote on corporate actions that require Board and shareholders' approval. Furthermore, this concentration of voting power may discourage or prevent a change in control or other business combination, which could deprive investors of an opportunity to receive a premium for the Common Shares as part of a sale of SMC. Top Frontier is not obligated to provide SMC with financial support. The interests of Top Frontier may differ from the interests of SMC's other shareholders.

Problems may develop among partners of joint ventures operated by SMC, which may result in disruptions to these businesses.

The businesses of some of SMC's subsidiaries and associates are conducted through joint ventures with other partners, including Kirin for beverages, Hormel Foods Corporation for processed meats, and NYG for packaging. Cooperation among the joint venture partners on business decisions is crucial to the sound operation and financial success of these joint venture companies. Although SMC believes it maintains good relationships with its joint venture partners, there is no assurance that these relationships will be sustained in the future or that problems will not develop. For example, SMC's joint venture partners may be unable or unwilling to fulfill their obligations, take actions contrary to its policies or objectives, or may experience

financial difficulties. If any of these events occur, the businesses of these joint ventures could be severely disrupted, which could have a material adverse effect on SMC's financial condition and results of operations.

SMC depends on its trademarks and proprietary rights to enhance its reputation, and any infringement of or failure to protect such rights could materially and adversely affect its business.

SMC uses various brand names and trademarks, including *San Miguel*, *Ginebra San Miguel*, *Purefoods*, *Magnolia*, *Petron* and other intellectual property rights to prepare, package, advertise, distribute and sell its products for its various businesses. Protection of those brands and intellectual property rights is important to maintaining SMC's distinctive corporate and market identities. If third parties sell products which use counterfeit versions of SMC brands or otherwise look like SMC brands, consumers may confuse SMC products with products that they consider to be inferior. This could negatively impact SMC's brand image and sales, as well as that of its other businesses, particularly the beverage and food businesses. In addition, SMC has been granted numerous trademark registrations covering its brands and products, and has filed, and expects to continue to file, trademark applications seeking to protect newly developed brands and products. There is no assurance that third parties would not challenge, invalidate or circumvent any existing or future trademarks issued to, or licensed by, SMC. Any failure to protect SMC's proprietary rights could severely harm SMC's competitive position, which could materially and adversely affect SMC's business, financial condition, results of operations and prospects, as well as SMC's reputation.

SMC may be unable to attract, train and retain skilled personnel in a competitive job market.

Any loss of key personnel, and an inability on the part of SMC to replace such personnel and to train and retain replacement personnel, could materially and adversely affect SMC's ability to provide products and services to its customers. Continued losses of trained personnel could also result in SMC incurring additional expenses in hiring and training replacement personnel, and it may take time for these new personnel to reach the level of technical skill and expertise of the personnel they are replacing. Any of the foregoing could have a material adverse effect on SMC's business, financial condition and results of operations. In addition, SMC has relied and will continue to rely significantly on the continued individual and collective contributions of its senior management team. If any of SMC's key personnel are unable or unwilling to continue in their present positions, or if they join a competitor or formed a competing business, SMC may not be able to replace them easily, and its business may be significantly disrupted and its business, financial condition, results of operations and prospects could be materially and adversely affected.

SMC's businesses may face labor disruptions that may interfere with its operations.

As of December 31, 2010, approximately 24% of SMC's employees were parties to various collective bargaining agreements between SMC and 39 labour unions within SMC's businesses.

While SMC has not experienced any strikes, work stoppages or other labor disruptions since 1995, SMC's businesses have faced labor disruptions in the past. While SMC considers its labor relations to be good, there is no assurance that it will not experience future labor disruptions to its operations due to disputes or other issues with its employees, which could materially and adversely affect its business, financial condition and results of operations.

Regulatory decisions and changes in the legal and regulatory environment across various industries could increase SMC's operating costs and adversely affect its business, results of operations and financial condition.

SMC's businesses and operations are subject to a number of national and local laws, rules and regulations governing several different industries in the Philippines and other countries where it conducts business.

For instance, although SMC's majority-owned subsidiary, Petron, operates in a deregulated industry, the Philippine government has intervened from time to time to restrict increases in the retail sales prices of petroleum products. On October 2, 2009, former President Gloria Macapagal-Arroyo declared a state of national calamity in view of the devastation caused by typhoons "Ondoy" and "Pepeng". President Arroyo

subsequently issued Executive Order No. 839 mandating that prices of petroleum products in Luzon be kept at October 15, 2009 levels effective October 23, 2009. As a result of the price freeze, Petron was unable to raise prices, which adversely affected its profitability for the period the executive order was in effect. Although Executive Order No. 839 was lifted on November 16, 2009, there is no assurance that the Philippine government will not invoke similar measures or reinstate price regulation in the future with respect to the oil industry.

SMC's power business, which is conducted through its wholly-owned subsidiary SMCGP, is also subject to extensive regulation in the Philippines, including the Electric Power Industry Reform Act of 2001 ("EPIRA"). As of the date of this Offering Circular, several bills relevant to the power industry have been filed with both houses of the Congress of the Philippines. Some of the proposed bills, if enacted, would impose additional costs on SMCGP, including by requiring direct remittances to local government units of financial benefits set aside for host communities and by redefining the term "host communities" to include all areas that protect and maintain the watersheds that supply a particular dam or hydroelectric power generation facility. Several bills proposing amendments to EPIRA have also been filed, some of which would include changes to the ability of power generators and distributors to pass on costs or allowable system losses to end-users. The enactment and implementation of any such bills or amendments to EPIRA, or other changes to Philippine laws and regulations relevant to the power industry, could have a material adverse effect on SMCGP's business, financial condition and results of operations or rules and regulations governing the power industry which could materially reduce revenues and profitability.

SMC's banking business, which is conducted through BOC, is also subject to stringent regulation in the Philippines. As the regulatory and legal framework governing SMC's banking business continues to evolve, SMC's banking business may incur substantial compliance and monitoring costs. Failure by SMC's banking business to comply with such rules and regulations may result in penalties, loss of regulatory permits and damage to business reputation, which could have a material adverse effect on its financial condition and results of operations.

SMC's operations are also subject to various taxes, duties and tariffs. For example, import duties for crude oil and petroleum products for Petron were increased in January 1, 2005 from 3.0% to 5.0% and then decreased again to 3.0% in 2006. The Philippine government imposed an additional 12.0% value added tax ("VAT") on the sale or importation of petroleum products in 2006 and then reduced VAT to 0% as of July 4, 2010, except for certain types of aviation gas. Therefore, there is no assurance that taxes applicable to SMC will not be increased again in the future.

In addition, the Philippine government may periodically implement measures aimed at protecting consumers from rising prices, which may constrain the ability of certain of SMC's businesses to pass on price increases to distributors who sell their products, as well as their customers. Implementation of any such measures could have a material adverse effect on SMC's business, financial condition and results of operations.

There is no assurance that changes in laws, rules or regulations, will not result in SMC having to incur substantial additional costs or capital expenditures to upgrade or supplement its existing facilities or being subject to an increased rate of taxation or fines and penalties.

SMC's businesses are exposed to substantial safety, health and environmental costs and liabilities.

SMC's businesses span several industries and are subject to a variety of laws, rules and regulations that impose limitations, prohibitions and standards with respect to health and safety as well as the use, discharge, emission, treatment, release, disposal and management of, regulated materials and waste, and hazardous substances. Safety, health and environmental laws and regulations in the Philippines have become increasingly stringent and it is possible that these laws and regulations will become significantly more stringent in the future. The adoption of new safety, health and environmental laws and regulations, new interpretations of existing laws, increased governmental enforcement of environmental laws or other developments in the future may require additional capital expenditures or the incurrence of additional operating expenses in order to comply with such laws and to maintain current operations as well as any costs related to fines and penalties.

Furthermore, if the measures implemented by SMC to comply with these laws and regulations are not deemed sufficient by governmental authorities, compliance costs may significantly exceed current estimates. If SMC fails to meet safety, health and environmental requirements, it may be subject to administrative, civil and criminal proceedings by governmental authorities, as well as civil proceedings by environmental groups and other individuals, which could result in substantial fines and penalties against SMC, as well as orders that could limit or affect its operations. There is no assurance that SMC will not become involved in future litigation or other proceedings or be held responsible in any such future litigation or proceedings relating to safety, health and environmental matters in the future, the costs of which could be material. Environmental compliance and remediation costs at sites on which its facilities are located and related litigation and other proceedings could materially and adversely affect SMC's cash flow, results of operations and financial condition.

Outbreaks of disease, including avian influenza, could adversely affect SMC's financial condition and results of operations.

Several countries in Asia and Europe have in recent years reported cases of avian influenza, or bird flu. While there have been no known outbreaks of bird flu in the Philippines or any known cases of human-to-human transmission of bird flu, there is no assurance that the virus will not mutate, thereby causing a human pandemic in the Philippines and elsewhere. A false positive case of avian flu in 2005 contributed to decreased growth in the Philippine poultry industry in that year. Any outbreaks could significantly decrease consumer demand for SMC's products, adversely affect its ability to adequately staff its operations, and severely disrupt the distribution networks for its products, as well as the general level of economic activity in the Philippines, and elsewhere in the Asia Pacific region.

SMC has adopted policies and controls at its food business facilities to prevent the outbreak or recurrence of diseases. However, there is no assurance that SMC's policies and controls will be successful in preventing disease outbreaks or recurrences in the future or that any future actual or suspected outbreak of bird flu or any other contagious disease in the Philippines or elsewhere will not occur. Any occurrence of such events could have a material adverse effect on SMC's financial condition and results of operations.

SMC's financial performance may be materially and adversely affected by disruptions in the supply of, or price fluctuations in, major raw materials.

SMC's products and businesses depend on raw materials most of which are procured from third parties, including purchases of some critical raw materials. These raw materials are subject to price volatility caused by a number of factors, including changes in global supply and demand, foreign exchange rate fluctuations, weather conditions and governmental controls. For example, the recent decrease in supply of global crops has contributed, and may continue to contribute to, higher prices for the wheat, malted barley and adjuncts for beer and molasses for liquor, which are among the most important raw materials for the flour and beverages businesses. The beverages operations also depend heavily on the supply of water and although the beer business uses its own deep wells for water at several breweries, it is still reliant on a third party source for the Polo brewery. The prices of certain raw materials used in food businesses such as dairy, spreads and oils ("DSO") business, including milk, curds and others, also increased significantly in 2007 and 2008 as a result of reduced global supply caused by unfavorable weather conditions, reduced number of cattle herds, significant appreciation in the currencies of certain export-oriented countries and the elimination of export subsidies in the European Union.

SMC may also face increased costs or shortages in supply of raw materials due to the imposition of new laws, regulations or policies. For example, in Mindanao in the southern part of the Philippines, a significant portion of the population is Muslim, and consequently all of its poultry processing plants in that region are halal-certified. Legislation has been proposed to require additional halal certification for feedmills that supply poultry farms from which halal products are sourced. If this proposed legislation is enacted and implemented, certain raw materials may have to be eliminated from SMC's poultry feeds used in this region. This could increase the cost of poultry feeds and the cost of poultry production in the region, which could materially reduce net income and profitability.

Although SMC actively monitors the availability and prices of raw materials, there is no assurance that these items will be supplied in adequate quantities or at the required quality to meet its needs or will not be subject to significant price fluctuations in the future. While SMC may, in certain limited instances, be able to shift to alternative raw materials to produce its products, there is no assurance that it will be able to reduce its reliance on these raw materials in the future. SMC may only have a limited ability to hedge against commodity prices and any hedging activities may not work as planned. Moreover, market prices of raw materials could increase significantly if there are material shortages due to, among other things, competing usage, drastic changes in weather or natural disasters. There is no assurance that any increases in product costs could be passed on to consumers. As a result, any significant shortages or material increase in the market price of such raw materials could have a material adverse effect on SMC's financial and operating performance.

SMC's businesses and prospects may be adversely affected by changes in consumers' preferences.

SMC's ability to successfully develop and launch new products and maintain demand for existing products depends on the acceptance of such products by consumers, as well as the purchasing power of such consumers. Consumer preferences may shift for a variety of reasons, including changes in culinary, demographic and social trends or leisure activity patterns. Concerns about health effects due to negative publicity regarding alcohol consumption, negative dietary effects or other factors may also affect consumer purchasing patterns of food and beverage products. If SMC's marketing strategies are not successful or do not respond timely or effectively to changes in consumer preferences, SMC's businesses and prospects could be materially and adversely affected.

SMC is exposed to foreign exchange risk. Fluctuations in the exchange rate between the Peso and other currencies, such as the U.S. dollar, could have a material adverse effect on SMC's business, financial condition and results of operations.

A substantial portion of SMC's revenues is denominated in Pesos, while a substantial portion of its expenses, including raw materials, crude oil purchases and foreign currency denominated debt service costs, are denominated in U.S. dollars. In addition, as of December 31, 2010, the percentage of SMC's outstanding debt that was denominated in foreign currencies was 31%.

In addition, SMC's financial reporting currency is the Peso, and therefore depreciation of the Peso would result in increases in SMC's foreign currency denominated expenses as reflected in its Peso financial statements, and could also result in foreign exchange losses resulting from the revaluation of foreign currency denominated assets and liabilities, including increases in the Peso amounts of SMC's foreign currency denominated debt obligations, thereby adversely affecting SMC's results of operations and financial condition. In addition, there is no assurance that SMC could increase its Peso-denominated product prices to offset increases in costs resulting from any depreciation of the Peso.

Since January 1, 2007, the value of the Peso against the U.S. dollar has fluctuated from a high of ₱40.360 per U.S. dollar on February 28, 2008 to a low of ₱49.984 per U.S. dollar on November 20, 2008. While SMC uses a combination of natural hedges, which involve holding U.S. dollar-denominated assets and liabilities, and derivative instruments to manage its exchange rate risk exposure, its exchange rate exposures are not fully protected. There is no assurance that the value of the Peso will not decline or continue to fluctuate significantly against the U.S. dollar and any significant future depreciation of the Peso could have a material adverse effect on SMC's margins, results of operations and financial condition.

In addition, changes in currency exchange rates may result in significantly higher domestic interest rates, liquidity shortages and capital or exchange controls. This could result in a reduction of economic activity, economic recession, sovereign or corporate loan defaults, lower deposits and an increased cost of funds. The foregoing events, if they occur, could have a material adverse effect on SMC's businesses, financial condition, liquidity and results of operations.

Failure to obtain financing or the inability to obtain financing on reasonable terms could adversely affect the execution of SMC's expansion and growth plans.

SMC's expansion and growth plans are expected to be funded through a combination of internally generated funds and external fund raising activities, including debt and equity financing. SMC's continued access to debt and equity financing as a source of funding for new projects and acquisitions and for refinancing maturing debt is subject to many factors, including: (i) Philippine regulations limiting bank exposure (including single borrower limits) to a single borrower or related group of borrowers; (ii) SMC's compliance with existing debt covenants; (iii) the ability of SMC, its affiliates and subsidiaries to service new debt, (iv) perceptions in the capital markets regarding SMC and the industries in which it operates and other factors, some of which may be outside of its control, including general conditions in the debt and equity capital markets, political instability, an economic downturn, social unrest, changes in the Philippine regulatory environment or the bankruptcy of an unrelated company operating in one or more of the same industries as SMC, any of which could increase SMC's cost of borrowing or other financing or restrict its ability to obtain debt or equity financing. In addition, while there are growing signs of recovery from the current disruptions in global capital and credit markets, which began in the second half of 2008, such disruptions may continue indefinitely or intensify and such disruptions as a result of uncertainty or failures of significant financial institutions could adversely affect SMC's access to financing. There is no assurance that SMC will be able to arrange financing on acceptable terms, if at all. Any inability of SMC to obtain financing from banks and other financial institutions or from capital markets would adversely affect SMC's ability to execute its expansion and growth strategies as well as its financial condition and prospects.

Losses and/or property damage, production loss and accident claims at SMC's facilities that are not covered by insurance could have a material adverse effect on its financial condition and results of operations.

SMC may not be fully insured against, and insurance may not be available for, losses caused by natural disasters, breakdowns or other events that could affect the facilities and processes used by its businesses. Any losses caused by such events against which it is not fully insured could have a material adverse effect on, its businesses, financial condition and results of operations. Any accident at SMC's operations and facilities could result in significant losses. It could suffer a decline in production, receive adverse publicity and be forced to invest significant resources in addressing such losses, both in terms of time and money. There is no assurance that there will not be work-related or other accidents in the future. Furthermore, there is no assurance that amicable settlements will be secured in the future or that accidents will not result in future litigation or regulatory action against SMC. Such events could materially and adversely affect its financial condition and results of operations.

If any of SMC's third party contractors fails to perform its obligations, or if SMC is unable to find new contractors to meet increased demand, SMC's businesses and results of operations, including revenues and profitability, could be materially and adversely affected.

SMC outsources most of its beverage, food and packaging manufacturing, production and distribution operations to third party contractors. Similarly, the retail distribution of SMC's products for its fuel business, and the operation of its power generation facilities for its power business, are contracted by SMC to third party dealers or operators. To ensure the timely production and distribution of its products, SMC continuously monitors the efficiency and manufacturing capabilities of the relevant production facilities for its food, beverage and packaging business, as well as the generation capabilities of its power plants for its power business. However, from time to time, any of them could experience operational issues that could cause production shortages and distribution delays, or power generation deficiencies in the case of SMC's power business. If one or more of SMC's contract manufacturers, facility operators or distributors fails to or is unable to manufacture, produce or distribute products in a timely manner, in sufficient quantities or at satisfactory quality levels, SMC's ability to bring products to the market and its reputation could suffer, which could have a material adverse effect on SMC's businesses and financial performance, as well as its prospects. In addition, there is no assurance that SMC will continue to find new contract manufacturers, operators or distributors in

line with increased customer demand in the future, which could materially and adversely affect SMC's businesses and prospects.

Any significant disruption at SMC's facilities and operations could materially and adversely affect its businesses, financial condition and results of operations as well as subject SMC to potential liabilities.

SMC's facilities and operations could be severely disrupted by many factors, including accidents, breakdown or failure of equipment, interruption in power supply, human error, natural disasters and other unforeseen circumstances and problems. For example, in November 2008, the main electrical facilities in the utilities area of Petron's refinery were damaged by fire, which necessitated repairs and resulted in higher maintenance and repair costs in 2009. These disruptions could result in product run-outs, facility shutdown, equipment repair or replacement, increased insurance costs, personal injuries, loss of life and unplanned inventory build-up, all of which could have a material adverse effect on SMC's business, financial condition and results of operations.

SMB, SMPFC and SMPI are currently not in compliance with the minimum public ownership requirement of the PSE.

SMB, SMPFC and SMPI are currently not in compliance with the 10% minimum public ownership requirement of the PSE for listed companies. SMB, SMPFC and SMPI are evaluating options and measures in order to comply with the requirement. However, the Philippine regulatory authorities may take enforcement action, which could include delisting from the PSE, if such actions are not effective or are not implemented in time. Any delisting of SMB, SMPFC or SMPI could cause the trading price of the Offer Shares to decline significantly.

Risks Relating to SMC's Beverages Business

Product liability claims or other circumstances could harm the integrity and customer support for brands and materially and adversely affect the sales of its products.

The success of SMC's beverages business depends in large part upon consumers' perception of its brands. The contamination of products by bacteria or other external agents, whether arising accidentally or through deliberate third party action, could result in product liability claims. Product liability claims, whether or not they are successful, could adversely affect the reputation of the brands used by SMC's beverages business and the sales by SMC's beverages business. In addition, other manufacturers, primarily affiliates of SMC that produce and sell beer outside of the Philippines, have rights to produce products that carry the same brands and trademarks as used by SMC's beverages business. Actions by these other manufacturers, including producing deficient quality products, could tarnish the overall reputation of the relevant brands. Any of the problems mentioned above may adversely affect SMC's beverages business' reputation and its ability to charge a premium for its products, which may result in reduced sales and profitability of the affected brand or all of the SMC's beverages business' brands.

Increases in excise tax applicable to alcoholic beverages, such as beer and other liquor products, or increases in other taxes to which SMC's beverages business may reduce consumption of the products of SMC's beverages business or the margins of SMC's beverages business or reduce both.

Alcoholic products, such as beer and other liquor products, are subject to excise taxes, and increases in excise taxes or value added taxes may reduce overall consumption of the products of SMC's beverages business or the profit margins of SMC's beverages business or both. The excise tax rates applicable to alcoholic products have been increased by 8% every two years beginning January 1, 2005 with the last such increase implemented on January 1, 2011. Additional scheduled increases and non-scheduled increases in excise tax or value added tax rates are possible. Previous increases in excise tax rates have adversely affected the sales volume of SMC's beverages business. Future increases in excise tax or other taxes to which SMC's beverages business may (i) reduce consumption of the beer and alcoholic products of SMC's beverages business if passed on to the consumers by way of upward price adjustments, (ii) reduce the margins of SMC's

beverages business if prices remain unchanged or (iii) have both such effects if additional taxes are not fully passed on to consumers.

SMB and Ginebra are exposed to the credit risks of their customers, and defaults in payment by their customers could have a material adverse effect on SMB's and/or Ginebra's financial condition, results of operations and liquidity.

SMB and/or Ginebra are exposed to the credit risk of its customers, and default on material payments owed to SMB and/or Ginebra by their customers could significantly reduce SMB and/or Ginebra's operating cash flows and liquidity, as well as have a material adverse effect on their financial condition and results of operations. Some of SMB's and/or Ginebra's customers could also experience cash flow activities or become subject to liquidation which could, in turn, lead to SMB and/or Ginebra experiencing long delays in collection of payments, if at all. SMB's average trade receivables turnover in 2008, 2009 and 2010 were approximately 21, 20 and 10 days, respectively. Ginebra's average trade receivables turnover in 2008, 2009 and 2010 were approximately 49, 39 and 46 days, respectively.

There is no assurance that the exposure of SMB and/or Ginebra to the risk of delayed payments from their customers or defaults in payment by their customers will not increase, or that SMB and/or Ginebra will not experience losses or cash flow constraints as a result. If any of these events were to occur, SMB's and/or Ginebra's financial condition and results of operations could be materially and adversely affected.

Competition in SMC's beverages business and markets may cause it to lose market share or suffer reduced operating margins, which could have a material adverse effect on SMC's financial condition and results of operations.

SMC's beverages business is operated by its subsidiaries SMB and Ginebra. As a general matter, the Philippine alcoholic beverage industry is highly competitive. While SMB and Ginebra have the largest market share in the Philippines with respect to beer and liquor, respectively, there is no assurance that SMB and Ginebra will be able to maintain their current market shares, or that they will be able to increase their market shares in the future. In particular, SMB faces competition from another domestic beer producer, which sells both its own brand and foreign brands it produces under license, and from foreign brewers. Each of SMB and Ginebra also competes with producers of other alcoholic beverages.

In both the beer and liquor industries, and more generally the alcoholic beverage industry, competitive factors generally include price, product quality, brand awareness and loyalty, distribution coverage and the ability to respond effectively to shifting consumer tastes and preferences. Each of SMB's and Ginebra's products compete with other discretionary items, including other food and beverage products, and other goods and services generally. Any consolidation of either or both of SMB's and Ginebra's competitors, the entrance of new or larger competitors into the Philippine alcoholic beverage market, or unanticipated actions by existing competitors could lead to downward pressure on prices or a decline in SMB's and Ginebra's market shares. Any such event could materially and adversely affect SMB's and Ginebra's businesses, financial condition and results of operations.

Consolidation of sales channels in the Philippines may materially and adversely affect SMB's and Ginebra's financial condition and results of operations.

The Philippine retail market has historically been highly fragmented and dominated by numerous small neighborhood stores. These small neighborhood stores serve limited geographical areas and purchase relatively small quantities of SMB's and Ginebra's products from distributors and larger supermarkets. In recent years, larger supermarkets have begun to gain market share in the Philippines. There is a risk that SMB's and Ginebra's businesses may become increasingly concentrated in fewer, larger customers, which could increase the relative bargaining power of those customers. There is no assurance that those customers will not exert downward pressure on wholesale prices of SMB's and Ginebra's products, which could materially and adversely affect SMB's and Ginebra's financial condition and results of operations.

Demand for SMB's and Ginebra's products is highly price sensitive, and if either SMB or Ginebra increases its prices, sales volumes for their respective products could decrease significantly and could materially reduce their revenues and profitability.

A substantial percentage of beer and liquor consumers in the Philippines have limited discretionary income. Accordingly, the beer market and certain segments of the liquor market in the Philippines are highly price sensitive. If SMB and Ginebra raise the prices of their products, sales volumes could decrease significantly, and may result in materially lower revenues and net income. Furthermore, the price sensitivity of SMB's and Ginebra's products may limit their ability to pass on increases in excise taxes, raw material costs or other expenses, which may negatively affect their results of operations, including financial and operating performance.

Risks Relating to SMC's Food Business

Product liability claims or other circumstances could harm the reputation of, and customer support for, SMC's food products and materially reduce the sales and profitability of SMC's food business.

As discussed under "Risks Relating to SMC's Beverages Business" above, any event or development that detracts from the perceived reliability or quality of SMC's food products could materially reduce demand for such products. In the same manner that such problems can have a material adverse effect on SMC's beverages business, such problems may also have a material adverse effect on the financial condition, prospects and customer demand for SMC's food products, which may result in reduced sales and profitability of the affected food products.

SMPFC operates in a competitive environment, and if it is unable to maintain its competitive position, SMPFC's market share and operating margins may be reduced, and its business, financial condition, results of operations and prospects may be materially and adversely affected.

The Philippine food industry is, in general, highly competitive. While SMPFC is the market leader across several of its product categories in terms of market share as of the date of this Offering Circular, there is no assurance that SMPFC will be able to maintain or grow its current market share. In the food industry, competitive factors generally include price, product quality, brand awareness, distribution coverage, customer service and the ability to respond effectively to shifts in consumer tastes and preferences. Consolidation of SMPFC's competitors, the entry of new, larger competitors into the Philippine food market or other irrational actions by SMPFC's competitors could exert downward pressure on prices or cause SMPFC's market share to decline. Any failure by SMPFC to successfully compete with its competitors could have a material adverse effect on its business, financial condition, results of operations and prospects.

In order to maintain its customer base and market share, SMPFC has continuously developed new and innovative products to meet its customers' demands. If its competitors are able to develop more innovative or better quality products or less expensive products of similar quality, SMPFC may not be able to maintain its competitive edge or market share, and SMPFC's business, financial condition, business, results of operations and prospects could be materially and adversely affected.

SMPFC's business and prospects may be materially and adversely affected by increased imports of lower-priced products as import duties are decreased or eliminated.

SMPFC may face increased competition from less expensive imports to the Philippines as import duties on those products are decreased or eliminated. In particular, the Philippines is a signatory to several free trade agreements, including the ASEAN Free Trade Agreement, the ASEAN-China Free Trade Agreement, the ASEAN-Korea Free Trade Area Agreement, the Japan-Philippines Economic Partnership Agreement, the ASEAN-Japan Comprehensive Economic Partnership and the ASEAN-Australia-New Zealand Free Trade Area Agreement and the ASEAN-India Free Trade Area Agreement each of which may lead to increasingly lower-priced imported products entering the Philippine market. For example, as of January 1, 2010, import duties on certain value-added products, such as instant coffee, were reduced from 5.0% to zero for imports from other ASEAN countries. SMPFC has already experienced the effects of increased competition as a result

of the elimination of these lower import duties, and expects that competition from imported products will continue to increase. If SMPFC is unable to compete effectively with lower-priced imports, its market share and sales will decrease, and SMPFC's business, financial condition, results of operations and prospects could be materially and adversely affected.

Certain products of SMC's food businesses are subject to price control by the Philippine government.

Basic necessities such as fresh pork, beef and poultry meat, milk, coffee and cooking oil, and prime commodities such as flour, dried, processed and canned pork, beef and poultry meat, and other dairy products and swine and poultry feeds may be made subject to price control by the Philippine government. Under the Philippine Republic Act No. 7581, otherwise known as the Price Act ("Price Act"), the President of the Philippines may impose a price ceiling on basic necessities and prime commodities in cases of calamities, emergencies, illegal price manipulation or when the prevailing prices have risen to unreasonable levels.

If the exigent conditions provided for under the Price Act occur, there is no assurance that the President of the Philippines will not exercise the price control powers provided under the Price Act and impose price ceilings on certain products of SMC's food business which are considered basic necessities and prime commodities under the said law. Any resulting price control, or the continuance thereof, may have a material adverse effect on SMPFC's business, results of operations and financial performance.

Outbreaks of disease at any of the hog, cattle or poultry farms owned or contracted by SMC's food business could materially and adversely affect its financial condition and results of operations.

The fresh meats and poultry operations of SMC's food business, being operated by SMPFC are subject to risk of losses caused by outbreaks of disease at any of the hog, cattle or poultry farms that it owns or contracts. The livestock industry in the Philippines has experienced outbreaks of disease in the past. In particular, an industry-wide porcine epidemic diarrhea outbreak that affected several of SMC's food business facilities in the second quarter of 2008 and the third quarter of 2010 and a porcine reproductive and respiratory syndrome at contract growing facilities in the second and third quarters of 2008 negatively affected growth in the fresh meats operations during those periods.

While SMPFC has adopted policies and controls in its facilities to prevent the outbreak and recurrence of diseases, including the separation of its hog breeding, nursery and growing operations, bird proofing to prevent the entry of outside birds into its poultry facilities, there is no assurance that such policies and controls will be successful in preventing disease outbreaks or recurrences. Any such outbreak or recurrence could have a material adverse effect on the financial condition and result of operations of SMPFC.

The growth in the number and scale of supermarkets as well as a general consolidation of wholesale buyers in the Philippine market could have a material adverse effect on SMPFC's financial condition and results of operations.

The Philippine retail market has historically been highly fragmented among numerous small neighborhood stores, groceries and more traditional wet markets. Traditional wet markets remain a major source of food products for many Philippine consumers. In addition, small neighborhood stores service limited geographical areas and purchase relatively small quantities of SMPFC's products from distributors and larger supermarkets. In recent years, larger supermarkets have begun to gain market share in the Philippines. There is a risk that SMPFC's business may become concentrated in fewer, larger customers, which could increase the relative bargaining power of these customers. There is no assurance that supermarkets or one of these larger customers will not exert downward pressure on wholesale prices of SMPFC's products, which could have a material adverse effect on SMPFC's financial condition and results of operations.

SMPFC is exposed to the credit risks of its customers, and defaults in payment by its customers could have a material adverse effect on SMPFC's financial condition, results of operations and liquidity.

SMPFC is exposed to the credit risk of its customers, and defaults on material payments owed to SMPFC by customers could significantly reduce SMPFC's operating cash flows and liquidity, as well as have a

material adverse effect on SMPFC's financial condition and results of operations. Some of SMPFC's customers could also experience cash flow difficulties or become subject to liquidation, which could in turn lead to SMPFC experiencing long delays in collection of payments, if at all. SMPFC's average trade receivables turnover in 2008, 2009 and 2010 was approximately 41, 52 and 44 days, respectively. There is no assurance that SMPFC's exposure to the risk of delayed payments from its customers or defaults in payment by its customers will not increase, or that it will not experience losses or cash flow constraints as a result. If any of these events were to occur, SMPFC's net income and cash flows could be materially reduced.

SMPFC generally does not have long-term contracts with its customers, and it is subject to uncertainties and variability in demand and product mix, which could materially decrease net sales and materially and adversely affect its business, financial condition and results of operations.

As is common in the industry in which SMPFC operates, SMPFC does not have long-term contracts with its customers and, consequently, its revenues are subject to short-term volatility. SMPFC's customers have no obligation to place new orders with SMPFC following the expiration of their current obligations, and may cancel, reduce or delay orders for a variety of reasons. The level and timing of orders placed by SMPFC's customers may vary due to a number of factors including:

- seasonality and other fluctuations in demand for SMPFC's products;
- the competitiveness of SMPFC's selling prices in the industry;
- customer satisfaction with the level of service SMPFC provides; and
- customers' inventory management.

SMPFC has experienced terminations of, and reductions and delays in its customers' orders in the past. If SMPFC does not receive substitute orders, such events could lower its facility utilization rates, which could materially decrease SMPFC's revenues and profitability. In addition, seasonality in demand for SMPFC's products could result in significant fluctuations in quarterly results.

SMPFC intends to co-invest alongside SMC, potentially in areas outside SMPFC's existing business areas, and the loss of any or all of the principal of these investments could materially and adversely affect SMPFC's financial condition and results of operations.

SMPFC intends to co-invest alongside SMC, potentially in areas outside of the food business. SMPFC's board of directors has not yet identified any definite investee targets and is continually assessing investment opportunities as they arise, taking into consideration, among others, the expected returns from potential investments. As these investments may extend outside SMPFC's existing competencies, SMPFC may lack the expertise to assess and manage the risks associated with these investments to the same extent as it could on investments in the food industry. In addition, these investments could be passive in nature and SMPFC may not have control of the management or policies of its investees. The loss of any or all of these investments including those relating to businesses in which SMPFC has limited control could have a material adverse effect on SMPFC's financial condition and results of operations.

Risks Relating to SMC's Packaging Business

SMC's packaging business is vulnerable to shortages in supply, and fluctuation in prices, of various inputs, including raw materials and electricity.

SMC's packaging business is operated by SMYPC, SMPIL, and its subsidiaries, SMYAC and Mincorr, (collectively, the "Packaging Group"). In order to ensure timely delivery of quality products to customers at competitive prices, the Packaging Group needs to obtain sufficient quantities of quality raw materials, including recycled glass, silica sand, soda ash, aluminum, paper, plastics and composites in a timely manner. The Packaging Group also requires a significant amount of electricity in order to maintain its operations. There is no assurance that the Packaging Group will be able to obtain sufficient quantities of raw materials of

acceptable quality from its suppliers at acceptable prices in a timely manner or that it will not suffer from electricity disruptions or shortages in the future.

Furthermore, the Packaging Group is vulnerable to the risk of rising raw material prices, which are determined by market conditions and other conditions beyond its control. A significant increase in the price of raw material inputs, and any inability to pass on such increases in costs to customers or find alternative suppliers to supply raw materials at reasonable prices, could materially affect the results of operations of the Packaging Group.

Products produced by the customers of the Packaging Group could be contaminated, which could materially and adversely affect the reputation, business, financial performance and prospects of the Packaging Group.

Lack of care in the handling or storage by distributors of products produced by the customers of the Packaging Group, tampering, vandalism or terrorist activities could result in the contamination or adulteration of the finished products. There is no assurance that products packaged by the Packaging Group would not be contaminated during manufacturing, distribution or retail process. Any lack of care or tampering of such products, especially in instances where it is not readily capable of detection, could negatively impact the reputation of the Packaging Group's products and have a material adverse effect on the business, financial performance and prospects of the Packaging Group.

The Packaging Group faces competition and is required to continually develop new products and production processes.

In order to compete in the packaging material industry, the Packaging Group is required to continually develop and implement product innovations and improve its production technology, processes and efficiencies. The success of the packaging business may also depend on its ability to identify and meet changing customer requirements and trends in the industry. Any failure to timely develop and introduce new products, or enhance existing products, in response to changing customer requirements or industry standards could have a material adverse effect on the Packaging Group's business, financial performance and prospects.

In addition, research and development of any new technology or production methods require significant capital investments and could take a significant amount of time. Moreover, there is no assurance that the Packaging Group will successfully develop such technology and production methods, or that they will be accepted by existing customers or attract new customers. These factors could have a material adverse effect on the business, financial performance and prospects of the Packaging Group.

Risks Relating to SMC's Fuel and Oil Business

If the number or severity of claims for which Petron is self-insured increases, or if it is required to accrue or pay additional amounts because the claims prove to be more severe than its recorded liabilities, Petron's financial condition and results of operations may be materially adversely affected.

SMC's fuel and oil business is operated by Petron. Petron uses a combination of self-insurance and reinsurance to cover its properties and certain potential liabilities. Petron's insurance coverage includes property, marine cargo and third-party liability. Petron's business interruption insurance has a US\$79.7 million limit that covers losses at its refinery. All of Petron's insurance policies are provided by its wholly-owned subsidiary, Petrogen Insurance Corporation and a portion of such insurance coverage is reinsured with leading local and foreign reinsurers through Overseas Ventures Insurance Corporation, a wholly-owned subsidiary of Petron. Petron estimates the liabilities associated with the risks retained by it, in part by considering historical claims, experience and actuarial assumptions which, by their nature, are subject to a degree of uncertainty and variability. Among the causes of this uncertainty and variability are unpredictable external factors affecting future inflation rates, discount rates, litigation trends, legal interpretations and actual claim settlement patterns. If the number or severity of claims for which Petron is self-insured increase, or if it is required to accrue or pay additional amounts because the claims prove to be more severe than its original assessments, Petron's financial condition, results of operations and cash flows may be materially adversely affected.

Volatility in the price of crude oil could have a material adverse effect on the business and financial performance of Petron.

Petron's financial performance is affected to a significant extent by volatility in crude oil prices, particularly with regard to the prices for refined petroleum products that it sells and the prices for imported crude oil that it buys. In particular, imported crude oil accounts for approximately 80% of Petron's total cost of goods sold. Many factors influence the price of crude oil, including changes in global supply and demand, international economic conditions, geopolitical conflicts, weather conditions, domestic and foreign governmental regulation and other factors beyond Petron's control. Currently, with recent events in the Middle East, and historically, international crude oil prices have been, and are, volatile, and are likely to continue to be volatile in the future. For example, in 2008, Petron suffered a net loss of ₱3.92 billion, primarily because the prices for the products it sells decreased at a faster rate than the prices for crude oil.

Petron holds an approximately 55-day crude oil reserve and finished petroleum products inventory. In 2008, Petron suffered a loss due to a sharp drop in crude oil prices as it produced refined petroleum products with crude oil previously purchased at higher prices and sold those refined petroleum products at relatively lower prices. Even if Petron were able to pass on increases in the price of crude oil to its customers without being subject to price control restrictions, demand for its products may decrease as a result of such price increases.

In addition, a sharp rise in crude oil prices increases the requirements for short-term financing for working capital, which could lead to higher financing costs for Petron. Any significant crude oil price fluctuations, price controls or increased cost of capital could have a material adverse effect on Petron's business, financial performance and prospects.

Petron relies primarily on a single source of supply for a significant portion of its crude oil requirements.

Petron purchases a significant portion of its crude oil from Saudi Arabian Oil Company ("Saudi Aramco"), which is Saudi Arabia's national oil company. In 2010, Petron purchased approximately 74% of its total crude oil requirements from Saudi Aramco under a crude oil supply agreement. Under Petron's 2008 contract with Saudi Aramco, Petron can purchase up to 140,000 barrels per day ("bpd") of crude oil of various grades, with prices calculated by an agreed formula that is linked to international industry benchmarks. However, the supply of imported crude oil is subject to a range of factors beyond Petron's control, including import and export restrictions, geopolitical, weather and overall economic conditions, and local and foreign government regulations. If this source of crude oil supply is disrupted, Petron would be required to replace it with other sources, including spot market purchases at potentially significantly higher prices, which could have a material adverse effect on Petron's business, financial condition and results of operations.

In line with its crude oil optimization strategy, Petron's refinery in Limay, Bataan is being configured to process other types of crude oil, and Petron is exploring the utilization of various types of crude oil, other than those supplied by Saudi Aramco. However, there are limitations on the ability of Petron's refinery to process other types of crude oil, and there is no assurance that Petron will be able to process other types of crude oil efficiently or in a timely manner. Any failure in obtaining or maintaining a secure crude oil supply or in adapting its refinery to process alternative types of crude oil could have a material adverse effect on Petron's business, financial performance and prospects.

Petron operates in a highly competitive market for petroleum and related products in the Philippines.

Petron faces intense competition in the sale of petroleum and related products in the Philippines. In particular, Petron competes with a number of multinational, national, regional and local companies in the refined petroleum products business for sales and market share. As petroleum products are generally considered to be commodity products, competition in the international markets as well as in the Philippines is based primarily on price, with a relatively high price sensitivity. The Philippine fuel and oil industry is also affected by smuggling and illegal trading of petroleum products. These illegal activities have resulted in decreases in sales volume and sales price for legitimate oil market participants in the Philippines, and have negatively impacted Petron's ability to compete effectively. Moreover, Petron's competitiveness is dependent

on its ability to manage costs, enhance efficiency at its refinery, effectively hedge against fluctuations in crude oil prices and maximize asset utilization. Any failure by Petron to compete effectively or to improve efficiencies and differentiate products, or any failure by the Philippine government to implement or enforce measures against illegal activities, could have a material adverse effect on Petron's operating and financial results.

Petron's business strategies require significant capital expenditures and funding, which are subject to a number of risks and uncertainties.

Petron's business and operations are capital intensive. Specifically, the processing and refining of crude oil and the purchase, construction and maintenance of machinery and equipment require substantial capital expenditures. Petron's ability to maintain and increase sales, net income and cash flows requires continued capital spending, and its current business strategies involve various upgrades to its refinery, the construction of new facilities and the expansion of its service station network. If Petron fails to complete its capital expenditure projects on time, or within budget or at all, or fails to operate them at their designed capacity, it may be unable to increase its sales and profits or to capture additional market share as planned, and Petron's business, financial performance and prospects could be materially and adversely affected.

In addition, Petron has recently incurred a substantial amount of debt to finance its capital expenditure projects. As a significant portion of that debt is due within the next five years, Petron's ability to complete its capital expenditure projects and meet its debt servicing obligations will depend in part on its ability to generate sufficient cash flows from its operations and obtain adequate additional financing. There is no assurance that Petron will be able to generate sufficient cash flows from its operations or obtain adequate financing on acceptable terms or at all for its capital expenditure projects or to meet debt servicing obligations. Any failure by Petron to finance and successfully implement its capital expenditure projects could have a material adverse effect on Petron's business, financial performance and prospects.

Any significant disruption at Petron's refinery operations could materially and adversely affect its business and financial performance, as well as subject Petron to potential liabilities.

Petron's operation of its refinery could be severely disrupted by many factors, including accidents, breakdown or failure of equipment, interruption in power supply, human error, natural disasters and other unforeseen circumstances and problems. For example, in November 2008, the main electrical facilities in the utilities area of the refinery were damaged by fire, which necessitated repairs and resulted in higher maintenance and repair costs in 2009. These disruptions could result in product run-outs, facility shutdown, equipment repair or replacement, increased insurance costs, personal injuries, loss of life and unplanned inventory build-up, all of which could have a material adverse effect on Petron's business and financial performance.

While Petron has in place insurance policies covering some of these risks, including business interruption insurance, there is no assurance that they will cover all potential losses, and insurance may not be available for all risks to which Petron is exposed or on commercially reasonable terms. There is no assurance that operational disruptions will not occur in the future or that insurance will adequately cover the full extent of the losses or other financial impact on Petron. The occurrence of any such factors, accidents or uninsurable or inadequately insured loss could result in Petron suffering material losses and have a material adverse effect on Petron's business, financial condition and results of operations.

Risks Relating to SMC's Power Business

SMCGP is a new participant in the power industry and has a limited track record operating in that industry.

SMC's power business is operated by SMCGP. As a new participant in the power industry, SMCGP faces many challenges, including: (a) developing the expertise required to successfully operate and grow recently acquired assets in the power industry; (b) developing a positive reputation in the power industry; (c) attracting and retaining customers, suppliers and managers in the power industry and more specifically those in the

specific regional markets into which it is expanding; and (d) successfully competing with companies engaged in similar businesses in the same markets, some of which may be larger in size, have a longer operating history and have greater expertise and financial resources. In addition, SMCGP may incur substantial expenditures in bidding for, acquiring and developing its business. There is no assurance that SMCGP will be a successful participant in the power industry, or that it will not suffer significant losses that could have a material adverse effect on SMCGP's business, financial condition and results of operations.

Increased competition in the power industry, including competition resulting from legislative, regulatory and industry restructuring efforts, could have a material adverse effect on SMCGP's operations and financial performance.

In recent years, the Philippine government has sought to implement measures designed to establish a competitive power market. These measures include the planned privatization of at least 70% of the NPC-owned and-controlled power generation facilities and the grant of a concession to operate transmission facilities, as well as the establishments of the WESM. The move towards a more competitive environment could result in the emergence of new and numerous competitors. These competitors may have greater financial resources, and have more extensive operational technological, financial and other challenges more quickly than SMCGP, giving them the ability to respond to operational, technological, financial and other challenges more quickly than the SMCGP. These competitors may therefore be more successful than SMCGP in acquiring existing power generation facilities or in obtaining financing for and the construction of new power generation facilities. The type of fuel that competitors use for their generation facilities may also allow them to produce electricity at a lower cost and to sell electricity at a lower price. SMCGP may therefore be unable to meet the competitive challenges it will face.

The impact of the ongoing restructuring of the Philippine power industry will change the competitive landscape of the industry and such changes are expected to affect SMCGP's financial position, results of operations and cash flows in various ways. For example, the establishment and operation of the WESM has resulted in a more transparent price setting mechanism. Although offtakers such as Meralco will continue to be obligated to pay for capacity and energy at the tariffs set under the terms of their respective offtake agreements, if market-based wholesale prices significantly differ from the contractual tariffs, SMCGP could come under pressure to review or renegotiate the terms of such offtake agreements, that may lead to a downward adjustment of tariffs, and SMCGP's financial condition and results of operations could be adversely affected.

To the extent that distribution utilities or industrial offtakers agree to purchase from other generation companies that otherwise could be purchased from SMCGP, the ability of SMCGP to increase its revenues and of SMCGP to sell additional electricity to distribution utilities or industrial offtakers through its generation facilities would be adversely affected.

Disruptions in fuel supply may adversely affect the operation of SMCGP's power generation assets.

The operations of the Sual Power Plant, the Ilijan Power Plant and the Limay Power Plant depend on the availability of fuel, in particular coal, natural gas and oil, respectively. Pursuant to the terms of its IPPA Agreements with PSALM, SMCGP is responsible, at its cost, for supplying the Sual Power Plant with the fuel required for its operations. In addition, SMCGP is responsible, at its cost, for the supply of oil to the Limay Power Plant. There is no assurance that there will not be any interruption or disruption in, or change in terms of, the fuel supplies to these power plants, or that there will be sufficient fuel in the open market or sufficient transportation capacity available to ensure that these power plants receive sufficient fuel supplies required for their operations on a timely basis or at all. There is also no assurance that SMCGP will be able to purchase all of its required fuel supplies from its regular suppliers that produce fuel of acceptable and known quality. Consequently, SMCGP could experience difficulties ensuring a consistent quality of fuel, which could negatively affect the stability and performance of these power plants. Such factors, which may include events which are beyond SMCGP's control, could impact the normal operation of these power plants which could have material adverse effect on SMCGP's business, financial condition and results of operations.

SMCGP relies on Independent Power Producers (“IPPs”) for the operation and maintenance of the independent power producer administrator (“IPPA”) power plants and a third-party operator for the operation and maintenance of the Limay Power Plant. Failure of any such IPP or operator to comply with its contractual obligations or the loss of any such IPP or operator as an operation and maintenance provider to any of these facilities may adversely affect SMCGP’s financial condition and results of operations.

Power generation involves the use of highly complex machinery and processes and SMCGP’s success depends on the effective maintenance of equipment for its power generation assets. The IPPs associated with the respective IPPA power plants are responsible for the operation and maintenance of the IPPA power plants. In addition, a third-party operator is responsible for the operation and maintenance of the Limay Power Plant.

Although the IPPs’ energy conversion agreements (“ECAs”) or power purchase agreements (“PPAs”) with NPC in respect of the IPPA power plants contain bonus and penalty provisions, and the third-party operations and maintenance agreement in respect of the Limay Power Plant contain penalty provisions, these do not eliminate the risk of failure on the part of the IPPs or the third-party operator to satisfactorily perform their respective operations and maintenance obligations. Any failure on the part of such IPPs or the third-party operator to properly operate and/or adequately maintain their respective power plants could have a material adverse effect on SMCGP’s business, financial condition and results of operations.

Administration and operation of power generation plants involve significant risks.

The administration and/or operation of power generation plants involve significant risks, including:

- breakdown or failure of power generation equipment, transmission lines, pipelines or other equipment or processes, leading to unplanned outages and operational issues;
- flaws in the equipment design or in power plant construction;
- issues with the quality or interruptions in the supply of key inputs, including fuel or water;
- material changes in legal, regulatory or licensing requirements;
- operator error;
- performance below expected levels of output or efficiency;
- industrial actions affecting power generation assets owned or managed by SMCGP or its contractual counterparties;
- pollution or environmental contamination affecting the operation of power generation assets;
- force majeure and catastrophic events including fires, explosions, earthquakes, volcanic eruptions, floods and terrorist acts that could cause forced outages, suspension of operations, loss of life, severe damage and plant destruction;
- planned and unplanned power outages due to maintenance, expansion and refurbishment;
- inability to obtain or the cancellation of required regulatory, permits and approvals; and
- opposition from local communities and special interest groups.

There is no assurance that any event similar or dissimilar to those listed above will not occur or will not significantly increase costs or decrease or eliminate revenues derived by SMCGP from its power generation assets. While SMCGP’s IPPA Agreements provide certain relief in the event the IPPA power plants cannot produce or dispatch electricity, if any of SMCGP’s power generation assets is unable to generate or deliver electricity to customers for an extended period of time, SMCGP’s customers may be exempt from making certain payments so long as any such events continue. In addition, if SMCGP fails to generate or deliver electricity beyond contractually agreed periods, SMCGP’s counterparties in its power supply contracts (“PSCs”) may have a right to terminate those contracts, and replacement contracts may not be entered into on

comparable terms or at all. Any of the foregoing could have a material adverse effect on SMCGP's financial and operating performance.

SMCGP's acquisitions of existing power plants are subject to risks and uncertainties.

SMCGP actively participates in public auctions of power generation assets that are being privatized by PSALM. SMCGP has acquired all of its power generation assets in those auctions, and intends to make additional acquisitions in the future. However, there is no assurance that SMCGP will be successful in bidding for other power generation assets in the future. There is also no assurance that those auctions will be conducted according to publicized schedules, as auctions have been postponed and publication of auction guidelines have been delayed in the past. In addition, bids may also not be successful for reasons beyond SMCGP's control, including an auction not attracting the requisite number of bids or bids not meeting minimum reserve prices.

Moreover, a successful bid will not guarantee a successful takeover and operation of a power generation asset. A successful bidder must also satisfy all of the conditions precedent to assuming control under an IPPA Agreement or an asset purchase agreement. Even after a successful takeover, there is no assurance that operations will be a success if, for example, the acquiror discovers pre-existing problems or faults, especially as privatized power generation assets are typically sold on an "as is, where is" basis and are sometimes sold independently of the land on which they are located. Consequently, any unplanned rehabilitation or power generation asset upgrade may disrupt its operations and cause it to miss target operational and financial performance goals. There is also no assurance on the performance or condition of the assets, including generating capacity, or on the adequacy or availability of transmission lines through which electricity output is transmitted. Other related risk factors include strong competition, difficult market conditions, increased operating costs and failure to renew requisite licenses and permits.

Even with extensive due diligence, the acquiror may not be able to ascertain all of the associated risk factors prior to acquisition or taking over operations, and the occurrence of any of these factors could have a material adverse effect on SMCGP's business, financial performance and prospects.

Significant and unpredictable price fluctuations in the wholesale power markets and other market factors beyond SMCGP's control could have a material adverse effect on SMCGP's operating and financial results.

From the time WESM for Luzon began operating in June 2006, market prices for electric power have fluctuated substantially. Unlike many other commodities, electric power can only be stored on a very limited basis and generally must be produced concurrently with its use. As a result, power prices are subject to significant volatility from supply and demand imbalances. Long-term and short-term power prices may also fluctuate substantially due to other factors outside of SMCGP's control, including:

- increases and decreases in generation capacity in SMCGP's markets, including the addition of new supplies of power from existing competitors or new market entrants as a result of the development of new generation power plants, expansion of existing power plants or additional transmission capacity;
- changes in power transmission or fuel transportation capacity constraints or inefficiencies;
- electric supply disruptions, including power plant outages and transmission disruptions;
- changes in the demand for power or in patterns of power usage, including the potential development of demand-side management tools and practices;
- climate, weather conditions, natural disasters, wars, embargoes, terrorist attacks and other catastrophic events;
- availability of competitively priced alternative power sources;
- development of new fuels and new technologies for the production of power; and
- changes in the power market and environmental regulations and legislation.

These factors could have a material adverse effect on SMCGP's business, financial condition and results of operations.

The loss of certain tax exemptions and tax incentives will increase SMCGP's tax liability and decrease SMCGP's future profits.

As of the date of this Offering Circular, certain subsidiaries of SMCGP — namely, Panasia Energy Holdings Inc. ("Panasia"), as IPP for the Limay Power Plant, SMEC, as IPPA for the Sual Power Plant, SPDC, as IPPA for the San Roque Power Plant, South Premiere Power Corp. ("SPPC"), as IPPA for the Ilijan Power Plant, and Sultan Energy Phils. Corp. ("SEPC"), as concession holder for the Sultan coal deposit — benefited from certain tax exemptions and tax incentives, such as a four-year income tax holiday on income tax due on revenues derived from its power generation activities for Panasia, SMEC, SPDC and SPPC, deductions from taxable income subject to certain capital requirements and duty-free importation of capital equipment, spare parts and accessories. In addition, SEPC may make use of tax credits equivalent to national internal revenue taxes and duties paid on raw materials and supplies and semi-manufactured products used in producing its export products for a period of ten years from June 2011.

If these tax exemptions or tax incentives that SMCGP or any of its subsidiaries are entitled to are revoked or repealed, SMCGP's income from these sources will be subject to the corporate income tax rate, which is 30.0% of net taxable income as of the date of this Offering Circular. As a result, SMCGP's tax expense would increase and its profitability would decrease. There have also been reports in the Philippine press that the Philippine government may in the future discontinue its policy of granting tax incentives for similar types of projects, and there is no assurance that SMCGP will be able to obtain and benefit from similar tax incentives for future projects. The expiration, non-renewal, revocation or repeal of these tax exemptions and tax incentives, and any associated impact on SMCGP, could have a material adverse effect on SMCGP's business, financial condition and results of operations.

SMCGP's PSCs with distribution companies and industrial customers are short-term agreements, while SMCGP's payment obligations to PSALM under its IPPA Agreements are long-term obligations, which could expose SMCGP to price volatility in the WESM if SMCGP is unable to enter into new PSCs on satisfactory terms or at all.

In connection with SMCGP's acquisition of its power generation assets from PSALM, PSALM assigned various short-term PSCs entered into with various distribution companies and industrial customers, the majority of which will expire by December 31, 2011. However, SMCGP's payment obligations under its IPPA Agreements are long-term obligations. While SMCGP seeks to enter into new PSCs to provide stable and predictable revenue streams to meet its long-term obligations, there is no assurance that once the PSCs expire that SMCGP will be able to enter into new PSCs with longer durations on similar terms, or at all. If SMCGP is unable to enter into new PSCs on satisfactory terms or at all, SMCGP will be further exposed to fluctuations in electricity prices in the WESM, and if revenues from sales on the WESM are lower than SMCGP's payment obligations under its IPPA Agreements with PSALM, SMCGP's business, financial condition and results of operations could be materially and adversely affected.

The distribution rates of SMCGP's offtakers that are distribution utilities are regulated and reviewed by the Energy Regulatory Commission ("ERC"), and the imposition of more stringent regulations and similar measures by the ERC could have a material adverse effect on such offtakers' ability to meet their payment obligations under their respective PSCs and, in turn, on SMCGP's business, financial condition and results of operations.

SMCGP's primary sources of revenues are its offtakers, approximately 65% of which are distribution utilities. The ability of distribution utility offtakers to pay SMCGP in accordance with the terms of their respective PSCs depends, in large part, on their ability to pass on their generation costs to their customers. The rates these offtakers charge their customers are intended to cover their generation costs, which are subject to periodic review by the ERC.

There is no assurance that the ERC will permit SMCGP's distribution utility offtakers to increase their rates to recover all of their generation costs or that subsequent reviews by the ERC will not result in cancellation of any such increases or require such offtakers to refund payments previously received from their customers or that SMCGP will not come under pressure to review or renegotiate its tariffs downward. In addition, there is no assurance that any rate increases approved by the ERC will not be overturned by Philippine courts on appeal. Any restriction on the ability to pass on such costs or any intervention in such rates and tariffs could have a material adverse effect on SMCGP's business, financial conditions and results of operations.

SMCGP's power strategy may be curtailed by market limitations imposed by EPIRA.

As of December 31, 2010, SMCGP had a 29.2% market share of the Luzon grid and a 21.7% market share of the national grid in terms of installed capacity. The EPIRA limits a participant's market share to 30.0% per grid and 25.0% of the national grid by installed capacity. As a result, SMCGP may not receive permission to increase its capacity and market share if such increase would cause SMCGP to exceed the permitted capacity or market share. An inability to expand and grow the power business could materially and adversely affect SMCGP's business and prospects.

Meralco is controlled by other shareholders, whose interests may not be consistent with SMC's interests.

As of December 31, 2010, SMC had a 33.2% equity interest in Meralco, with the remaining equity interest held by other shareholders. The other shareholders of Meralco may be able to elect a majority of the members of the Meralco board of directors and to determine the outcome of other actions requiring a vote of Meralco shareholders, except in very limited cases. There is no assurance that such other shareholders will not take actions in relation to Meralco that are inconsistent with SMC's interests.

SMCGP may not succeed in its endeavors to conduct coal exploration and extraction activities.

One of SMCGP's current business strategies is to be a vertically integrated power company. This strategy includes the acquisition and development of coal mines as an indirect hedge against SMCGP's fuel costs. However, since SMCGP is focused primarily on operating and developing power plants for electricity generation, SMCGP may not have, and may not be successful in developing, the knowledge, experience or expertise necessary for the successful operation of the coal mines it may develop or acquire, whether on its own or in conjunction with a joint venture partner. In addition, acquisition, development and operation of coal mines will require significant managerial, operational and financial resources. If SMCGP does not successfully manage its diversification and growth strategy or identify or address the risks and uncertainties particularly associated with the exploration and excavation of coal from any of its current or future coal assets, its strategy may not succeed as anticipated, and its business, financial condition and results of operations could be materially and adversely affected.

As with all mining exploration properties or projects, there is a risk that they may not become commercially viable mines, due to project delays, cost overruns, changes in market circumstances or a project not producing coal in line with reserve estimates of the expected quality or grade. Consequently, SMCGP may not be able to achieve the intended economic benefits of these projects, which in turn could materially and adversely affect SMCGP's business, financial condition, results of operations and growth prospects.

In addition, the exploration and exploitation of coal reserves in the Philippines are subject to regulation by the DOE. There is no assurance that SMCGP will be successful in securing the requisite exploration permits or operating contracts for development of the coal mines, or in the extraction of coal resources. Any such failure could materially reduce SMCGP's revenues and profitability.

Risks Relating to SMC's Infrastructure Business:

SMC may fail to successfully operate its infrastructure business

SMC's ability to successfully grow and operate its infrastructure business is subject to various risks and uncertainties, including:

- the need to procure materials, equipment and services at reasonable costs and in a timely manner;
- reliance on third party providers and consultants, in particular for those aspects of the business where SMC has limited expertise or experience;
- the possible need to raise additional financing to fund infrastructure projects, which SMC may be unable to obtain on satisfactory commercial terms or at all;
- errors or delays in the design, engineering, construction, installation, inspection, commissioning, management or operation of each project;
- penalties if concession requirements are not satisfied;
- its ability to secure adequate right-of-ways for its toll road projects;
- its ability to complete projects according to budgeted costs and schedules;
- its ability to reach forecasted traffic figures;
- its ability to implement increases in toll rates; and
- delays or denials of required approvals, including required concessional and environmental approvals.

Occurrence of any of the foregoing or a failure by SMC to successfully operate its infrastructure business could have a material adverse effect on its business, financial condition and results of operations.

SMC may be unable to secure tariff increases.

The commercial success of SMC's infrastructure business and projects depends in part on the ability of SMC's affiliates to impose certain increases in tariffs and toll rates. While certain increases in tariffs and toll rates are permitted contractually pursuant to pricing formulas set forth in the applicable concession agreements, tariff increases may not be feasible commercially due to various factors, including competition, price sensitivity in consumer demand and changes in government policy. Any constraint on the ability of SMC's infrastructure business to increase tariffs could have a material adverse effect on its business, financial condition and results of operations.

Patronage may be materially reduced by external events.

The commercial success of SMC's infrastructure business depends on the ability of its projects to maintain or attract increases in patronage. External events may decrease the numbers of vehicles, airplanes or passengers that utilize SMC's infrastructure facilities. For example, rising oil prices could result in less passenger vehicle journeys, which could decrease revenue received from road tolls. Higher oil prices could also increase the cost of airfare for consumers, which could decrease passenger numbers at Caticlan airport. In addition, patronage could decrease as a result of construction of competing facilities, such as another airport on or near Boracay Island. Any decrease in patronage or any factor that would decrease patronage could have a material adverse effect on SMC's infrastructure business, financial condition, results of operations and prospects.

SMC may not be successful in securing new concessions.

SMC's future plans in relation to the infrastructure business contemplate the continued acquisition of new concessions and projects. SMC's ability to expand its business and increase operating profits may be limited as a result of various external events. For example, concessions for new projects under consideration may be awarded to competing bidders or competition for such concessions may increase the cost of new concessions,

thereby reducing returns. In addition, changes in laws, rules or regulations or government policy, such as unexpected changes in regulatory requirements (including with respect to taxation and tariffs), could increase the cost of conducting the infrastructure business or change the potential return available to SMC from the project which could have a material adverse effect on SMC's business, financial condition, results of operations and prospects.

Risks Relating to SMC's Other Businesses

Rapid changes in technology may severely disrupt SMC's telecommunication business as well as materially reduce its revenues and profitability.

The telecommunications industry has been characterized recently by rapid technological changes. There is no assurance that these developments will not result in competition from providers of new services or the need for SMC's telecommunications business to make substantial capital expenditures to upgrade its facilities. The future success of SMC's telecommunications business will depend, in part, on its ability to anticipate or adapt to such changes and to offer services that meet customer demands on a competitive and timely basis. SMC's telecommunications business may be unable to obtain new technologies on a timely basis or on satisfactory terms or implement them in an appropriate or effective manner. Future development of new technologies, services or standards could require significant changes to SMC's telecommunications business model, negatively impact its existing businesses and necessitate significant new investments. In addition, new products and services may be expensive to develop and may result in increased competition. Such strategic initiatives and technological developments could require SMC to incur significant additional capital expenditures. There is no assurance that SMC would be able to adopt and successfully implement new technologies. In addition, there is no assurance regarding how emerging and future technological changes will affect the operations or the competitiveness of SMC's telecommunications services. Rapid technological changes could materially reduce the revenues and profitability of SMC's telecommunications business, and its results of operations and prospects.

SMC's telecommunications business may not be able to compete effectively with its competitors, which include some of the largest telecommunications companies in the Philippines.

The market for communication services in the Philippines is intensely competitive. SMC expects competition to increase as the Philippine telecommunications industry continues to grow. There is also uncertainty as to the pace and extent of growth in subscriber demand and the extent to which prices for airtime and line rental will change. There is no assurance that SMC will be able to compete successfully against current or future competitors.

SMC's principal competitors include the following telecommunications companies in the Philippines: the Philippine Long Distance Telephone Company, Globe Telecommunications, Inc. and Digitel Telecommunications Philippines, Inc. SMC's principal competitors are relatively larger companies that may have greater market presence as well as greater engineering resources and experience. Unlike SMC, which is a relative newcomer to the telecommunications industry, SMC's major competitors in the telecommunications industry have already spent significant resources to build nationwide networks and have developed large subscriber bases. Many of the voice and data communications customers of these telecommunications companies may also prefer to use companies that provide multiple services for their telecommunications needs, rather than using those companies controlled by SMC. If SMC is not able to compete successfully with these companies, such inability could have a material adverse effect on SMC's business, financial condition, results of operations and prospects.

Changes in domestic and international banking policies and regulations in response to the 2007-2008 global financial crisis could have a material adverse effect on the financial condition and results of operations of SMC's banking business.

The recent global financial crisis has led, and is expected to continue to lead, to significant regulatory and policy changes in the banking and financial sector in various countries, including the Philippines. Changes

to policies or regulations governing capital and liquidity ratios, cross-border capital flows, local lending obligations, management compensation and consumer protection could have an impact on various aspects of SMC's banking business. The BSP has issued such regulations affecting the risk-based capital adequacy framework for banks, as discussed in more detail in the section on "Regulation".

The extent and impact of such changes is difficult to anticipate and estimate. There is no assurance that future changes in the legal and regulatory environment for banks in the Philippines and internationally will not materially and adversely affect the growth, capital adequacy and profitability of SMC's banking business or its future financial performance. In addition, SMC's banking business could also be materially and adversely affected by changes in international policies, income tax laws and rules and accounting principles, as well as international conventions and standards relating to commercial banking operations.

Risks Relating to the Philippines

SMC's operations are concentrated and its assets are located in the Philippines, and any downturn in general economic conditions in the Philippines could have a material adverse effect on SMC's business, financial condition, results of operations and prospects.

Historically, SMC's financial condition and results of operations have been influenced, and will continue to be influenced, to a significant extent by the overall performance of the Philippine economy. In particular, the Philippines has experienced periods of slow or negative growth, high inflation, significant devaluation of the Peso and the imposition of exchange controls. Currently, over 90% of SMC's revenue is derived from business activity in the Philippines.

In addition, demand for many of SMC's products is tied closely to domestic consumer purchasing power and disposable income levels, which may be adversely affected by unfavorable economic developments in the Philippines. For example, in 2008, the macroeconomic slowdown in the Philippines negatively affected sales volumes in SMC's flour and DSO businesses, as consumers prioritized staple commodities such as rice over bread and bread spreads. Similarly, with respect to SMC's beverages business, unfavorable economic developments may induce consumers of SMC's beverage products to purchase more private label or economy brands, sales of which produce lower profit margins. As SMC's businesses expand their product and brand portfolios in higher-priced premium market segments in their respective industries, their businesses and prospects will be increasingly affected by any deterioration in consumer purchasing power. Any decrease in consumer purchasing power and disposable income levels could have a material adverse effect on SMC's financial and operating performance.

In addition, global financial, credit and currency markets have, since the second half of 2007, experienced, and may continue to experience, significant dislocations and liquidity disruptions. There is significant uncertainty as to the potential for a continued downturn in the United States and Europe, as well as the global economy, which could cause economic conditions in the Philippines to deteriorate. Any downturn in the Philippine economy may negatively impact consumer sentiment and general business conditions in the Philippines, which may materially reduce SMC's revenues, profitability and cash flows. Moreover, there is no assurance that current or future government policies will continue to be conducive to sustaining economic growth.

Political instability or acts of terrorism in the Philippines could destabilize the country and may have a negative effect on SMC.

The Philippines has from time to time experienced political and military instability. In the last few years, there has been political instability in the Philippines, including impeachment proceedings against former Presidents of the Philippines, and public and military protests arising from alleged misconduct by previous administrations. In addition, there is no guarantee that acts of election-related violence will not occur in the future and such events could negatively impact the Philippine economy. An unstable political environment, whether due to the imposition of emergency executive rule, martial law or widespread popular demonstrations or rioting, could negatively affect the general economic conditions and operating environment in the Philippines, which could have a material adverse effect on SMC's business, financial condition and results of

operations. The Philippines has also been subject to a number of terrorist attacks since 2000, and the Philippine armed forces have been in conflict with groups which have been identified as being responsible for kidnapping and terrorist activities in the Philippines. In addition, bombings have taken place in the Philippines, mainly in cities in the southern part of the country. Political instability, acts of terrorism, violent crime and similar events could have a material adverse effect on SMC's business, financial condition, results of operations and prospects.

The occurrence of natural catastrophes may materially disrupt SMC's operations

The Philippines has experienced a number of major natural catastrophes over the years including typhoons, volcanic eruptions and earthquakes that may materially disrupt and adversely affect SMC's business operations. There is no assurance that the insurance coverage SMC maintains for these risks will adequately compensate it for all damages and economic losses resulting from natural catastrophes.

The credit rating of the Philippines may materially and adversely affect SMC's ability to obtain financing on commercially acceptable terms, or at all.

International credit rating agencies issue credit ratings for companies with reference to the country in which they are resident. As a result, the sovereign credit ratings of the Philippines directly affect companies that are resident in the Philippines, such as SMC. There is no assurance that Moody's, S&P or other international credit rating agencies will not downgrade the credit rating of the Philippines in the future. Any such downgrade could have a material adverse effect on liquidity in the Philippine financial markets and the ability of the Philippine government and Philippine companies, including SMC, to raise additional financing, and will increase borrowing and other costs.

If foreign exchange controls were to be imposed in the Philippines, SMC's ability to purchase raw materials or to meet its foreign currency payment obligations could be severely constrained.

The Philippines currently does not have any foreign exchange controls in effect. However, the BSP has statutory authority, with the approval of the President of the Philippines, during a foreign exchange crisis or in times of national emergency, to: (i) suspend temporarily or restrict sales of foreign exchange; (ii) require licensing of foreign exchange transactions; or (iii) require the delivery of foreign exchange to the BSP or its designee banks for the issuance and guarantee of foreign currency-denominated borrowings.

SMC purchases certain critical key inputs from abroad and requires foreign currency to make these purchases. There is no assurance that foreign exchange controls will not be imposed by the Philippine government in the future. Any foreign currency restrictions could severely curtail SMC's ability to pay for certain key inputs or to meet its foreign currency payment obligations, which could materially and adversely affect its financial condition and results of operations.

Corporate governance, disclosure and financial reporting standards in the Philippines may differ from those in other countries.

There may be less publicly available information about Philippine public companies, such as SMC, than is regularly made available by public companies in other countries. In addition, although it complies with the requirements of the Philippine SEC with respect to corporate governance standards, these standards may differ from those applicable in other jurisdictions. For example, the Philippine SEC requires public companies such as SMC to have at least two independent directors. SMC has at least two independent directors in compliance with Philippine laws, rules and regulations, whereas a greater number of independent directors may be required in other jurisdictions.

Investors may face difficulties enforcing judgments against SMC.

SMC is organized under the laws of the Republic of the Philippines and a substantial portion of its assets are located in the Philippines. It may be difficult for investors to effect service of process outside the Philippines upon SMC with respect to claims pertaining to the Offer or the Offer Shares. Moreover, it may be

difficult for investors to enforce in the Philippines judgments against it obtained outside the Philippines in any actions pertaining to the Offer or the Offer Shares, particularly with respect to actions for claims to which SMC has not consented to service of process outside the Philippines. In addition, most of its directors and officers are residents of the Philippines and all or a substantial portion of the assets of such persons are or may be located in the Philippines. As a result, it may be difficult for investors to effect service of process upon such persons outside the Philippines or enforce against such persons in the Philippines judgments obtained in courts outside the Philippines.

The Philippines is not a party to any international treaty relating to the recognition or enforcement of foreign judgments. Philippine law provides that a judgment or final order of a foreign court is enforceable in the Philippines, unless there is evidence that: (i) such judgment was obtained by collusion or fraud; (ii) the foreign court rendering such judgment did not have jurisdiction over the subject matter of the action in accordance with its jurisdictional rules; (iii) such order or judgment is contrary to Philippine laws on good customs, public order or public policy; (iv) SMC did not have notice of the proceedings before the foreign court; or (v) such judgment was based upon a clear mistake of law or fact.

Risks Associated with the Offer and the Common Shares

SMC has a high level of debt and other debt-like obligations.

SMC has significant long-term debt, substantial long-term obligations under finance leases related to the power plants in its power business and significant commitments in respect of preferred share dividend payments. As of December 31, 2010, SMC's noncurrent liabilities included long-term debt (net of current maturities and debt issue costs) of ₱156,378 million and finance lease liabilities (net of current portion) of ₱197,461 million. As of December 31, 2010, SMC's current liabilities included drafts and loans payable of ₱74,128 million, finance lease liabilities (current portion) of ₱10,946 million and current maturities of long-term debt (net of debt issue costs) of ₱12,549 million. In addition to these liabilities that appear on SMC's consolidated financial statements, SMC and its subsidiaries also have an aggregate of ₱97,788 million of preferred shares outstanding, which have defined cumulative dividend rates of between 8.0% and 9.5281% per year. Although the dividends on these preferred shares are not required to be paid each year as a contractual matter, SMC does intend to make these dividend payments, and its cash flow projections for dividend payments in respect of these preferred shares are ₱7,975.8 million in each year.

SMC's level of debt and debt-like obligations could:

- require SMC to dedicate a substantial portion of its cash flow from operations to debt payments or other payment obligations, thereby decreasing the availability of its cash flow for business operations, including expansion and acquisitions;
- increase SMC's vulnerability to general adverse economic and industry conditions; and
- prevent SMC from accessing credit or equity markets to satisfy its repayment obligations as they become due on favorable terms, or at all.

The Offer Shares may not be a suitable investment for all investors.

Each potential investor in the Offer Shares must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of SMC and its businesses, the merits and risks of investing in the Offer Shares and the information contained in this Offering Circular;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Offer Shares and the impact the Offer Shares will have on its overall investment portfolio;

- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Offer Shares, including where the currency for purchasing and receiving dividends on the Offer Shares is different from the potential investor's currency;
- understand and be familiar with the behavior of any relevant financial markets; and
- be able to evaluate (either alone or with the help of a financial advisor) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

The market price of the Common Shares may be affected if additional shares are sold by a significant shareholder or are issued by SMC.

The Selling Shareholder is a significant shareholder of SMC immediately before this Offer. Following this Offer, and assuming no exercise of the Over-Allotment Option or the Domestic Option, the Selling Shareholder will hold approximately 63% of SMC's Common Shares and will control approximately 84% of the voting rights of the Common Shares of SMC. The Selling Shareholder has agreed that it will not sell, contract to sell, pledge or otherwise dispose of any of its shares in SMC for a period of 180 days from the Closing Date. After this date, there is no assurance that the Selling Shareholder will not dispose of additional Common Shares or that SMC will not issue additional shares in the future. In addition, SMC cannot predict the effect, if any, that any future sales of shares by the Selling Shareholder, or the availability of shares for sale by the Selling Shareholder or the issuance of Common Shares by SMC, may have on the market price of the Common Shares. Sales by the Selling Shareholder or issuance by SMC of substantial quantities of additional shares, or the market perception that such sales or issuances may occur, could have a material adverse effect on the prevailing market price of the Common Shares.

Issues relating to SMC's Series "1" preferred shares held by the Coconut Industry Investment Fund ("CIIF") companies may affect the market price of the Common Shares.

As of December 31, 2010, the CIIF companies hold 753,848,312 Series 1 preferred shares of SMC. The Series 1 preferred shares are perpetual, cumulative and non-voting shares with an issue price of ₱75.00 per share and a dividend rate of 8% per annum computed in reference to the issue price. SMC may, at its option, redeem all or part of the Series 1 preferred shares commencing at the end of three years from the date of issue or on any dividend payment date at a redemption price equal to the issue price plus all cumulated and unpaid cash dividends.

The Series 1 preferred shares, including those held by the CIIF companies, were issued by SMC following an offer it made to all holders of SMC Common Shares in June 2009 to convert their Common Shares to Series 1 preferred shares on a 1:1 basis. Pursuant to this offer, in October 2009, SMC converted a total of 873,173,353 Common Shares into the corresponding Series 1 preferred shares. In addition, SMC issued a total of 97,333,000 Series 1 preferred shares by way of a private placement to qualified institutional investors in December 2009.

On July 24, 2009, the Philippine Coconut Producers Federation, Inc. ("COCOFED") filed a motion with the Supreme Court of the Republic of the Philippines seeking the conversion of the Common Shares then held by the CIIF companies into Series 1 preferred shares, and for such Series 1 preferred shares to be held by a trust fund to be established for the benefit of the coconut farmers. The Presidential Commission on Good Government ("PCGG") joined the proceedings, claiming that conversion was proper, but questioned the legal standing of COCOFED to initiate the action for the conversion of the Common Shares held by the CIIF companies. Other parties intervened and opposed the conversion, claiming that the Philippine government was required to show that the conversion would be advantageous to the public interest or could result in clear and material benefit.

On September 17, 2009, the Supreme Court ruled that decisions regarding the Common Shares held by the CIIF companies should be made by the PCGG, not COCOFED. As part of its resolution of the case, the Supreme Court approved the conversion of the Common Shares held by the CIIF companies, ruling that

conversion was necessary to preserve the value of the Common Shares. SMC effected the conversion and issued the preferred shares to the CIIF companies in October 2009 following approval by the Supreme Court, which was reaffirmed by the Supreme Court in a resolution dated February 11, 2010.

At the time that the PCGG sought to exercise its option to convert the Common Shares in the name of the CIIF companies, the Common Shares were trading on the PSE at prices ranging between approximately ₱50 and ₱60 per share.

According to recent press reports, the PCGG, under a new administration, questioned in an audit report the conversion of the Common Shares then held by the CIIF companies into Series 1 preferred shares at the conversion price of ₱75 per share. This audit report could result in an investigation of the previous PCGG officials who authorized the conversion which, in turn, could lead to the PCGG instituting legal action against the previous PCGG officials and proceedings before the Supreme Court for the reversal of the previous approval given by the Supreme Court in relation to the conversion of the preferred shares. Such adverse development could have a material adverse effect on the prevailing market price of the Common Shares.

The liquidity and trading price of the Common Shares may be volatile, which could result in substantial losses to investors.

The trading price of the Common Shares may be volatile and could fluctuate in response to factors beyond SMC's control, including general market conditions in the Philippines, the Asia Pacific region and elsewhere in the world. In particular, the performance and fluctuation of the market prices of securities of other companies that operate in the same industries as SMC may affect the volatility in the price of and trading volume for the Common Shares. Broad market and industry factors may cause the market price of the Common Shares to decline, regardless of SMC's operating performance. If the price of the Common Shares declines after the Offer, investors could lose all or a significant part of their investment. In addition to market and industry factors, the price and trading volume of the Common Shares may be highly volatile for specific business reasons. In particular, factors such as variations in SMC's revenues, earnings and cash flow could cause the market price of the Common Shares to change substantially. Any of these factors may result in large and sudden changes in the volume and trading prices of the Common Shares.

Shareholders may experience liquidity problems with respect to the Common Shares.

The securities market in the Philippines is smaller and less liquid than the securities markets in the United States and certain other countries. The total market capitalization of all companies listed on the PSE at the end of 2009 was approximately ₱4.0 trillion, and, at the end of 2010, the total market capitalization of all companies listed on the PSE was approximately ₱6.7 trillion. There is no assurance regarding the liquidity of the market of Philippine securities in general. Liquidity fluctuations may arise as a result of temporary exchange closures, broker defaults, settlement delays and broker strikes. Accordingly, there is no assurance that a shareholder will be able to dispose of the Offer Shares, or direct the sale of such Offer Shares through the PSE, at prices or at times at which such shareholder may have been able to do so in other, more liquid, markets, or at all.

SMC may be unable to pay dividends on the Common Shares.

There is no assurance that SMC can or will declare dividends on the Common Shares in the future. Future dividends, if any, will be at the discretion of the Board and will depend upon SMC's future results of operations and general financial condition, capital requirements, its ability to receive dividends and other distributions and payments from its subsidiaries, foreign exchange rates, legal, regulatory and contractual restrictions, loan obligations, including loan obligations of its subsidiaries, and other factors the Board may deem relevant. In particular, SMC's debt instruments contain restrictive covenants which could impair its ability to pay dividends.

In addition, SMC is primarily a holding company and is a separate and distinct legal entity from its subsidiaries. SMC conducts limited business operations and typically derives its cash flow principally from dividends from its subsidiaries and other investments. As a result, SMC's ability to pay dividends and meet

other obligations is partially dependent on receiving such payments from its subsidiaries and other investments. SMC's subsidiaries incur debts and issue preferred shares on their own behalf and the instruments governing the debts and preferred shares they incur may restrict their ability to pay dividends or make other distributions to SMC, which in turn would limit SMC's ability to pay dividends on the Common Shares.

Since the Offer Price is higher than SMC's net tangible book value per Share, purchasers of SMC's Offer Shares will incur immediate and substantial dilution.

Purchasers of the Offer Shares in this Offer will pay more for their Offer Shares on a per share basis than the pro forma net tangible book value per share as of December 31, 2010. As a result, such purchasers will experience immediate and substantial dilution of approximately ₱65.25 per share, representing the difference between SMC's pro forma net tangible book value per share as of December 31, 2010, after giving effect to this Offer, and the Offer Price of ₱110 per share. SMC may issue additional Common Shares in the future. In the event that it does so, purchasers of the Offer Shares may experience further dilution.

The price of the Common Shares could fall between the time of pricing and the Closing Date or such later time when the trading halt on the Common Shares has been lifted and stabilization activities, if any, have ended.

As part of the Offer, the PSE approved a suspension of trading in the Common Shares on the PSE from April 13, 2011 to May 5, 2011, and SMC appointed the Stabilizing Agent to engage in activities to stabilize the price of the Common Shares. Such trading suspension and stabilizing activities may cause the price of the Common Shares to be higher than the price that would otherwise exist in the absence of such trading suspension and stabilizing activities. There is no assurance that the price of the Common Shares will not decline significantly after any such trading suspension is lifted and stabilizing activities end.

Furthermore, since the closing of the Offer is not expected to take place until at least 15 days following pricing of the Offer Shares, investors are also subject to the risk that the price of the Offer Shares could fall between the time of pricing and the Closing Date.

The Offer Shares are subject to restrictions on transfer.

The Offer Shares are being offered and sold only outside the United States to non-U.S. persons in compliance with Regulation S, and may be transferred or resold in the United States only in transactions registered under or exempt from registration under the Securities Act and applicable state securities laws. These restrictions on transfer may materially limit the ability of any holder of the Offer Shares to transfer the Offer Shares in the United States or to, or for the account or benefit of, U.S. persons.

If foreign exchange controls were to be imposed, access to foreign currency and dividends may be adversely affected.

The Philippine government has, in the past, instituted restrictions on the conversion of Pesos into foreign currency and the use of foreign exchange received by Philippine residents to pay foreign currency denominated obligations. The Monetary Board of the BSP, with the approval of the President of the Philippines, has statutory authority, during a foreign exchange crisis or in times of national emergency, to suspend temporarily or restrict sales of foreign exchange, require licensing of foreign exchange transactions or require delivery of foreign exchange to the BSP or its designee. SMC is not aware of any pending proposals by the Philippine government regarding such restrictions. Although the Philippine government has from time to time made public pronouncements of a policy not to impose restrictions on foreign exchange, there is no assurance that the Philippine government will maintain such policy or will not impose economic or regulatory controls that may restrict free access to foreign currency. Any such restriction imposed in the future could adversely affect the ability of investors to repatriate foreign currency upon sale of the Offer Shares or receipt of any dividends.

SMC follows the applicable corporate disclosure standards for common shares listed on the PSE, which standards are different from those applicable to shares in other countries.

SMC is subject to reporting obligations in respect of the Offer Shares listed on the PSE. The disclosure standards imposed by the PSE are different from those imposed by securities exchanges in other countries or regions such as the United States or Hong Kong. As a result, the level of information that is available may not correspond to what investors in the Offer Shares are accustomed to in other jurisdictions.

Rights of shareholders under Philippine law may be more limited than under the laws of other jurisdictions.

The obligations under Philippine law of majority shareholders and directors with respect to minority shareholders may be more limited than those in certain other countries, such as the United States and United Kingdom. Consequently, minority shareholders may not be able to protect their interests under current Philippine law to the same extent as in certain other countries.

For example, under PSE Rules, a majority of the Board may pass a resolution to privatize and delist SMC shares from the PSE, subject to making a tender offer following which the person(s) making the tender offer will acquire at least 95% of the issued and outstanding shares of SMC. Furthermore, Philippine Batas Pambansa Blg. 68 (the “Corporation Code”) grants dissenting shareholders appraisal rights to require the corporation to purchase such shareholder’s shares in certain instances. In addition, derivative actions are rarely brought on behalf of corporations in the Philippines. Accordingly, there is no assurance that legal rights or remedies of minority shareholders will be the same, or as extensive, as those available in other jurisdictions or that they will be sufficient to protect the interests of minority shareholders.

Overseas shareholders may not be able to participate in SMC’s future rights offerings or certain other equity issues

If SMC offers or causes to be offered to holders of the Offer Shares rights to subscribe for additional Offer Shares or any right of any other nature, SMC will have discretion as to the procedure to follow in making such rights available to holders of the Offer Shares or in disposing of such rights for the benefit of such holders and making the net proceeds available to such holders.

For example, SMC will not offer such rights to holders of Offer Shares who are U.S. persons (as defined in Regulation S) or have a registered address in the United States unless:

- a registration statement is in effect, if a registration statement under the Securities Act is required in order for SMC to offer such rights to holders and sell the securities represented by such rights; or
- the offer and sale of such rights or the underlying securities to such holders are exempt from registration under the provisions of the Securities Act.

SMC has no obligation to prepare or file any registration statement. Accordingly, shareholders who are subject to similar restrictions may be unable to participate in rights offerings and may experience a dilution in their holdings as a result.

Repatriation of dividends denominated in currencies other than Philippine Pesos may be subject to certain restrictions.

Under BSP regulations, Philippine residents may, in general, freely dispose of their foreign exchange receipts and foreign exchange may be freely sold and purchased outside the Philippine banking system. Restrictions exist on the sale and purchase of foreign exchange within the Philippine banking system. In particular, a foreign investment must be registered with the BSP if foreign exchange needed to service the repatriation of capital and the remittance of dividends, profits and earnings which accrue thereon shall be sourced from the Philippine banking system. See “BSP Foreign Exchange Regulations.”

Risks Relating to Certain Statistical Information in this Offering Circular

Certain statistical information in this Offering Circular relating to the Philippines, the industries and markets in which SMC's businesses compete and other data used in this Offering Circular were obtained or derived from internal surveys, market research, governmental data, publicly available information and/or industry publications. Industry publications generally state that the information they contain has been obtained from sources believed to be reliable. However, there is no assurance that such information is accurate or complete. Similarly, internal surveys, industry forecasts and market research have not been independently verified by SMC and may not be accurate, complete, up-to-date, balanced or consistent with other information compiled within or outside the Philippines.

EXCHANGE RATES

The PDS, a computer network supervised by the BSP, through which the members of the Bankers Association of the Philippines effect spot and forward currency exchange transactions, was introduced in 1992. The PDS was adopted by the BSP as a means to monitor foreign exchange rates. The BSP Rate is the weighted average rate for the purchase of U.S. dollars with Pesos, which is quoted by the PDS and published in the BSP's Reference Exchange Rate Bulletin and major Philippine financial press on the following business day. On April 20, 2011, the BSP Rate was ₱43.366 = US\$1.00.

The following table sets forth certain information concerning the BSP Rate between the Peso and the U.S. dollar for the periods and dates indicated, expressed in Pesos per US\$1.00:

<u>Year</u>	<u>Peso/U.S. dollar exchange rate</u>			
	<u>Period end</u>	<u>Average⁽¹⁾</u>	<u>High⁽²⁾</u>	<u>Low⁽³⁾</u>
2007	41.401	46.148	49.156	41.142
2008	47.485	44.475	49.984	40.360
2009	46.356	47.637	49.056	45.947
2010	43.885	45.248	46.983	42.516
2011				
January	44.088	44.172	44.585	43.705
February	43.837	43.703	44.311	43.358
March	43.432	43.516	43.948	43.300

⁽¹⁾ Simple average of daily closing exchange rates for the period.

⁽²⁾ Highest closing exchange rate for the period.

⁽³⁾ Lowest closing exchange rate for the period.

Source: Reference Exchange Rate Bulletin, Treasury Department of the BSP.

USE OF PROCEEDS

The net proceeds of the Offer to be received by SMC will be approximately ₱2,980 million, at the Offer Price of ₱110 per share and after deducting an estimated ₱54 million for underwriting fees, discounts and commissions, applicable taxes and other expenses related to the Offer and payable by SMC, assuming no exercise of the Over-Allotment Option. The net proceeds of the Offer to be received by Top Frontier will be ₱8,940 million, at the Offer Price of ₱110 per share and after deducting an estimated ₱162 million for underwriting fees, discounts and commissions, applicable taxes and other expenses related to the Offer and payable by Top Frontier, assuming no exercise of the Domestic Option.

If the Over-Allotment Option is exercised in full, the net proceeds of the Offer to be received by SMC will be ₱3,831 million, after deducting an estimated ₱69 million for underwriting fees, discounts and commissions, applicable taxes and other expenses related to the Offer and payable by SMC. If the Domestic Option is exercised in full, the net proceeds of the Offer to be received by Top Frontier will be ₱11,920 million, after deducting an estimated ₱216 million for underwriting fees, discounts and commissions, applicable taxes and other expenses related to the Offer and payable by Top Frontier.

From the net proceeds of the Offer and the Concurrent Offer, SMC intends to use an amount of approximately ₱22 billion for investments in its infrastructure businesses, and the balance for working capital and other general corporate purposes.

Top Frontier intends to use the net proceeds of the Offer that it will receive to repay advances from its shareholders (not including SMC) which Top Frontier used to fund purchases of Common Shares. The shareholders receiving repayment from Top Frontier will in turn use such repayment to repay their respective loans from an affiliate of Standard Chartered Securities (Singapore) Pte. Limited, one of the International Joint Bookrunners.

DIVIDEND POLICY

Dividends may be declared at the discretion of the Board and will depend upon SMC's future results of operations and general financial condition, capital requirements, its ability to receive dividends and other distributions and payments from its subsidiaries, foreign exchange rates, legal, regulatory and contractual restrictions, loan obligations both at the parent and subsidiary level and other factors the Board may deem relevant. While there is no assurance that SMC will declare dividends on the Offer Shares in the future, the table below sets forth the amount of dividends declared and paid since 2007:

Common Shares

<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2007	Cash	0.35	March 1	March 16	April 16
	Cash	0.35	May 8	June 8	July 2
	Cash	0.35	July 24	August 17	September 10
	Cash	<u>0.35</u>	December 6	December 21	January 21
Total:		<u>1.40</u>			
2008	Cash	0.35	March 6	March 28	April 24
	Cash	0.35	June 26	August 1	August 25
	Cash	0.35	September 25	November 3	November 17
	Cash	<u>0.35</u>	December 8	January 16	February 10
Total:		<u>1.40</u>			
2009	Cash	0.35	March 26	April 17	May 11
	Cash	<u>0.35</u>	June 25	July 24	August 17
Total:		<u>0.70</u>			
2010	Cash	0.35	January 6	January 22	February 15
	Cash	0.35	February 2	February 19	March 8
	Cash	0.35	March 15	March 29	April 12
	Cash	0.35	July 27	August 10	August 25
	Special Cash	5.0	July 27	August 10	August 25
	Cash	<u>0.35</u>	October 8	November 2	November 22
Total:		<u>6.75</u>			
2011	Cash	<u>0.35</u>	March 14	March 28	April 11

Preferred Shares — Series 1

<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2010	Cash	1.5	January 6	January 22	February 15
	Cash	1.5	April 14	April 28	April 28
	Cash	1.5	June 17	July 9	August 2
	Cash	<u>1.5</u>	October 8	October 22	November 15
Total:		<u>6.0</u>			
2011	Cash	1.5	February 10	February 4	February 18

In addition, SMC conducts limited business operations and typically derives its cash flow principally from dividends from its subsidiaries and other investments. SMC relies substantially on dividend payments from its subsidiaries and other investments to pay its dividends, including the following dividends paid since 2008:

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<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2008	Cash	0.14	July 24	August 8	August 22
	Cash	<u>0.15</u>	October 16	October 31	November 12
Total:		<u>0.29</u>			
2009	Cash	0.19	January 27	February 13	February 23
	Cash	0.185	April 8	April 28	May 7
	Cash	0.11	July 14	July 28	August 10
	Cash	<u>0.11</u>	November 26	December 11	December 23
Total:		<u>0.595</u>			
2010	Cash	0.13	February 25	March 11	March 22
	Cash	0.14	May 14	May 28	June 14
	Cash	0.14	August 10	August 27	September 13
	Cash	<u>0.14</u>	November 10	November 25	December 13
Total:		<u>0.55</u>			
2011	Cash	0.14	March 11	March 25	April 11

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<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2008	Cash	0.375	March 3	March 19	April 7
	Cash	0.375	May 12	May 27	June 10
	Cash	0.375	August 11	August 29	September 15
	Cash	<u>0.375</u>	November 4	November 19	December 1
Total:		<u>1.5</u>			
2009	Cash	0.375	March 19	April 3	April 20
	Cash	0.375	May 7	May 22	June 8
	Cash	0.375	August 7	August 24	September 14
	Cash	<u>0.375</u>	November 4	November 21	December 7
Total:		<u>1.5</u>			
2010	Cash	0.375	March 30	April 16	May 7
	Cash	0.375	May 6	May 21	June 8
	Cash	0.375	August 9	August 23	September 6
	Cash	<u>0.375</u>	November 11	November 26	December 13
Total:		<u>1.50</u>			
2011	Cash	0.375	March 8	March 23	April 8

Petron**Common Shares**

<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2008	Cash	<u>0.10</u>	May 7	June 2	June 27
Total:		<u>0.10</u>			
2010	Cash	<u>0.10</u>	July 12	July 30	August 16
Total:		<u>0.10</u>			

Preferred Shares

<u>Year</u>	<u>Type</u>	<u>Per Share Amount (P)</u>	<u>Date Declared</u>	<u>Record Date</u>	<u>Payment Date</u>
2010	Cash	2.382	April 29	May 19	June 7
	Cash	2.382	July 13	August 10	September 6
	Cash	<u>2.382</u>	October 21	November 16	December 6
Total:		<u>7.146</u>			
2011	Cash	2.382	February 2	February 21	March 7

CAPITALIZATION AND INDEBTEDNESS

The following table sets forth SMC's consolidated cash and cash equivalents, short term debt, long term debt and shareholders' equity in accordance with PFRS as of December 31, 2010 and as adjusted to give effect to the issuance of the Offer Shares pursuant to the Offer and the receipt of the estimated net proceeds to SMC from: (i) the Offer, which SMC currently estimates to be approximately ₱2,980 million after deducting the underwriting fees, discounts and commissions, applicable taxes and other expenses payable by SMC in the Offer, using an Offer Price of ₱110 per share; and (ii) the Concurrent Offer of US\$600 million of 2.0% exchangeable bonds, which SMC currently estimates to be approximately ₱25,909 million after deducting the underwriting fees payable by SMC in the Concurrent Offer. The table assumes that the Over-Allotment Option is not exercised.

The adjusted information below is illustrative only and SMC's capitalization following the completion of the Offer will be determined by the Offer Price and other terms of the Offer and the Concurrent Offer determined at pricing.

This table should be read in conjunction with the consolidated financial statements, related notes and other financial information contained elsewhere in this Offering Circular.

	As of December 31, 2010		
	Actual	As Adjusted (In millions)	As Adjusted in US\$
Cash and cash equivalents	<u>₱125,188</u>	<u>₱154,077</u>	<u>US\$ 3,511</u>
Short-term debt			
Drafts and loans payable	74,128	74,128	1,689
Current maturities of long-term debt — net of debt issue costs	<u>12,549</u>	<u>12,549</u>	<u>286</u>
Total short-term debt	<u>86,677</u>	<u>86,677</u>	<u>1,975</u>
Long-term debt			
Exchangeable bonds	—	25,909	590
Long-term debt — net of current maturities and debt issue costs	<u>156,378</u>	<u>156,378</u>	<u>3,563</u>
Total long-term debt.	<u>156,378</u>	<u>182,287</u>	<u>4,154</u>
Shareholders' equity			
Capital stock, common, par value ₱5: 3,390,000,000 Shares authorized, 2,329,945,530 Shares subscribed and outstanding	16,343	16,343	372
Capital stock, preferred, par value ₱75: 1,110,000,000 Shares authorized, 970,506,353 Shares subscribed and outstanding	4,852	4,852	111
Additional paid-in capital	101,406	101,406	2,311
Revaluation increment	1,391	1,391	32
Cumulative translation adjustments	5,365	5,365	122
Retained earnings ⁽¹⁾	156,215	156,215	3,560
Treasury stock	(69,541)	(66,561)	(1,517)
Non-controlling interests	<u>50,794</u>	<u>50,794</u>	<u>1,157</u>
Total shareholders' equity	<u>266,825</u>	<u>269,805</u>	<u>6,148</u>
Total capitalization ⁽²⁾	<u>₱423,203</u>	<u>₱452,092</u>	<u>US\$10,302</u>

⁽¹⁾ Retained earnings reflect appropriated amounts plus unappropriated amounts.

⁽²⁾ Total capitalization computed as sum of long term debt and total shareholders' equity.

SELECTED FINANCIAL AND OTHER INFORMATION

You should read the selected financial information presented below in conjunction with SMC's consolidated financial statements and the notes to those consolidated financial statements included elsewhere in this Offering Circular. You should also read "Management's Discussion and Analysis of Financial Condition and Results of Operations".

SMC's selected financial and operating information presented below as of and for the years ended December 31, 2008, 2009 and 2010 was derived from SMC's consolidated financial statements, audited by Manabat Sanagustin & Co., CPAs and prepared in compliance with PFRS. The information below should be read in conjunction with SMC's consolidated financial statements and the related notes thereto, which are included elsewhere in this Offering Circular. SMC's historical financial condition, results of operations and cash flows are no guarantee of its future operating and financial performance.

SMC's consolidated financial statements are reported in Pesos and are presented in accordance with PFRS. All conversions of amounts in Pesos into U.S. dollars are provided for convenience only.

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
CONSOLIDATED STATEMENT OF INCOME DATA				
Sales	₱ 168,041	₱ 174,213	₱ 246,109	US\$ 5,608
Cost of sales	124,072	124,295	173,906	3,963
Gross profit.	43,969	49,918	72,203	1,645
Selling and administrative expenses	(29,151)	(30,249)	(37,426)	(853)
Interest expense and other financing charges	(6,032)	(7,926)	(16,578)	(378)
Interest income	6,630	5,989	3,023	69
Equity in net earnings (losses) of associates	(1,132)	2,816	6,817	155
Gain on sale of investments and property and equipment . .	8,746	50,630	529	12
Other income (charges) — net	(2,262)	(6,843)	6,926	158
Income before income tax from continuing operations . . .	₱ 20,768	₱ 64,335	₱ 35,494	US\$ 809
Income tax expense	(6,098)	(3,706)	(11,438)	(261)
Income from continuing operations	14,670	60,629	24,056	548
Income after income tax from discontinued operations . . .	5,413	—	—	—
Net income	₱ 20,083	₱ 60,629	₱ 24,056	US\$ 548
Attributable to:				
Equity holders of SMC	₱ 19,348	₱ 57,799	₱ 20,091	US\$ 458
Non-controlling interests	735	2,830	3,965	90
	₱ 20,083	₱ 60,629	₱ 24,056	US\$ 548
CONSOLIDATED STATEMENT OF FINANCIAL POSITION DATA				
ASSETS				
Current Assets				
Cash and cash equivalents	₱ 116,939	₱ 209,411	₱ 125,188	US\$ 2,853
Trade and other receivables — net	50,814	49,082	75,904	1,730
Inventories	25,836	25,458	57,442	1,309
Current portion of biological assets — net	2,932	2,525	3,267	74
Prepaid expenses and other current assets	7,742	8,891	16,914	385
	204,263	295,367	278,715	6,351
Assets held for sale	—	2,746	823	19
Total Current Assets	204,263	298,113	279,538	6,370

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Noncurrent Assets				
Investments and advances — net	₱ 32,253	₱ 39,005	₱ 152,814	US\$ 3,482
Available-for-sale financial assets	—	351	3,597	82
Property, plant and equipment — net	68,313	65,919	308,073	7,020
Investment properties — net	1,838	1,867	2,133	49
Biological assets — net of current portion	1,814	1,847	1,479	34
Goodwill — net	5,201	6,408	30,251	689
Other intangible assets — net	3,812	3,630	10,980	250
Deferred tax assets	7,638	8,883	7,134	163
Other noncurrent assets — net	14,241	12,468	33,801	770
Total Noncurrent Assets	135,110	140,378	550,262	12,539
Total Assets	₱ 339,373	₱ 438,491	₱ 829,800	US\$ 18,909
LIABILITIES AND EQUITY				
Current Liabilities				
Drafts and loans payable	₱ 48,560	₱ 56,789	₱ 74,128	US\$ 1,689
Accounts payable and accrued expenses	23,292	31,391	69,774	1,590
Finance lease liabilities — current portion	—	13	10,946	249
Income and other taxes payable	4,429	4,186	10,001	228
Dividends payable	1,563	573	826	19
Current maturities of long-term debt — net of debt issue costs	9,044	1,077	12,549	286
Total Current Liabilities	86,888	94,029	178,224	4,061
Noncurrent Liabilities				
Long-term debt — net of current maturities and debt issue costs	₱ 40,719	₱ 71,885	₱ 156,378	US\$ 3,563
Deferred tax liabilities	17,851	12,037	13,752	313
Finance lease liabilities- net of current portion	—	17	197,461	4,500
Other noncurrent liabilities	25,691	19,585	17,160	391
Total Noncurrent Liabilities	84,261	103,524	384,751	8,767
Equity				
Equity Attributable to Equity Holders of SMC				
Capital stock — common	₱ 16,112	₱ 16,150	₱ 16,343	US\$ 372
Capital stock — preferred	—	4,852	4,852	111
Additional paid-in-capital	31,183	99,085	101,406	2,311
Revaluation increment	18	18	1,391	32
Cumulative translation adjustments	4,837	5,845	5,365	122
Retained earnings:				
Appropriated	5,522	5,497	5,671	129
Unappropriated	96,298	151,911	150,544	3,430
Treasury stock	(4,053)	(69,541)	(69,541)	(1,585)
Total Liabilities and Equity	149,917	213,817	216,031	4,923
Non-controlling Interests	18,307	27,121	50,794	1,157
Total Equity	168,224	240,938	266,825	6,080
Total Equity Attributable to Equity Holders of SMC . .	₱ 339,373	₱ 438,491	₱ 829,800	US\$ 18,909

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Cash Flows From Operating Activities				
Income before income tax from continuing operations	₱ 20,768	₱ 64,335	₱ 35,494	US\$ 809
Income (loss) before income tax from discontinued operations	(19)	—	—	—
Gain (loss) from disposal of discontinued operations	5,425	—	—	—
Income before income tax adjustments for:	26,174	64,335	35,494	809
Depreciation, amortization and others — net	9,303	14,724	9,457	215
Interest expense and financing charges	6,032	7,926	16,578	378
Interest Income	(6,630)	(5,989)	(3,023)	(69)
Equity in net losses (earnings) of associates	1,132	(2,816)	(6,817)	(155)
Loss (gain) from disposal of discontinued operations . . .	(5,425)	—	—	—
Gain on sale of investments and property and equipment	(8,746)	(50,630)	(5,020)	(114)
Operating income before working capital changes	21,840	27,550	46,669	1,063
Changes in noncash current assets, certain current liabilities and others	(1,291)	(1,183)	13,112	299
Cash generated from operations	20,549	26,367	59,781	1,362
Interest paid	(5,665)	(6,348)	(5,155)	(12)
Income taxes paid	(7,835)	(6,651)	(9,312)	(212)
Net cash flows provided by operating activities	7,049	13,368	45,314	1,033
Cash Flows From Investing Activities				
Acquisitions of subsidiaries, net of cash and cash equivalents acquired	₱ —	₱ (1,494)	₱ (18,978)	US\$ (432)
Additions to investments and advances	(6,667)	(5,771)	(99,762)	(2,273)
Additions to property, plant and equipment	(6,437)	(6,249)	(8,518)	(194)
Increase in other noncurrent assets and others	(16,010)	(950)	1,424	32
Payments by (advances to) related parties	31,708	3,243	(6,070)	(138)
Proceeds from sale of investments and property and equipment	13,663	55,127	1,175	27
Proceeds from disposal of discontinued operations, net of cash and cash equivalents disposed of	9,083	—	—	—
Interest received	6,558	5,249	3,798	87
Dividends received	—	—	—	—
Net cash flows provided by investing activities	₱ 31,898	₱ 49,155	₱(126,931)	US\$ (2,892)
Cash Flows From Financing Activities				
Proceeds from:				
Short term borrowings	₱ 608,756	₱ 691,093	₱ 685,768	15,626
Long term borrowings	64	67,786	72,937	1,662
Payments of:				
Short term borrowings	(605,088)	(683,569)	(703,376)	(16,028)
Long term borrowings	(13,336)	(44,657)	(29,196)	(665)
Payment of finance lease liabilities	—	(12)	(4,798)	(109)
Cash dividends paid	(4,463)	(3,301)	(21,118)	(481)
Proceeds from issuance of capital stock	3	7,087	2,314	53
Dividends paid to non-controlling shareholders	(393)	(2,192)	(4,883)	(111)
Increase in non-controlling interests	592	315	126	3
Net cash flows provided by (used in) financing activities . .	(13,865)	32,550	(2,226)	(51)

	Years Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Effect of exchange rate changes on cash and cash equivalents	(1,424)	(2,601)	(380)	(9)
Net increase (decrease) in cash and cash equivalents.	23,658	92,472	(84,223)	(1,919)
Cash and cash equivalents at beginning of year	93,281	116,939	209,411	4,772
Cash and cash equivalents associated to assets held for sale	—	—	—	—
Cash and cash equivalents at end of year	<u>₱ 116,939</u>	<u>₱ 209,411</u>	<u>₱ 125,188</u>	<u>US\$ 2,853</u>

OTHER FINANCIAL DATA

Calculation of Adjusted EBIT and Adjusted EBITDA⁽¹⁾

	Years Ended December 31			
	2008	2009	2010	2010
	(In millions)			
Net income	₱20,083	₱ 60,629	₱24,056	US\$548
Add (deduct)				
Income tax expense	9,012	3,706	11,438	261
Net financing charges				
Interest expense	6,032	7,926	16,578	378
Interest income	(6,630)	(5,989)	(3,023)	(69)
Gain on sale of Investments	(7,477)	(50,831)	—	—
Other charges (income)	321	—	(4,490)	(102)
Foreign exchange losses (gains)	(8,684)	3,364	(6,097)	(139)
Marked-to-market losses (gains)	<u>8,836</u>	<u>(399)</u>	<u>(122)</u>	<u>(3)</u>
Adjusted EBIT	<u>₱21,493</u>	<u>₱ 18,406</u>	<u>₱38,340</u>	<u>US\$ 874</u>
Depreciation and amortization and impairment	<u>6,767</u>	<u>11,607</u>	<u>14,196</u>	<u>324</u>
Adjusted EBITDA	<u><u>₱28,260</u></u>	<u><u>₱ 30,013</u></u>	<u><u>₱52,536</u></u>	<u><u>US\$ 1,197</u></u>

⁽¹⁾ Adjusted EBIT and Adjusted EBITDA are measures used by SMC's management to internally evaluate the performance of its businesses. Adjusted EBIT is calculated as net income plus the following: income tax expense, net financing charges (interest income net of interest expense), gain on sale of investments, other income (charges), foreign exchange losses (gains) and marked-to-market losses (gains). Adjusted EBITDA is calculated as Adjusted EBIT plus depreciation and amortization and impairment losses. Adjusted EBIT and Adjusted EBITDA are not measures determined in accordance with PFRS, and prospective investors should not consider Adjusted EBIT or Adjusted EBITDA as an alternative to net income as a measure of operating performance or to cash flow as a measure of free cash flow for management's discretionary use, as they do not reflect certain cash requirements such as interest payments, tax payments and capital expenditures. SMC's calculation of Adjusted EBIT and Adjusted EBITDA may be different from the calculations used by other companies, and, as a result, SMC's Adjusted EBIT and Adjusted EBITDA may not be comparable to other similarly titled measures of other companies.

CONSOLIDATED PRO FORMA FINANCIAL INFORMATION

For the Year Ended December 31, 2010					
	Actual	SRC and Petron from January 1 to December 14, 2010	SMCGP from January 1 to July 31, 2010	Other Pro forma adjustments	Pro forma Combined
(In millions, except per share data)					
Sales	P246,109	P208,199 ⁽¹⁾	P20,301 ⁽²⁾	—	P474,609
Cost of sales	173,906	189,612 ⁽¹⁾	13,576 ⁽²⁾	—	377,094
Gross profit	72,203	18,587	6,725	—	97,515
Selling and administrative expenses . . .	(37,426)	(6,825) ⁽¹⁾	(114) ⁽²⁾	—	(44,365)
Interest expense and other financing charges	(16,578)	(4,803) ⁽¹⁾	(4,559) ⁽²⁾	846 ⁽³⁾	(25,094)
Interest income	3,023	739 ⁽¹⁾	23 ⁽²⁾	(1,928) ⁽⁴⁾	1,857
Equity in net earnings of associates . . .	6,817	(151) ⁽¹⁾	—	(4,596) ⁽⁵⁾	2,070
Gain on sale of investments and property and equipment	529	(8) ⁽¹⁾	—	—	521
Other income (charges) — net	6,926	1,620 ⁽¹⁾	7,421 ⁽²⁾	(3,832) ^(6,7)	12,135
Income before income tax	35,494	9,159	9,496	(9,510)	44,639
Income tax expense (benefit)	11,438	2,160 ⁽¹⁾	(367) ⁽²⁾	(132) ⁽⁸⁾	13,099
Net income	<u>P 24,056</u>	<u>P 6,999</u>	<u>P 9,863</u>	<u>P (9,378)</u>	<u>P 31,540</u>
Net income attributable to :					
Equity holders of the parent company . .	20,091	7,071	9,376	(11,446)	25,092
Non-controlling interests	3,965	(72) ⁽¹⁾	487 ⁽²⁾	2,068 ^(9,10)	6,448
	<u>P 24,056</u>	<u>P 6,999</u>	<u>P 9,863</u>	<u>P (9,378)</u>	<u>P 31,540</u>
Basic earnings per share	<u>P 6.18</u>	<u>P 3.06</u>	<u>P 4.06</u>	<u>P (4.95)</u>	<u>P 8.34</u>
Adjusted EBITDA ⁽¹¹⁾	<u>P 52,536</u>	<u>P 15,037</u>	<u>P14,821</u>	<u>—</u>	<u>P 71,646</u>

⁽¹⁾ Represents the results of SRC and Petron from January 1 to December 14, 2010.

⁽²⁾ Represents results of SMCGP and its subsidiaries SMEC and SPDC from January 1 to July 31, 2010.

⁽³⁾ Represents adjustment in interest expense of SRC assuming that SRC used a portion of the amount advanced by SMC to pay off SRC's loans payable as of January 1, 2010.

⁽⁴⁾ Represents reduction in interest income assuming:

- SMC used P50,277 million in cash on January 1, 2010 in connection with the acquisition of SRC and Petron and that such cash would have generated interest totalling P1,807 million, computed at the prevailing market interest rate for the relevant period.
- SMC had used P4,320 million in cash on January 1, 2010 in connection with the acquisition of SMCGP and that such cash would have generated interest totalling P121 million, computed at the prevailing market interest rate for the relevant period.

⁽⁵⁾ Adjustments in equity in net earnings of associates:

- Represents reversal of SMC's share in net income of Petron for the period commencing June 15 and ending December 15, 2010 totalling P1,599 million, assuming SMC acquired SRC and Peron on January 1, 2010.
- Represents reversal of SMC's 40.0% share in the net income of SMEC and SPDC for the period commencing January 1 and ending September 30, 2010 totalling P3,361 million, assuming SMC acquired 100.0% equity interests in SMCGP on January 1, 2010.
- Represents adjustment in SMCGP's 6.2% share in the net income of Meralco for the period commencing January 1 and ending July 31, 2010 totalling P364 million, assuming that the Investment in shares of Meralco was classified as investment in associates from January 1, 2010.

⁽⁶⁾ Represents reversal of SMCGP's (i) dividend income of P390 million from Meralco and (ii) unrealized fair value gain of P5,762 million from its investment in shares of Meralco, assuming that such investment was classified as investment in associates from January 1, 2010.

- ⁽⁷⁾ Adjustment for acquisition of SMCGP at less than book value, assuming the acquisition occurred on January 1, 2010.
- ⁽⁸⁾ Assumes adjustments for (i) interest income in connection with the acquisition of SMCGP, SRC and Petron were subject to a Philippine tax rate of 20.0% and (ii) the reversal in interest expense and other financing charges in connection with the acquisition of SRC and Petron were subject to the Philippine statutory income tax rate of 30.0%.
- ⁽⁹⁾ Represents reversal of non-controlling interests (i) for SMC's 40.0% share in the net income of SMEC and SPDC for the period commencing January 1 and ending September 30, 2010 totalling P487 million and (ii) for the 25.0% share of other shareholders in the net loss of SMCGP for the month of August 2010 totalling P49 million, assuming SMC acquired SMCGP on January 1, 2010.
- ⁽¹⁰⁾ Represents the net income attributable to the 31.7% interest held by non-controlling interests in Petron for the period commencing January 1 and ending December 14, 2010 totalling P2,506, assuming SMC acquired SRC and Petron on January 1, 2010.
- ⁽¹¹⁾ Adjusted EBITDA is a measure used by SMC's management to internally evaluate the performance of its business. Adjusted EBITDA is calculated as net income plus the following: income tax expense, net financing charges (interest income net of interest expense), gain on sale of investments, other income (charges), foreign exchange losses (gains), marked-to-market losses (gains), plus depreciation and amortization and impairment losses. Adjusted EBITDA is not a measure determined in accordance with PFRS, and prospective investors should not consider Adjusted EBITDA as an alternative to net income as a measure of operating performance or to cash flow as a measure of free cash flow for management's discretionary use, as it does not reflect certain cash requirements such as interest payments, tax payments and capital expenditures. SMC's calculation of Adjusted EBITDA may be different from the calculations used by other companies, and, as a result, SMC's Adjusted EBITDA may not be comparable to other similarly titled measures of other companies.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Prospective investors should read the following discussion and analysis of SMC's consolidated financial condition and results of operations together with (i) SMC's audited consolidated financial statements and the notes relating thereto (ii) SMC's pro forma consolidated statements of income included elsewhere in this Offering Circular.

OVERVIEW

SMC is one of the largest companies in the Philippines in terms of market capitalization and is a highly diversified conglomerate. SMC has businesses that are market leaders in their respective industries. These businesses include the largest beer producer in the Philippines in terms of sales, the largest gin seller and third largest distilled spirit seller by volume in the world, a food company with numerous market leading brands in the Philippine food industry, and one of the largest packaging operations in the Philippines. In addition to producing, marketing and distributing various branded products, including beer, liquor, non-alcoholic beverages, processed and packaged food products, meat, poultry, dairy products and packaging products, SMC has also recently acquired the largest integrated oil refining and marketing company by sales in the Philippines and established the largest electricity supplier in terms of installed capacity in the Philippines. Furthermore, SMC has acquired businesses and interests in the infrastructure, telecommunications, banking and mining industries in the Philippines, which SMC believes will position it to capture additional growth opportunities. SMC had sales of ₱168,041 million, ₱174,213 million and ₱246,109 million, respectively, and net income of ₱20,083 million, ₱60,629 million and ₱24,056 million, respectively, in 2008, 2009 and 2010. SMC's pro forma sales, gross profit and Adjusted EBITDA, including the results of Petron from January 1, 2010 to December 14, 2010 and the results of SMCGP from January 11, 2010 to July 31, 2010, were ₱474,609 million, ₱97,515 million and ₱71,646 million, respectively, in 2010.

Recent Acquisitions

As part of its growth strategy, SMC has made a series of acquisitions in the fuel and oil, power, infrastructure, telecommunications, banking and mining industries over the past three years. SMC believes these acquisitions provide exposure to industries that are aligned with the development and growth of the Philippine economy. Following these new acquisitions, SMC's financial condition and results of operations are affected by a variety of competitive factors, regulatory restrictions and market conditions that are significantly different from those of SMC's traditional core businesses. A summary of these transactions is set forth below.

- SMC acquired a 22.0% equity interest in Petron on June 15, 2010. As of October 18, 2010, SMC had increased its equity interest in Petron to approximately 38.2%, of which approximately 18.2% was held directly by SMC and the remaining 20.0% was held indirectly through SRC, a wholly-owned subsidiary of SMC. On December 15, 2010, SMC increased its equity interest in Petron to 68.3%. Petron is the largest integrated oil refining and marketing company in the Philippines, and its core business involves the refining of crude oil and the marketing and distribution of refined petroleum products, primarily for the domestic market.

SMC's fuel and oil business accounted for approximately 4.2% of SMC's sales and 2.0% of SMC's operating income in 2010. See "Consolidated Pro Forma Financial Information" for certain pro forma information relating to the acquisition of Petron.

- SMC entered into the following transactions in the power industry:
 - SMC has acquired rights, pursuant to IPPA Agreements with Philippine government-owned entities, to administer three power plants in Sual, Ilijan and San Roque. SMC commenced administration of: (i) the Sual Power Plant on November 6, 2009; (ii) the Ilijan Power Plant on June 26, 2010; and (iii) the San Roque Power Plant on January 26, 2010. On January 18, 2010, SMC acquired the Limay Power Plant, which it operates as the IPP. SMC's interests in these power plants make it one

of the largest electricity suppliers in the Philippines with a combined installed capacity of 3,165MW, accounting for 29.2% of the Luzon grid and 21.7% of the national grid, as of December 31, 2010.

- Through agreements dated October 27, 2008 and August 9, 2010, SMC acquired a 33.2% equity interest in Meralco, of which 27.0% is held by SMC directly and 6.2% is held through SMCGP, a wholly-owned subsidiary of SMC. Meralco is the Philippines' largest power distributor and private sector utility.

SMC's power business accounted for 18.5% of SMC's sales and 27.5% of SMC's operating income in 2010. See "Consolidated Pro Forma Financial Information" contained elsewhere in this Offering Circular for more detailed information.

- SMC made the following infrastructure acquisitions:
 - On September 11, 2009, SMC acquired a 35.0% equity interest in PIDC, which holds a 35-year concession to build and operate an 88.6 kilometer two-lane expressway that will connect Tarlac, Pangasinan and La Union.
 - On April 8, 2010, SMC acquired a 93.0% equity interest in Trans Aire Development Holdings Corp. ("TADHC") (formerly known as Caticlan International Airport Development Corporation), which holds a 25-year contract-add-operate-transfer arrangement for rehabilitating and operating Caticlan airport near Boracay Island, a popular tourist destination in the Philippines.
 - On October 28, 2010, SMC entered into an agreement to acquire a 51.0% equity interest in Universal LRT Corporation (BVI) Limited ("Universal LRT"), which holds a 25-year build-gradual transfer-operate-maintain-and-manage concession on the MRT-7 rail and road project extending the metro rail system servicing Metro Manila. Universal LRT had not commenced commercial operations as of December 31, 2010.

SMC's infrastructure business did not have any sales, and had an operating loss, in 2010.

- SMC made the following telecommunications acquisitions:
 - SMC acquired a 32.7% equity interest in the then issued and outstanding capital stock of Liberty Telecommunications Holdings Inc. ("Liberty") on July 8, 2009, which was increased to 41.5% on October 5, 2010. Liberty is a telecommunications carrier listed on the PSE, offering telephone services nationwide in the Philippines, as well as data communications, inter-exchange carrier services and international voice and data connectivity services.
 - On August 1, 2010, SMC acquired a 100.0% equity interest in Bell Telecommunications Philippines Inc. ("BellTel"), which is a telecommunications company licensed to offer data services throughout the Philippines and data services to all central business districts and special economic zones.
 - On December 30, 2010, SMC, acquired a 40% equity interest in Eastern Telecommunications Philippines Inc. ("ETPI"), through the acquisition of 100.0% of the issued and outstanding shares of A.G.N. Philippines Inc., through SMC's wholly-owned subsidiary, Vega Telecom, Inc. ("Vega"). ETPI provides voice, data and internet services to the business process outsourcing market.
- SMC's telecommunications business did not have any sales, and had an operating loss, in 2010.
- SMC made the following mining acquisitions:
 - SMC acquired a 100.0% equity interest in each of the three concession holders of coal deposits in the Southern Mindanao region of the Philippines — the Daguma and Bonanza coal deposits on January 29, 2010 and the Sultan coal deposit on May 13, 2010, respectively. Exploration of these deposits is still at a preliminary stage.
 - SMC acquired a 10.1% equity interest in Indophil Resources NL on October 8, 2010, which indirectly holds a 37.5% equity interest in a joint venture entity with rights to explore, develop and operate the Tampakan copper and gold project in the Southern Mindanao region of the Philippines.

SMC's mining business did not contribute to SMC's sales or operating income in 2010.

- SMC made the following acquisitions in other industries:
 - In the banking industry, SMC acquired a 30.0% equity interest in BOC through a series of acquisitions in 2007 and 2008, and SMC increased its equity interest in BOC to 32.8% as of December 31, 2010.
 - On January 6, 2010, SMC acquired 49.0% of the outstanding common shares of Top Frontier, a Philippine based investment holding company that is the Selling Shareholder. SMC also paid a deposit for the future subscription for 100% of the preferred shares of Top Frontier on January 7, 2010. These preferred shares were issued to SMC on October 22, 2010 after the Philippine SEC approved the Selling Shareholder's application for an increase in its authorized capital stock. See "Business — Other Operations and Investments — Top Frontier".

Since December 31, 2010, SMC has completed the following series of investments and acquisitions:

- On January 3, 2011, Petron entered into agreements to acquire 35.0% of the outstanding and issued shares of Manila North Harbour Port Inc. Manila North Harbour Port Inc. has a 25-year concession from the Philippine Ports Authority to operate Manila North Harbour, the busiest domestic cargo port in the Philippines. SMC plans to use the facilities for the establishment of fuel tanks to serve its petroleum product storage requirements, as well as grain terminals and bulk cement silos for the needs of other SMC businesses.
- On January 13, 2011, San Miguel Properties Inc. agreed to acquire a 7.2% equity interest in BOC. Upon the completion of the acquisition, SMC will hold a 39.9% equity interest in BOC.
- On February 8, 2011, the Philippine SEC approved the incorporation of San Miguel Electric Corp., as a wholly-owned subsidiary of SMC. SMC has announced plans for San Miguel Electric Corp., together with the other power generation subsidiaries of SMC, to engage in the business of generating electricity and processing alternative fuels for power generation.

Accounting Treatment of Recent Acquisitions

As a result of the foregoing transactions, SMC's financial and operating results for 2010 are not comparable to its financial and operating results for prior periods.

Investment in Subsidiaries

The acquisitions of the 68.3% equity interest in Petron, 100.0% equity interest in SMCGP, 93.0% equity interest in TADHC, 51.0% equity interest in Universal LRT and 100.0% equity interest in BellTel were accounted for as investments in subsidiaries using the acquisition method as of their respective acquisition dates.

The acquisition method requires SMC to recognize and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The consideration transferred upon the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by SMC, if any. The consideration transferred also includes the fair value of any contingent asset or liability. Acquisition-related costs are expensed as they are incurred, and subsequent changes in the fair value of contingent consideration are recognized directly as profit or loss. See note 5 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at fair values on the acquisition date. SMC recognizes on an acquisition-by-acquisition basis, any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the acquiree's net assets.

In connection with its acquisitions of subsidiaries, SMC measures goodwill as of the acquisition date as: (i) the fair value of the consideration transferred; plus (ii) the recognized amount of any non-controlling

interests in the acquiree; plus (iii) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; and less (iv) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. Goodwill on the acquisitions of Petron, TADHC and Universal LRT is presented as part of goodwill in SMC's consolidated statements of financial position. On the other hand, if the acquisition price is less than the fair value of the net assets of an acquired subsidiary, the difference is recognized directly as a gain on acquisition. SMC recognized such a gain on the acquisition of SMCGP, and it is presented as part of other income (charges) in SMC's consolidated statements of income. After acquisition, goodwill is measured at cost less any accumulated impairment in value. SMC reviews goodwill for impairment annually or on a more frequent basis if events or changes in circumstances indicate that the carrying amount may be impaired.

Investment in Associates

SMC's acquisition of the 41.5% equity interest in Liberty, 40.0% equity interest in ETPI, 35.0% equity interest in PIDC, 33.2% equity interest in Meralco, 32.8% in BOC and 49.0% equity interest in Top Frontier, and its 38.2% equity interest in Petron were accounted for, prior to December 16, 2010, as investments in associates. Investments in associates are initially recognized at cost and subsequently accounted for using the equity method. Any goodwill or fair value adjustment attributable to the share in the associate is included in the amount recognized as investment in associates.

SMC's investment in an associate is initially recognized at cost, and the carrying amount is increased or decreased to recognize SMC's share of the profit or loss of the associate after the date of acquisition. SMC reports changes resulting from profit or loss generated by its associate as equity in net earnings (losses) of associates in its consolidated statements of income.

Adjustments to the carrying amount of SMC's investments in associates may also be necessary for changes in SMC's proportionate interest in an associate arising from changes in the associate's other comprehensive income, including from revaluation of property, plant and equipment and from foreign exchange translation differences. Changes resulting from other comprehensive income of the associate's equity are proportionally recognized in other comprehensive income of SMC. Any dividend received from an associate is recognized as a reduction in the carrying amount of investment in the associate. SMC discontinues applying the equity method when its investment in an associate is reduced to zero, and thereafter SMC recognizes losses only to the extent that SMC has incurred obligations or made payments on behalf of such an associate. If such associate subsequently reports profits, SMC recognizes its share of the profits in that associate only after such share exceeds the accumulated share of the losses that has previously not been recognized by SMC.

SMC also determines from time to time whether it is necessary to recognize any additional impairment loss with respect to SMC's net investment in its associates. Profits and losses resulting from transactions between SMC and its associate are eliminated to the extent of the interest in its associate. See note 13 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Available-for-Sale Financial Assets

SMC's acquisition of a 10.1% equity interest in Indophil Resources NL was accounted for as an available-for-sale financial asset. SMC recognizes available-for-sale financial assets at fair value, with changes in value recognized in its consolidated statement of comprehensive income as fair value reserve, net of any effects arising from income taxes. When SMC disposes of an available-for-sale financial asset or SMC determines the asset is impaired, the cumulative gain or loss previously recognized in equity as part of fair value reserve is reclassified to profit or loss. Dividends that SMC receives on available-for-sale financial assets are recognized as dividend income when SMC receives the right to receive such dividends. See note 3 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Factors Affecting Results of Operations

The following are the primary factors that affect SMC's results of operations:

Raw Materials and Other Input Costs

SMC depends on raw materials sourced from third parties, and these materials are subject to price volatility caused by a number of factors, including changes in global supply and demand, weather conditions, and government regulations and controls. In recent years, the prices of certain raw materials, including wheat, malted barley and adjuncts for the beer business, molasses for the liquor business and crude oil for the fuel and oil business, have been increasing. In addition, SMC's ability to obtain raw materials is affected by a number of factors beyond SMC's control, including interruptions in production by suppliers, decisions by suppliers to allocate raw materials to other purchasers and the availability and cost of transportation.

Taxes and Regulatory Environment

SMC's businesses are subject to various taxes, duties and tariffs. For example, in the Philippines, excise tax accounts for a significant portion of SMC's beer and liquor production costs. In 2009, the Philippine government increased the excise tax rates applicable to SMC's beer operations by 8.0% and the excise tax rates applicable to SMC's liquor operations by approximately 8%. Changes in tax rates could affect SMC's profit margins as well as the pricing of, and demand for, SMC's products.

In addition, SMC operates in several highly regulated industries, including beverages, food, fuel and oil, power, infrastructure, telecommunications, banking and mining. SMC is also subject to a number of national and local laws, rules and regulations in the Philippines and other countries in which it operates. These include, among others, laws, rules and regulations relating to environmental protection, employee health and safety, product labeling requirements, as well as certain restrictions on advertising. Changes in laws, rules and regulations could result in substantial compliance costs and have material adverse effects on SMC's business and operations. See "Regulation".

Competition

SMC faces competition in all segments of its businesses in the Philippines as well as in the other countries in which it operates. In particular, SMC competes with a number of multi-national, national, regional and local competitors. Although many of SMC's products and services have significant market shares in the Philippines, SMC expects to face increasing competition as it continues to grow its businesses in the Philippines. Competitive factors generally affecting SMC's businesses include price, costs, product quality, production efficiency and worker productivity, access to raw materials and water, access to fuel and other sources of energy, access to financing sources, technological innovation, relationships with suppliers and governmental authorities, brand awareness and loyalty, distribution coverage, and the ability to effectively respond to changes in the regulatory environment as well as to shifting consumer tastes and preferences.

Economic, Social and Political Conditions in the Philippines

While SMC has operations outside the Philippines, over 90% of SMC's assets were located in the Philippines as of December 31, 2010, and approximately 90% of its sales in 2010 were derived from its operations in the Philippines. As a result, SMC's financial condition and results of operations are influenced to a substantial degree by the economic, social and political conditions in the Philippines. While the Philippine economy has recently experienced growth, the Philippine economy has also experienced periods of slow growth as well as negative growth and high inflation. Sales of many of SMC's products, including beer, liquor and certain non-essential products, are also closely tied to consumer confidence and disposable income levels in the Philippines. Furthermore, SMC's operations in the telecommunications, fuel and oil, and power industries are impacted by trends in the broader Philippine economy. According to the Philippine National Statistical Coordination Board ("NSCB"), real GDP growth in the Philippines was 3.7%, 1.1% and 7.3%, respectively, in 2008, 2009 and 2010.

The Philippines has from time to time experienced social and political instability. For example, there have been a number of coup attempts against the Philippine government over the past 20 years. SMC's financial condition and results of operations are expected to continue to be affected by these economic, social and political conditions in the Philippines.

CRITICAL ACCOUNTING POLICIES

SMC's significant accounting policies are set forth in note 3 to SMC's consolidated financial statements included elsewhere in this Offering Circular. SMC's consolidated financial statements are prepared in accordance with PFRS, which requires SMC's management to make judgments, estimates and assumptions that affect amounts reported in its consolidated financial statements and the related notes. SMC has identified the following accounting policies as critical to the understanding of its financial condition and results of operations, as the application of these policies requires significant management assumptions and estimates that could result in the reporting of materially different amounts if different assumptions or estimates are made.

Useful Lives of Property, Plant and Equipment

As of December 31, 2010, SMC had property, plant and equipment, net of accumulated depreciation, amortization and impairment losses, of P308,073 million. Property, plant and equipment, excluding land, are stated at cost less accumulated depreciation and amortization, and any accumulated impairment in value. Land is stated at cost, less any impairment in value. SMC reviews the carrying amounts for property, plant and equipment for impairment when events or changes in circumstances indicate that such carrying amounts may not be recoverable.

SMC calculates depreciation and amortization using the straight-line method over the following estimated useful lives for the following assets:

	<u>Number of Years</u>
Land improvements	5 - 50
Buildings and improvements	2 - 50
Power plants	3 - 43
Refinery and plant equipment	5 - 16
Service stations and related equipment	1.5 - 10
Machinery and equipment	3 - 40
Transportation equipment	5 - 7
Tools and small equipment	2 - 5
Office equipment, furniture and fixtures	2 - 10
Molds	2 - 5
Leasehold improvements	5 - 50
	or term of the lease, whichever is shorter

SMC estimates the useful lives of property, plant and equipment based on the period over which these assets are expected to be available for use. SMC reviews the estimated useful lives of its property, plant and equipment periodically and updates them if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, SMC's estimation of the useful lives of its property, plant and equipment, is based on an assessment that takes into consideration factors such as industry practice, internal technical evaluation and experience with similar assets. A reduction in the estimated useful lives of SMC's property, plant and equipment, could increase SMC's cost of sales and selling and administrative expenses and decrease noncurrent assets. Changes in such estimates could significantly affect SMC's financial condition and results of operations. In particular, a reduction in the estimated useful lives of SMC's property, plant and equipment could increase SMC's depreciation expense and reduce its operating income.

Business Combinations

Prior to January 1, 2010, SMC accounted for business combinations under PFRS using the purchase method. Beginning on January 1, 2010, SMC accounted for business combinations under PFRS using the acquisition method as of the acquisition date, which is the date on which control is transferred to SMC. Among other differences, the two methods vary with respect to the treatment of acquisition costs incurred in connection with the business combination and the recognition of goodwill. Under the purchase method, transaction costs attributable to the acquisition formed part of the acquisition costs, whereas these costs are now expensed under the acquisition method. In addition, business combinations achieved in stages may have an impact on previously recognized goodwill under the acquisition method.

For acquisitions on or after January 1, 2010, SMC measures goodwill as of the acquisition date as: (i) the fair value of the consideration transferred; plus (ii) the recognized amount of any non-controlling interests in the acquiree; plus (iii) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; and less (iv) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. When the excess is negative, SMC recognizes a gain (known as a bargain purchase gain) immediately in profit or loss. Subsequently, SMC measures goodwill at cost less any accumulated impairment in value. SMC reviews goodwill for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired. SMC had goodwill of ₱30,251 million as of December 31, 2010.

See note 3 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Financial Assets and Financial Liabilities

Date of Recognition. SMC recognizes a financial asset or a financial liability in its consolidated statements of financial position when it becomes a party to the related instrument. Regular way purchases or sales of financial assets are recognized using settlement date accounting.

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at fair value of the consideration given (in case of an asset) or received (in case of a liability). The initial measurement of financial instruments, except for those designated at fair value through profit or loss, includes transaction costs.

SMC classifies its financial assets in the following categories: available-for-sale financial assets, financial assets at fair value, held-to-maturity investments, and loans and receivables. SMC classifies its financial liabilities as either financial liabilities at fair value or other liabilities. The classification of these assets depends on the purpose for which the investments is acquired and whether it is quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation as of every reporting date. SMC had no held-to-maturity investments in 2009 or 2010.

Determination of Fair Value. The fair value of financial instruments traded in active markets as of the reporting date is based on their quoted market price or quoted dealer price (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction is used as long as there is no significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Asset Impairment

SMC periodically reviews the carrying amounts of property, plant and equipment and other long-lived assets, including goodwill, intangible assets and investment properties for impairment. Under PFRS, depending on the type of asset, SMC assesses impairment annually and/or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Determining the recoverable amount of assets requires SMC to estimate the cash flows expected to be generated from the continued use and ultimate disposition of such assets. While SMC believes that the assumptions it used in the estimation of fair values reflected in its consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect SMC's assessment of recoverable amounts, and any resulting impairment loss could have a material adverse impact on the financial condition and results of operations. In 2010, SMC recognized impairment loss on noncurrent assets totaling ₱4,384 million and, as of December 31, 2010, the aggregate value of property, plant and equipment, goodwill, intangible assets and investment properties was ₱351,437 million. See notes 16, 17 and 19 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Pension and Other Retirement Benefits

SMC and a majority of its subsidiaries have funded, non-contributory, defined benefit retirement plans covering all of their permanent employees. In 2010, SMC's net pension cost was ₱285 million, and as of December 31, 2010, SMC's net pension liabilities were ₱267 million. SMC determines retirement costs actuarially using the projected unit credit method. This method reflects services rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. The defined benefit liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not yet recognized, reduced by past service costs not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate amount is negative, the resulting asset is measured at the lower of such aggregate amount or the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan.

In 2010, the principal actuarial assumptions made by SMC in determining retirement benefits are as follows:

Discount rate	5.0% to 8.0%
Salary increase rate	8.0%
Expected return on plan assets	10.0%

Changes in the various estimates and assumptions SMC uses in the calculation of net pension cost and net pension liability could significantly affect SMC's financial condition and results of operations. See note 36 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Finance Leases

Finance leases, which transfer to SMC substantially all the risks and benefits incidental to the ownership of the leased assets, are capitalized at the inception of the lease at the fair value of the leased assets or, if lower, at the present value of the minimum lease payments. SMC classifies obligations arising from plant assets under finance lease agreements as finance lease liabilities in SMC's consolidated statements of financial position. SMC apportions lease payments between financing charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Financing charges are recognized in the profit or loss account. SMC depreciates capitalized lease assets over the estimated useful life of the assets when there is reasonable certainty that SMC will obtain ownership of such assets by the end of the lease term.

In accounting for its IPPA Agreements with PSALM, SMC has made a judgment that each IPPA Agreement is an agreement that contains a lease. Furthermore, SMC has made a judgment that it has acquired substantially all of the risks and rewards incidental to the ownership of the Sual Power Plant, the Ilijan Power

Plant and the San Roque Power Plant. Accordingly, SMC has accounted for the IPPA Agreements as finance leases and recognized those power plants and finance lease liabilities at the present value of the agreed monthly payments under the IPPA Agreements.

Deferred Tax Assets

In 2008, 2009 and 2010, SMC had deferred tax assets of ₱7,638 million, ₱8,883 million and ₱7,134 million, respectively. SMC reviews its deferred tax assets as of each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. SMC reassesses its unrecognized deferred tax assets as of each reporting date and recognizes them to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. See note 25 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Allowance for Doubtful Accounts

As of December 31, 2010, SMC had trade and other receivables of ₱80,423 million and allowance for impairment losses of ₱4,519 million. SMC makes provision for specific and groups of accounts where objective evidence of impairment exists. SMC evaluates these accounts based on factors that affect the collectability of the accounts. These factors include, but are not limited to, the length of SMC's relationship with its customers and counterparties, the customers' current credit status based on third party credit reports, general economic conditions, average age of accounts, collection experience and historical loss experience.

Allowance for Inventory Losses

SMC values finished goods, goods in process and materials and supplies at the lower of cost and net realizable value. Net realizable value of finished goods and goods in process is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs of sale. Net realizable value of materials and supplies is the current replacement cost. For petroleum products, crude oil, and tires, batteries and accessories, the net realizable value is the estimated selling price of these items in the ordinary course of business, less the estimated costs to complete and/or market and distribute them. SMC provides an allowance for inventory losses whenever net realizable value becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes. SMC reviews the allowance account periodically to accurately reflect the net realizable value in the financial statements. The carrying amounts of inventories was ₱57,442 million as of December 31, 2010. See note 11 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Contingencies

SMC has certain contingent liabilities in the form of tax assessments and legal claims. See note 45 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information. SMC does not recognize contingent liabilities in its consolidated financial statements, but these contingent liabilities are disclosed in the notes to the consolidated financial statements. SMC's estimates of the probable costs for the resolution of its tax assessments and legal claims have been developed in consultation with legal counsel and are based upon analyses of the potential outcomes. If the estimates made in such analyses change or the outcome of the tax assessments and legal claims differs from SMC's expectations, SMC's financial condition and results of operations could be materially and adversely affected. Contingent assets are not recognized in the consolidated financial statements unless and until it is probable that such assets will be realized. See note 45 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

KEY INCOME STATEMENT COMPONENTS

Sales

SMC generates its sales from its beverages, food, packaging, fuel and oil and power businesses. SMC recognizes sales when the significant risks and rewards of ownership of the products have passed to the customer and the amount of revenue could be reliably measured, which generally occurs at the time of delivery. In 2008, 2009 and 2010, SMC had sales of ₱168,041 million, ₱174,213 million and ₱246,109 million, respectively, with sales in the Philippines accounting for approximately 90% of total sales in each year. The following table sets forth SMC's sales (excluding intercompany sales) by business for the periods indicated:

	For the Year Ended December 31,						
	2008		2009		2010		
	₱ (In millions)	%	₱ (In millions)	%	₱ (In millions)	US\$ (In millions)	%
Beverages	₱ 78,599	46.8%	₱ 82,735	47.5%	₱ 90,407	US\$2,060	36.7%
Food	73,830	43.9	77,220	44.3	80,415	1,832	32.7
Power	—	—	—	—	45,636	1,040	18.5
Packaging	15,612	9.3	14,258	8.2	19,268	439	7.8
Fuel and Oil	—	—	—	—	10,383	237	4.2
Total	<u>₱168,041</u>	<u>100.0%</u>	<u>₱174,213</u>	<u>100.0%</u>	<u>₱246,109</u>	<u>US\$5,608</u>	<u>100.0%</u>

Cost of Sales

SMC's cost of sales primarily consists of:

- inventory costs, including the cost of raw materials that SMC uses in its operations;
- taxes and the cost of licenses, including excise tax, tariffs and value-added tax;
- fuel and oil costs relating to production;
- depreciation and amortization, including depreciation on property, plant and equipment and biological assets;
- contracted services costs, including contract growers fees, slaughterhouse fees, franchise service provider fees and security charges;
- freight, trucking and handling costs;
- communications, light and water costs;
- personnel expenses, including salary and wages, retirement costs and other employee benefits attributable to cost of sales;
- repairs and maintenance costs relating to production equipment, facilities and buildings;
- rental expenses attributable to cost of sales; and
- other costs, such as administrative expenses, research and development costs and travel and transportation expenses attributable to cost of sales.

In 2008, 2009 and 2010, SMC's cost of sales was ₱124,072 million, ₱124,295 million and ₱173,906 million, respectively.

Selling and Administrative Expenses

In 2008, 2009 and 2010, SMC's selling and administrative expenses were ₱29,151 million, ₱30,249 million and ₱37,426 million, respectively.

SMC's selling expenses primarily consist of:

- advertising and promotion expenses incurred in marketing SMC's products, including the cost of media advertisements, event sponsorships, billboards, trade shows, merchandising activities and other marketing and promotional activities;
- personnel expenses, including salary and wages, employee benefits and retirement costs for sales employees attributable to selling expenses;
- freight, trucking and handling expenses in connection with the distribution of products;
- rental expenses, including for inventory warehouses, office space and office equipment attributable to selling expenses;
- depreciation, amortization and impairment losses including depreciation on property, plant and equipment attributable to selling expenses as well as amortization of computer software, land use rights, licenses and investment properties; and
- other selling expenses, such as communications, light and water expenses, supplies, taxes and licenses and professional fees.

In 2008, 2009 and 2010, selling expenses were ₱13,518 million, ₱12,905 million and ₱18,239 million, respectively.

SMC's administrative expenses primarily consist of:

- personnel expenses, including salary and wages, retirement costs and other employee benefits for employees attributable to administrative expenses;
- depreciation, amortization and impairment losses, including depreciation on property, plant and equipment, as well as amortization on goodwill, trademarks and brand names attributable to administrative expenses;
- professional fees expenses, including regular retainers, as well as fees and expenses for specifically commissioned professional services;
- repair and maintenance expenses, including expenses incurred for minor repairs and maintenance of fixtures and office equipment; and
- other administrative expenses, such as expenses incurred for advertising and promotion to maintain, and enhance SMC's general corporate image, supplies, taxes and licenses, communications, light and water expenses and rent.

In 2008, 2009 and 2010, administrative expenses were ₱15,633 million, ₱17,344 million and ₱19,187 million, respectively.

Interest Expense and Other Financing Charges

SMC's interest expense and other financing charges primarily consist of:

- interest on bank drafts and loans payable, which mainly consist of unsecured Peso-and foreign currency-denominated loans payable to local and foreign banks; and
- interest expense payable on long-term debt, including unsecured term notes, and Peso and foreign currency denominated loans payable by SMC.

In 2008, 2009 and 2010, SMC's interest expense and other financing charges were ₱6,032 million, ₱7,926 million and ₱16,578 million, respectively.

Interest Income

SMC's interest income primarily consists of:

- interest received on short-term investments and cash deposited with banks;
- trade and non-trade receivables, including finance leases and operating leases; and
- interest received on amounts owed by related parties.

In 2008, 2009 and 2010, SMC's interest income was ₱6,630 million, ₱5,989 million and ₱3,023 million, respectively.

Equity in Net Earnings (Losses) of Associates

SMC's equity in net earnings of associates represents SMC's share of the net profit of an associate, while equity in net losses of associates represents SMC's share of the net loss of an associate, in each case after the date of acquisition.

In 2008, SMC's equity in net losses of associates was ₱1,132 million. In 2009 and 2010, SMC's equity in net earnings of associates was ₱2,816 million and ₱6,817 million, respectively.

Gain on Sale of Investments and Property and Equipment

SMC's gain on sale of investments and property and equipment primarily consists of:

- gain on sale of investments in shares of subsidiaries and associates; and
- gain on sale of land and land improvements, buildings and improvements, machinery and equipment, tools and small equipment, office equipment, furniture and fixtures, molds, leasehold improvements, and constructions in progress.

In 2008, 2009 and 2010, gain on sale of investments and property and equipment was ₱8,746 million, ₱50,630 million and ₱529 million, respectively.

Other Income (Charges)

SMC's other income consists primarily of:

- foreign exchange gains; and
- gains on derivatives.

SMC's other charges consist primarily of:

- foreign exchange losses;
- losses on impairment of goodwill, trademarks and brand names, property, plant and equipment, and idle assets; and
- losses on derivatives.

In 2008 and 2009, other charges were ₱2,262 million and ₱6,843 million, respectively. In 2010, other income was ₱6,926 million.

Income Tax Expense

SMC's income tax expense consists primarily of:

- current income tax expense;
- deferred income tax expense; and
- income tax expense from gain on disposal of discontinued operations.

In 2008, 2009 and 2010, income tax expense was ₱6,098 million, ₱3,706 million and ₱11,438 million, respectively.

Income after Income Tax from Discontinued Operations

In 2008, income after income tax from discontinued operations was ₱5,413 million, which consisted of a gain on the sale of investment in San Miguel Australia Holdings Ltd., partially offset by a loss from discontinued operations of SMC's agribusiness division, which consisted of the operations of its Iligan coconut oil mill. There were no discontinued operations in 2009 or 2010.

RESULTS OF OPERATIONS

Recent Acquisitions and Comparability of Financial Statements

As discussed above in “— Recent Acquisitions” and “— Accounting Treatment of Recent Acquisitions”, SMC made several acquisitions during 2010, including its acquisition of additional equity interests in Petron in the fuel and oil industry and the acquisitions of SMC GP in the power industry, as a result of which SMC's financial and operating results for 2010 are not comparable with those for 2009. From June 15, 2010 to December 15, 2010, Petron was accounted for under the equity method, while for the period from December 16, 2010 to December 31, 2010, Petron was accounted for as a consolidated subsidiary. In the power business, SPDC was accounted for under the equity method from January 26, 2010 to July 31, 2010 and as a consolidated subsidiary from August 1, 2010 to December 31, 2010, while SMEC was accounted for under the equity method from November 6, 2009 to July 31, 2010 and as a consolidated subsidiary from August 1, 2010 to December 31, 2010. As discussed above under “— Accounting Treatment of Recent Acquisitions — Investment in Associates”, changes resulting from profit or loss generated by SMC's associates are reported as equity in net earnings (losses) of associates in its consolidated statements of income. Subsidiaries, in contrast, are accounted for on a consolidated basis.

As Petron, SPDC and SMEC are accounted for as consolidated subsidiaries for part of 2010, while in 2009 these companies were either not included in SMC's consolidated financial statements (in the case of Petron) or were included as associates accounted for under the equity method (in the case of SPDC and SMEC). SMC's consolidated statements of income for 2009 and 2010 are not comparable in important respects. For example, while SMC's cost of sales in 2010 were 39.9% higher than in 2009, this increase was largely due to an increase in inventory costs, which was wholly attributable to the inventory cost of the new subsidiaries. Excluding new subsidiaries acquired in 2010 from cost of sales, there would have been only a slight increase in 2010 compared with 2009. Similarly, SMC's sales for 2010 included sales of businesses that were not included in SMC's sales in 2009. In particular, Petron and SMC GP had no sales in 2009, as the businesses contributing sales in those segments were only acquired as consolidated subsidiaries in 2010. See “Consolidated Pro Forma Financial Information” for more detailed information.

Year ended December 31, 2010 compared to Year ended December 31, 2009

Sales

SMC's sales increased by 41.3% from ₱174,213 million in 2009 to ₱246,109 million in 2010. The following table sets forth SMC's sales, excluding intercompany sales, by line of business for the periods indicated:

	For the Year Ended December 31,	
	2009	2010
	(In millions)	
Beverages	₱ 82,735	₱ 90,407
Food	77,220	80,415
Power	—	45,636
Packaging	14,258	19,268
Fuel and Oil	—	10,383
Total	<u>₱174,213</u>	<u>₱246,109</u>

Beverages. Beverages sales increased 9.3% from ₱82,735 million in 2009 to ₱90,407 million in 2010. This increase was primarily due to increases in beer and liquor sales. In particular:

- Beer sales increased by 7.9% from ₱62,605 million in 2009 to ₱67,563 million in 2010. This increase was due to the full year effect in 2010 of a price increase for beer products that was made in November 2009 and a 3.3% increase in beer sales volume from 214 million equivalent cases (comprising twenty-four 320 ml bottles per case) in 2009 to 221 million equivalent cases in 2010. The increase in domestic beer sales volume was primarily the result of improved economic conditions in the Philippines and increased advertising and promotion programs, as well as the presidential, senate and local elections held in 2010, which were associated with higher alcoholic beverages consumption, in line with previous elections in the Philippines.
- Liquor sales increased by 21.0% from ₱18,654 million in 2009 to ₱22,564 million in 2010. This increase was due to a price increase for liquor products in February 2010 and a 11.1% increase in liquor sales volume from 36 million equivalent cases (comprising twelve 700 ml bottles per case) in 2009 to 40 million equivalent cases in 2010. The increase in liquor sales volume resulted from improved economic conditions in the Philippines, as well as the presidential, senate and local elections held in 2010, which were associated with higher alcoholic beverages consumption in line with previous elections in the Philippines.

Food. Food sales increased by 4.1% from ₱77,220 million in 2009 to ₱80,415 million in 2010. This increase was principally a result of increased sales volume for poultry, flour, coffee, ice cream, increased sales volume for most regional businesses due to higher demand and more product offerings.

Power. SMC acquired the Limay Power Plant on January 18, 2010, and commenced administration of the Sual Power Plant on November 6, 2009, the Ilijan Power Plant on June 26, 2010 and the San Roque Power Plant on January 26, 2010. These assets had sales of ₱45,636 million for the period commencing on their respective consolidation dates and ending December 31, 2010. SMC had no power sales in 2009. See "Consolidated Pro Forma Financial Information" for more detailed information.

Packaging. Packaging sales increased by 35.1% from ₱14,258 million in 2009 to ₱19,268 million in 2010. This increase was primarily due to sales attributable to Cospak Plastics Pty Ltd and Cospak NZ Ltd, SMC's packaging operations in Australia and New Zealand which were acquired by SMC in December 2009, as well as volume growth in most of its business segments, including higher sales of glass bottles to beverage and pharmaceutical companies and plastic products such as regrinds and pallets.

Fuel and Oil. SMC acquired a 38.2% interest in Petron on October 18, 2010, which was increased to 68.3% on December 15, 2010. Sales attributable to Petron were ₱10,383 million for the period commencing

December 15, 2010 and ending December 31, 2010. SMC had no fuel and oil sales in 2009. See “Consolidated Pro Forma Financial Information” for more detailed information.

Cost of Sales

Cost of sales increased by 39.9% from ₱124,295 million in 2009 to ₱173,906 million in 2010. This increase was primarily the result of a 36.1% increase in inventory costs from ₱75,051 million in 2009 to ₱102,166 million in 2010, an 8.5% increase in taxes and licenses from ₱21,515 million in 2009 to ₱23,343 million in 2010, a significant increase in fuel and oil costs from ₱2,170 million in 2009 to ₱17,504 million in 2010, a 45.9% increase in depreciation and amortization from ₱4,994 million in 2009 to ₱7,287 million in 2010, a 26.6% increase in contracted services costs from ₱4,682 million in 2009 to ₱5,929 million in 2010 and a 25.3% increase in freight, trucking and handling costs from ₱4,392 million in 2009 to ₱5,504 million in 2010.

The increase in inventory costs was principally the result of increased inventories attributable to SMCGP and Petron, for which there were no corresponding costs in 2009. The increase in taxes and licenses was mainly due to increased beer and liquor sales leading to increased sales taxes, as well as taxes attributable to Petron, for which there were no corresponding costs in 2009. The increase in fuel and oil costs was mainly due to fuel cost for the Limay Power Plant for which there were no corresponding costs in 2009, as well as higher fuel prices generally. The increase in depreciation and amortization was primarily attributable to depreciation on the Limay Power Plant acquired by SMCGP, for which there were no corresponding costs in 2009. The increase in contracted services costs was principally the result of increased tolling rates and contracting additional tolling plants to replace reduced production capacity due to the closure of the San Fernando poultry plant related to the food business, as well as SMCGP’s increased operation and maintenance costs for the Limay Power Plant, for which there were no corresponding costs in 2009. The increase in freight, trucking and handling costs was largely due to increased trucking rates and higher volumes for the poultry business and shipping operations.

Selling and Administrative Expenses

Selling and administrative expenses increased 23.7% from ₱30,249 million in 2009 to ₱37,426 in 2010. This increase was the result of increases in both selling expenses and administrative expenses. In particular:

Selling Expenses. Selling expenses increased by 41.3% from ₱12,905 million in 2009 to ₱18,239 million in 2010. This increase was primarily due to a significant increase in freight, trucking and handling expenses from ₱2,021 million in 2009 to ₱5,922 million in 2010, a 15.0% increase in personnel expenses from ₱3,635 million in 2009 to ₱4,180 million in 2010, a 13.2% increase in rent expenses from ₱1,060 million in 2009 to ₱1,200 million in 2010 and a 89.6% increase in depreciation and amortization from ₱221 million in 2009 to ₱419 million in 2010. The increase in freight, trucking and handling expenses was primarily due to additional expenses incurred in 2010 as a result of the closure of the San Fernando poultry plant and the Marikina value-added meats plant, which required food products to be transported longer distances from the value-added meats plant in Cavite and contracted tolling plant in Bataan. The increase in personnel expenses was principally due to an increase in salary rates and higher sales commissions due to higher sales. The increase in rent was principally due to higher rental rates and rent attributable to Petron, for which there were no corresponding costs in 2009. The increase in depreciation and amortization was mainly attributable to Petron, for which there were no corresponding costs in 2009.

Administrative Expenses. Administrative expenses increased by 10.6% from ₱17,344 million in 2009 to ₱19,187 million in 2010. This increase was primarily due to a 9.4% increase in personnel expenses from ₱7,385 million in 2009 to ₱8,081 million in 2010, a 13.9% increase in depreciation and amortization from ₱2,110 million in 2009 to ₱2,403 million in 2010 and a 46.1% increase in advertising and promotion expenses from ₱822 million in 2009 to ₱1,201 million in 2010, which were partially offset by a 26.6% decrease in professional fees from ₱2,383 million in 2009 to ₱1,750 million in 2010 and a 28.6% decrease in repairs and maintenance expenses from ₱952 million in 2009 to ₱680 million in 2010. The increase in personnel expenses was principally the result of increased salary rates for employees and increased sales commission due to

higher sales. The increase in advertising and promotion expenses was primarily due to increased brand building and product visibility activities of the food business in 2010. Professional fees were higher in 2009 primarily because of professional fees attributable to the sale by SMC of a 43.2% equity interest in SMB in 2009. The decrease in repairs and maintenance was largely attributable to cessation of operations of SMC's non-alcoholic beverages plants in Indonesia and China in 2010. The higher repairs and maintenance in 2009 was also attributable to the costs of repairing a flour plant in 2009.

Interest Expense and Other Financing Charges

Interest expenses and other financing charges increased significantly from ₱7,926 million in 2009 to ₱16,578 million in 2010. This increase was attributable to higher average balances of bank drafts and loans payable, long-term debt in the form of bonds and unsecured term notes incurred in 2010. Payments due to PSALM under the IPPA Agreements, which were reported for the first time in SMC's financial statements as an interest expense on SMCGP's finance lease liabilities following consolidation of SMCGP on August 1, 2010, also resulted in increased interest expense. See notes 23 and 31 to SMC's consolidated financial statements for more detailed information.

Interest Income

Interest income decreased by 49.5% from ₱5,989 million in 2009 to ₱3,023 million in 2010, primarily due to a decrease in SMC's short-term investments.

Equity in Net Earnings (Losses) of Associates

Equity in net earnings of associates increased significantly from ₱2,816 million in 2009 to ₱6,817 million in 2010, which largely reflected SMC's equity in net earnings of (i) Meralco, which has been accounted for under the equity method since November 1, 2008; (ii) SPDC, which was accounted for under the equity method from January 26, 2010 to July 31, 2010; (iii) SMEC, which was accounted for under the equity method from November 6, 2009 to July 31, 2010; and (iv) Petron, which was accounted for under the equity method from June 1, 2010 to December 15, 2010. These increases were partially offset by net losses incurred by Top Frontier and Liberty.

Gain on Sale of Investments and Property and Equipment

Gain on sale of investments and property and equipment decreased from ₱50,630 million in 2009 to ₱529 million in 2010. The significantly higher gain on sale of investments and property and equipment was mainly due to the recognition of a net gain of ₱50,537 million on SMC's sale of a 43.2% equity interest in SMB in 2009.

Other Income (Charges)

SMC had other income of ₱6,926 million in 2010 compared to other charges of ₱6,843 million in 2009. Other income in 2010 was attributable primarily to a foreign exchange gain and a gain on acquisition of a subsidiary, which was partially offset by impairment losses on noncurrent assets of SMBHK in Hong Kong and SMGBC in Guangdong, China. Other charges in 2009 were attributable primarily to an impairment loss on noncurrent assets of SMBHK and SMGBC, as well as foreign exchange losses on foreign currency swaps. See note 33 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Income Before Income Tax from Continuing Operations

As a result of the foregoing, income before income tax from continuing operations decreased by 44.8% from ₱64,335 million in 2009 to ₱35,494 million in 2010.

Income Tax Expense

Income tax expense increased significantly from ₱3,706 million in 2009 to ₱11,438 million in 2010. This increase was primarily due to SMC having been subject to a substantially lower effective tax rate in 2009 and having a higher amount of taxable income in 2010.

SMC's statutory income tax rate in the Philippines was 30.0% in each of 2009 and 2010. SMC's effective income tax rate was 33.2% in 2010 primarily as a result of certain income being subject to higher tax rates, which was partially offset by an increase in equity in net earnings of associates not subject to the corporate income tax rate of 30.0%. SMC's effective income tax rate was 5.8% in 2009 primarily due to its gain on the sale of a 43.2% interest in SMB not being subject to the corporate income tax rate of 30.0%.

Income from Continuing Operations

Income from continuing operations decreased by 60.3% from ₱60,629 million in 2009 to ₱24,056 million in 2010. The significantly higher income from continuing operations in 2009 was primarily attributable to SMC's recognition of a gain on its sale of a 43.2% equity interest in SMB.

Income after Income Tax from Discontinued Operations

There were no discontinued operations in 2009 or 2010.

Net Income

As a result of the foregoing, net income decreased from ₱60,629 million in 2009 to ₱24,056 million in 2010.

Year ended December 31, 2009 compared to Year ended December 31, 2008

Sales

SMC's sales increased by 3.7% from ₱168,041 million in 2008 to ₱174,213 million in 2009. The following table sets forth SMC's sales, excluding intercompany sales, by line of business for the periods indicated:

	For the Year Ended December 31,	
	2008	2009
	(In millions)	
Beverages	₱ 78,599	₱ 82,735
Food	73,830	77,220
Packaging	15,612	14,258
Total	<u>₱168,041</u>	<u>₱174,213</u>

Beverages. Beverages sales increased by 5.3% from ₱78,599 million in 2008 to ₱82,735 million in 2009. This increase was primarily due to increases in domestic beer sales and liquor sales. In particular:

- Beer sales increased by 7.3% from ₱58,338 million in 2008 to ₱62,605 million in 2009. This increase was primarily due to a 6.7% increase in average sales price, offset by a 0.9% decrease in sales volume from 216 million equivalent cases in 2008 to 214 million equivalent cases in 2009. The increase in average sales price was principally a result of SMC raising its domestic beer prices in November 2009, while beer sales volume declined due to lower sales volume in the international market, particularly in southern China.
- Liquor sales increased by 26.3% from ₱14,774 million in 2008 to ₱18,654 million in 2009. This increase was primarily due to a 12.5% increase in liquor sales volume from 32 million equivalent cases in 2008 to 36 million equivalent cases in 2009 and a higher average sales price for liquor during 2009

after sales price increases in May and August of 2008. The increase in liquor sales volume was principally a result of volume growth of *GSM Blue* and *Gran Matador* brandy.

Food. Food sales increased by 4.6% from ₱73,830 million in 2008 to ₱77,220 million in 2009. This increase was primarily due to increased sales volumes for poultry, basic meats, milk and ice cream products, as well as higher sales prices for poultry products compared to 2008. The increased sales volume for poultry, basic meats, milk and ice cream products was primarily due to increased product availability. Higher sales prices for poultry products was primarily due to favorable market conditions.

Packaging. Packaging sales decreased by 8.7% from ₱15,612 million in 2008 to ₱14,258 million in 2009. The decrease in packaging sales was mainly due to a decrease in sales volumes to major customers, particularly soft drink bottlers, and lower export sales.

Cost of Sales

Cost of sales increased by 0.2% from ₱124,072 million in 2008 to ₱124,295 million in 2009. This increase was primarily the result of a 9.2% increase in taxes and licenses costs by from ₱19,703 million in 2008 to ₱21,515 million in 2009, a 7.2% increase in depreciation and amortization from ₱4,660 million in 2008 to ₱4,994 million in 2009, a 9.0% increase in contracted services expenses from ₱4,296 million in 2008 to ₱4,682 million in 2009 and a 3.8% increase in freight, trucking and handling expenses from ₱4,230 million in 2008 to ₱4,392 million in 2009, which were almost fully offset by a 1.5% decrease in inventory costs from ₱76,205 million in 2008 to ₱75,051 million in 2009, a 13.5% decrease in communications, light and water costs from ₱4,232 million in 2008 to ₱3,662 million in 2009 and a 33.6% decrease in fuel and oil costs from ₱3,267 million in 2008 to ₱2,170 million in 2009.

The increase in taxes and licenses costs was mainly due to an 8.0% increase in excise taxes on beer and higher taxes on liquor that took effect on January 1, 2009, as well as higher beer and liquor sales volumes. The increase in depreciation and amortization was primarily due to depreciation on new equipment acquired to meet operational requirements. The increase in contracted services was principally the result of contracting additional personnel to meet increased volume to integrate warehousing and higher tolling fees for the non-alcoholic beverages business. The increase in freight, trucking and handling was largely attributable to increased sales volume. The decrease in inventory costs was principally the result of stable or lower prices for raw materials for SMC's food business. The decrease in communications, light and water was primarily due to improvements in operational efficiency and cost reduction initiatives implemented by SMC. The decrease in fuel and oil costs was mainly due to lower bunker fuel prices.

Selling and Administrative Expenses

Selling and administrative expenses increased by 3.8% from ₱29,151 million in 2008 to ₱30,249 million in 2009. This increase was the result of an increase in administrative expenses, which was partially offset by a decrease in selling expenses. In particular:

Selling Expenses. Selling expenses decreased by 4.5% from ₱13,518 million in 2008 to ₱12,905 million in 2009. This decrease was principally the result of a 12.6% decrease in advertising and promotion expenses from ₱5,697 million in 2008 to ₱4,980 million in 2009 and a 1.4% decrease in freight, trucking and handling expenses from ₱2,049 million in 2008 to ₱2,021 million in 2009, which were partially offset by an 11.8% increase in personnel expenses from ₱3,251 million in 2008 to ₱3,635 million in 2009 and a 6.5% increase in rent expenses from ₱995 million in 2008 to ₱1,060 million in 2009. The decrease in advertising and promotion expenses was primarily due to reduced trade promotional activities and media advertising in response to adverse economic conditions in the Philippines. The decrease in freight, trucking and handling was primarily due to logistics providers setting lower rates reflecting lower average fuel prices. The increase in personnel expenses was principally the result of increased salary rates for employees. The increase in rent was principally the result of renting additional warehouses for operational requirements of the liquor and non-alcoholic beverages businesses.

Administrative Expenses. Administrative expenses increased by 10.9% from ₱15,633 million in 2008 to ₱17,344 million in 2009. This increase was primarily the result of a 9.1% increase in personnel expenses from ₱6,771 million in 2008 to ₱7,385 million in 2009, a 13.5% increase in depreciation and amortization from ₱1,859 million in 2008 to ₱2,110 million in 2009 and an 85.7% increase in professional fees from ₱1,283 million in 2008 to ₱2,383 million in 2009, which were partially offset by a 49.1% decrease in advertising and promotion expenses from ₱1,614 million in 2008 to ₱822 million in 2009. The increase in personnel expenses was principally the result of increased salary rates for employees. The increase in depreciation and amortization was primarily attributable to depreciation on newly acquired fixed assets. The increase in professional fees was mainly attributable to professional fees incurred in the sale by SMC's sale of a 43.2% equity interest in SMB. The decrease in advertising and promotion expenses was primarily due to reduced promotional activities for supermarket customers in response to adverse economic conditions.

Interest Expense and Other Financing Charges

Interest expenses and other financing charges increased by 31.4% from ₱6,032 million in 2008 to ₱7,926 million in 2009. This increase was primarily due to higher outstanding balances on SMC's short-term and long-term debt in 2009.

Interest Income

Interest income decreased by 9.7% from ₱6,630 million in 2008 to ₱5,989 million in 2009, primarily due to a decrease in short-term investments.

Equity in Net Earnings (Losses) of Associates

Equity in net losses of associates was ₱1,132 million in 2008. Equity in net earnings of associates was ₱2,816 million in 2009, which largely reflected SMC's equity in net earnings of (i) Meralco, which was accounted for under the equity method from October 31, 2008; (ii) BOC, which was accounted for under the equity method from April 21, 2008; and (iii) SMEC, which was accounted for under the equity method from November 6, 2009. These were in part offset by SMC's share in net losses of Liberty.

Gain on Sale of Investments and Property and Equipment

Gain on sale of investments and property and equipment increased from ₱8,746 million in 2008 to ₱50,630 million in 2009, mainly due to the gain on SMC's sale of a 43.2% equity interest in SMB.

Other Income (Charges)

Other charges increased from ₱2,262 million in 2008 to ₱6,843 million in 2009. Other charges in 2009 were primarily attributable to an impairment loss on noncurrent assets of SMBHK in Hong Kong and SMGBC in Guangdong, China and foreign exchange losses on foreign currency swaps. Other charges in 2008 were attributable primarily to a net loss on derivatives, offset in part by a foreign exchange gain. See note 33 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Income Tax Expense

Income tax expense decreased by 39.2% from ₱6,098 million in 2008 to ₱3,706 million in 2009. This decrease was primarily due to a lower effective income tax rate in 2009.

The statutory income tax rate in the Philippines decreased from 35.0% in 2008 to 30.0% in 2009. SMC's effective income tax rate was 5.8% in 2009 primarily due to a significant gain on the sale of investments, which was not subject to the 30% corporate income tax rate. SMC's effective income tax rate was 29.4% in 2008, primarily as a result of decreases in income tax rate resulting from (i) interest income that was subject to a tax rate of 7.5% for U.S. dollar deposits and 20.0% for Philippine peso deposits, and (ii) gain on sale of

investments that was subject only to a Philippine stock transaction tax rate of 0.5%, which were partially offset by an increase in effective income tax rate resulting from a loss on derivatives, as the loss was not recognized for tax purposes.

Income from Continuing Operations

Income from continuing operations increased from ₱14,670 million in 2008 to ₱60,629 million in 2009. This increase was primarily due to SMC's gain on the sale of a 43.2% equity interest in SMB.

Income after Income Tax from Discontinued Operations

Income after income tax from discontinued operations was ₱5,413 million in 2008, million, which primarily consisted of the gain on the sale of investment in San Miguel Australia Holdings Ltd. and a loss from discontinued operations of SMC's agribusiness division. There were no discontinued operations in 2009.

Net Income

As a result of the foregoing, net income increased significantly from ₱20,083 million in 2008 to ₱60,629 million in 2009.

LIQUIDITY AND CAPITAL RESOURCES

The following table sets forth SMC's cash flows for the periods indicated:

	For the Year Ended December 31,			
	2008	2009	2010	2010
	(In millions)			
Net cash flows from operating activities	₱ 7,049	₱13,368	₱ 45,314	US\$ 1,033
Net cash flows provided by (used in) investing activities . . .	31,898	49,155	(126,931)	(2,892)
Net cash flows provided by (used in) financing activities . . .	(13,865)	32,550	(2,226)	(51)
Effect of exchange rate changes on cash and cash equivalents	(1,424)	(2,601)	(380)	(9)
Net increase (decrease) in cash and cash equivalents	<u>₱ 23,658</u>	<u>₱92,472</u>	<u>₱ (84,223)</u>	<u>US\$(1,919)</u>

Net Cash Flows from Operating Activities

Net cash flows from operating activities were ₱45,314 million in 2010 compared to ₱13,368 million in 2009 despite 2009 having substantially higher income before income tax from continuing operations. The increase in net cash flows from operating activities in 2010 compared to 2009 was principally due to a substantially larger negative adjustment for gain on sale of investments in 2009 and a substantially higher positive adjustment for property and equipment and interest expense and other financial charges in 2010.

Net cash flows from operating activities were ₱13,368 million in 2009 compared to ₱7,049 million in 2008. The increase in net cash flows from operating activities in 2009 compared to 2008 was principally due to a significant increase in income before income tax from continuing operations and a substantially higher positive adjustment for depreciation and amortization in 2009, although 2009 had a substantially higher negative adjustment for gain on sale of investments and property and equipment than in 2008.

Net Cash Flows provided by (used in) Investing Activities

Net cash flows used in investing activities were ₱126,931 million in 2010. Cash flows provided by investing activities were ₱49,155 million in 2009. This reversal in net cash flows was primarily due to substantially higher additions to investments and advances and higher acquisition of subsidiaries, net of cash and cash equivalents, which were partially offset by a decrease in proceeds from sale of investments and property and equipment in 2010 compared to 2009.

Net cash flows provided by investing activities were ₱49,155 million in 2009 compared to ₱31,898 million in 2008. The increase in net cash flows provided by investing activities in 2009 was mainly due to SMC's sale of a 43.2% equity interest in SMB in 2009, substantially increasing proceeds from sale of investments and property and equipment.

Net Cash Flows provided by (used in) Financing Activities

Net cash flows used in financing activities were ₱2,226 million in 2010, and principally reflected payments of short-term borrowings, long-term borrowings and cash dividends, which were offset by proceeds from short-term borrowings. Net cash flows provided by financing activities were ₱32,550 million in 2009, and principally reflected proceeds from short-term borrowings, long-term borrowings, and proceeds from the issuance of preferred shares, which were partially offset by payments of short-term borrowings and long-term borrowings. Net cash flows used in financing activities were ₱13,865 in 2008, and principally reflected payments of long-term and short-term borrowings and long-term borrowings, which were partially offset by proceeds from short-term borrowings.

Working Capital and Indebtedness

On January 25, 2011, SMCGP completed a US\$300 million bond offering. The 5-year bonds have an interest rate of 7% per annum. The proceeds from this bond offering will be used to finance investments in power related assets, financing payment or prepayment of obligation with PSALM and/or general corporate purposes.

On March 31, 2011, SMCGP signed a US\$200 million 3-year term loan with a syndicate of banks. Use of proceeds for the loan include: (i) financing payment or, subject to negotiations with PSALM, prepayment of SMCGP's payment obligations to PSALM under its IPPA Agreements; (ii) financing of additional capital expenditures to support expansion of existing power generation assets; and/or (iii) financing of new investment in power-related assets.

Contractual Obligations

The following table summarizes SMC's contractual obligations as of December 31, 2010:

	Carrying Amount	Contractual Cash Flow	1 Year or Less	> 1 Year — 2 Years	> 2 Years — 5 Years	Over 5 Years
	(In millions)					
Drafts and loans payable	₱ 74,128	₱ 75,057	₱ 75,057	₱ —	₱ —	₱ —
Accounts payable and accrued expenses (excluding current retirement liabilities and IRO)	69,198	69,198	69,198	—	—	—
Derivative liabilities (included under the accounts payable and accrued expenses account in the consolidated statements of financial position)	71	71	71	—	—	—
Long-term debt (including current maturities) ⁽¹⁾	168,927	209,335	22,250	28,947	126,378	31,760
Finance lease liabilities (including current portion) ⁽²⁾	208,407	314,678	11,794	18,479	60,458	223,947
Other noncurrent liabilities (excluding noncurrent retirement liabilities, asset retirement obligation and infrastructure restoration obligation)	16,168	16,168	—	16,168	—	—
Total	₱536,899	₱684,507	₱178,370	₱63,594	₱186,836	₱255,707

Notes:

⁽¹⁾ Includes bonds and unsecured term notes.

⁽²⁾ Include payment obligations under SMCGP's IPPA Agreements.

Capital Resources

As of December 31, 2010, SMC had cash and cash equivalents of ₱125,188 million. As of the same date, SMC had total outstanding short-term borrowings of ₱74,128 million in the form of bank loans and short-term commercial paper facilities. In 2010, the interest rate for SMC's Peso-denominated and foreign currency-denominated loans ranged from 3.1% to 4.5% and 1.8% to 16.5%, respectively. All of SMC's short-term borrowings are unsecured.

As of December 31, 2010, SMC had total outstanding long-term borrowings of ₱168,927 million. SMC obtained these borrowings from various financial institutions and investors, both in the Philippines and abroad. The debt agreements contain, among other provisions, covenants relating to merger and consolidation, maintenance of certain financial ratios, working capital requirements, restrictions on loans and guarantees, disposal of a substantial portion of assets, significant changes in the ownership or control of subsidiaries, payments of dividends and redemption of capital stock. See note 23 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

The following table sets forth a summary of the maturity profile of the outstanding long-term borrowings of SMC as of December 31, 2010:

<u>Payments Due by Period</u>	<u>Amount</u> <u>(In millions)</u>
Repayment within one year	₱ 12,549
2012	20,495
2013	4,708
2014	32,991
2015	70,970
2016	4,470
2017	19,964
2019	2,780
Total	<u>₱168,927</u>

As of December 31, 2010, SMC had current assets of ₱279,538 million and current liabilities of ₱178,224 million. As of the same date, SMC's working capital (current assets minus current liabilities) was ₱101,314 million. SMC believes that its available cash, including cash flow from operations, as well as borrowings and debt and equity financing, including this Offer and Concurrent Offer, will provide sufficient liquidity to fund its projected operating, investment and capital expenditures and debt service requirements for the next 12 months.

Capital Expenditures

In 2008, 2009 and 2010, SMC had capital expenditures totaling ₱21,204 million, which were primarily attributable the building and expanding of SMC's production and distribution facilities in the Philippines and internationally. SMC's capital expenditures were ₱6,437 million, ₱6,249 million and ₱8,518 million, respectively, in 2008, 2009 and 2010. SMC also had authorized but undisbursed capital expenditures of ₱4,856 million as of December 31, 2010.

SMC is projected to have substantial capital expenditures in the next three years, ranging from ₱80 billion to ₱120 billion, primarily related to Petron. Petron is expected to have capital expenditures in the next two years ranging from ₱60 billion to ₱100 billion for the implementation of RMP-2, construction of a cogeneration power plant, and expansion of its service station network. Petron expects to fund its capital expenditures with internally generated operating cash flow and third-party financing. SMC's beverages, food and packaging businesses are projected to require capital expenditure in the next two to three years of approximately ₱15 billion to ₱20 billion. SMC expects SMCGP to have no capital expenditure in the next two years, especially with respect to the three power plants that SMCGP administers as the IPPA. In addition to its expected capital expenditures for its existing businesses, SMC's infrastructure businesses are estimated to require funding of approximately ₱22 billion over the same period, which SMC intends to fund primarily with proceeds from the Offer. See "Use of Proceeds".

SMC's ability to fund its acquisitions and capital expenditures is dependent on the availability of internally generated funds and funds raised from external sources, including debt and equity financing. SMC's continued access to capital markets financing to fund new projects and acquisitions and to refinance maturing debt is subject to many factors, including: (1) the market's interest in SMC's debt and equity securities at the time of any offering, as well as overall market conditions; (ii) Philippine regulations limiting bank exposures (including borrower limits) to a single borrower or a related group of borrowers; (iii) SMC's compliance with existing debt covenants; (iv) the ability of SMC, its associates and subsidiaries to service new debt, and other factors, some of which may be out of SMC's control.

Off-Balance Sheet Arrangements

SMC does not have any material off-balance sheet arrangements, except for outstanding derivative transactions entered into by SMC as of and for the year ended December 31, 2010. SMC has derivative financial instruments, including commodity and currency options, forwards and swaps, to manage its exposures to exchange rates, interest rates and fluctuating commodity prices. See note 42 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial Risk Management Objectives and Policies

Objectives and Policies

SMC has significant exposure to the following market risks primarily from its use of financial instruments:

- interest rate risk;
- foreign currency risk; and
- commodity price risk.

Interest Rate Risk

SMC's exposure to changes in interest rates primarily relates to SMC's long-term borrowings and investment securities. SMC manages its interest cost by using a combination of fixed-rate and variable-rate debt instruments. SMC monitors the prevailing market-based interest rate and ensures that the interest rates charged on its borrowings are optimal and benchmarked against the interest rates charged by other banks.

SMC's investment policy is to maintain an adequate yield to match or reduce the net interest cost on its borrowings pending the deployment of funds for their intended use in SMC's operations and working capital management. SMC invests only in investment grade securities and maintains a diversified portfolio of securities to reduce concentration risk. See notes 41 and 42 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

Foreign Currency Risk

SMC's exposure to foreign currency risk results from significant movements in foreign currency exchange rates that could adversely affect SMC's foreign currency-denominated transactions. SMC's risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity. SMC enters into foreign currency hedges using a combination of non-derivative and derivative instruments, such as foreign currency forwards, options or swaps to manage its foreign currency risk exposure.

Short-term currency forward contracts (deliverable and non-deliverable) and options are entered into to manage foreign currency risks arising from imports, revenue and expense transactions, and other foreign currency-denominated obligations. Currency swaps are entered into to manage foreign currency risks relating to long-term foreign currency-denominated borrowings. See notes 41 and 42 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

The following table sets forth SMC's foreign currency-denominated monetary assets and liabilities and their Peso equivalents as of the dates indicated:

	As of December 31,			
	2009		2010	
	US\$(⁽¹⁾)	Peso Equivalent(⁽²⁾)	US\$(⁽¹⁾)	Peso Equivalent(⁽³⁾)
	(In millions)			
Assets				
Cash and cash equivalents	US\$2,817	P130,134	US\$ 1,456	P 63,812
Trade and other receivables	96	4,413	299	13,120
Noncurrent receivables	101	4,656	3	151
Total Assets	<u>3,014</u>	<u>139,203</u>	<u>1,758</u>	<u>77,083</u>
Liabilities				
Drafts and loans payable	137	6,332	139	6,065
Accounts payable and accrued expenses	98	4,528	965	42,290
Long-term debt (including current maturities).	664	30,674	1,333	73,995
Finance lease liabilities	—	—	2,636	115,556
Other noncurrent liabilities	—	—	1	35
Total Liabilities	<u>899</u>	<u>41,534</u>	<u>5,074</u>	<u>237,941</u>
Net foreign currency — denominated monetary assets (liabilities)	<u>US\$2,115</u>	<u>P 97,669</u>	<u>US\$(3,316)</u>	<u>P(160,858)</u>

(⁽¹⁾) Amounts in currencies other than U.S. dollars have been converted into U.S. dollars at the relevant period-end exchange rate.

(⁽²⁾) U.S. dollar amounts have been converted into Pesos based on an exchange rate of US\$1.00 = P46.20.

(⁽³⁾) U.S. dollar amounts have been converted into Pesos based on an exchange rate of US\$1.00 = P43.84.

Commodity Price Risk

SMC's commodity price risk exposure results primarily from the use of commodities as raw materials and fuel in its production processes. SMC enters into various commodity derivative instruments to manage its price risks on strategic commodities. Commodity hedging is intended to provide stability in prices, which offsets the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to SMC, thereby protecting SMC from raw material cost increases and preserving margins. For hedging transactions, if prices decrease, hedging positions may result in marked-to-market losses, which are in turn expected to be offset by lower raw material costs.

SMC enters into the following commodity derivative transactions on behalf of its subsidiaries and associates to reduce cost by optimizing purchasing synergies and managing inventory levels of common materials:

- *Commodity Swaps, Futures and Options.* Commodity swaps, futures and options are used to manage SMC's exposures to volatility in the prices of certain commodities, such as fuel oil, crude oil, aluminum, soybean meal and wheat.
- *Commodity Forwards.* SMC enters into commodity forward purchase agreements for various commodities, such as malt and coal. The prices of these agreements are fixed either with the commodity suppliers directly or by reference to an applicable commodity price index.

See notes 41 and 42 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

RECENT ACCOUNTING PRONOUNCEMENTS

SMC's consolidated financial statements have been prepared in compliance with PFRS. For a discussion of the significant accounting policies, adoption of new or revised standards, amendments to standards and interpretations effective as of 2010, see note 3 to SMC's consolidated financial statements included elsewhere in this Offering Circular.

OVERVIEW OF THE PHILIPPINE ECONOMY

Unless otherwise specified, all statistical data contained in this section was derived from publications of the NSCB, National Statistics Office (“NSO”); Bureau of the Treasury, Department of Finance; or the BSP.

SMC is a conglomerate with diverse interests across a number of industries, including beverages, food, packaging products, fuel and oil, power, infrastructure, mining, banking, telecommunications and property development. As a result, SMC believes that providing an overview of the Philippine economy would be more informative to potential investors than industry overviews for each of SMC’s businesses. Where relevant, appropriate information relating to the industry of each of SMC’s businesses is provided in the description of such business in the “Business” section of this Offering Circular.

General

The Philippine archipelago has over 7,000 islands with a total land area of approximately 300,000 square kilometers. The islands are grouped into three geographic regions: Luzon, the largest island, in the north, covering an area of 141,395 square kilometers; Visayas in the central region, covering an area of 56,606 square kilometers; and Mindanao in the south, covering an area of 101,999 square kilometers. Manila is the Philippine’s capital. According to the 2007 census, the Philippine’s population is estimated at approximately 88.6 million.

Economy

The Philippines has a mixed economy in which the Philippine national government is directly engaged in certain economic activities through Government-owned and controlled corporations (“GOCCs”) and Philippine government financial institutions (“GFIs”). The Philippine government actively encourages domestic and foreign private investment. The Philippines has undertaken liberalization of trade and investment in tandem with the deregulation of the financial system, foreign exchange liberalization, tax reforms, acceleration of privatization, enhancement of competition in the provision and operation of public utilities, and deregulation of the oil and power industries.

The principal sectors of the Philippine economy are services, industry and agriculture (including fishery and forestry). The services sector accounted for approximately 49.7% of total gross domestic product (“GDP”) in 2010, including the subsectors of trade (17.2% of GDP), transportation, communications and storage (8.4% of GDP) and private services (9.2% of GDP). The industry sector accounted for approximately 33.6% and the agriculture, fishery and forestry sector accounted for 16.8% of total GDP in 2010.

In 2010, real GDP grew by 7.3%, compared to growth of 1.1% in 2009. The increases in GDP growth was primarily attributable to the global economic recovery, improved business and consumer confidence, expansion in manufacturing and capital formation and the continued growth in remittances from abroad. Consumer spending grew by 5.3%, while Government expenditures grew by 2.7% in 2010, compared to growth of 4.1% and 11.0%, respectively, in 2009. With respect to production, GDP growth in 2010 was driven by the manufacturing, private services, trade, and construction subsectors. Growth in these subsectors was partially offset by the impact of the El Niño phenomenon on the agriculture and fishery subsector.

Foreign trade is important to the Philippine economy. Exports and imports of goods were equal to 20.8% and 25.0% of the Philippines’ gross national product, respectively, according to the NSO. Total exports of goods as reported by the NSO were \$38.4 billion in 2009. Manufactured goods accounted for 87.4% of the Philippines’s exports in 2009. Electronics, machinery and transport equipment and garments have historically been the Philippines’s leading manufactured exports.

In 2010, the labor force in the Philippine, excluding overseas Filipino workers (“OFW”), totaled 38.9 million people. Workers in the Philippine remained employed primarily in service industries, such as wholesale and retail trade and repair of motor vehicles, motorcycles and personal and household goods. Workers in the services sector comprised 51.8% of the total workforce of the Philippine, followed by the agriculture, fishery and forestry sector, which comprised 33.2% of the total workforce, and the industry sector, which comprised 15.0%. The average rate of unemployment in the Philippines in 2010 was 7.4%, a decline

from the 7.5% rate recorded in 2009. In 2010, the services sector continued to employ the highest number of workers, while the industry sector recorded the fastest growth in employment compared to 2009.

In 2010, preliminary data indicates that the overall balance of payments position of the Philippines recorded a surplus of \$14.4 billion, which was 124.3% higher than the \$6.4 billion surplus recorded in 2009.

As of September 30, 2010, the Philippines' outstanding external debt approved by the BSP was \$59.8 billion, a 9.2% increase from the \$54.7 billion recorded as of September 30, 2009. The increase was mainly due to new borrowings by the Philippines during this period exceeding the Philippine's loan repayments by more than \$4.0 billion, as well as foreign exchange revaluation adjustments of \$1.1 billion, mainly as a result of the weakening of the U.S. dollar against other major currencies in which the Philippine's debt is denominated, such as the Japanese yen. Approximately 48.5% of the Philippine's BSP-approved external debt was denominated in U.S. dollars, 29.1% was denominated in Japanese yen, and 11.8% was denominated in other currencies. Multi-currency loans from the World Bank and the Asian Development Bank accounted for the remaining 10.6% of total BSP-approved external debt.

As of April 8, 2011, the PSE composite index closed at 4,212.5, a 0.3% increase from the 4,201.1 recorded as of the end of 2010. In 2010, the average PSE composite index was 3,550.9, compared to the average composite index of 2,508.7 in 2009, and 2,587.4 in 2008.

On April 8, 2011, the Peso-to-U.S. dollar exchange rate was ₱43.112 per U.S. dollar, compared to ₱43.885 per U.S. dollar on December 31, 2010, ₱46.356 per U.S. dollar on December 31, 2009, and ₱47.485 per U.S. dollar on December 31, 2008.

In 2010, the average exchange rate was ₱45.110 per U.S. dollar, compared to ₱47.637 per U.S. dollar in 2009, and ₱44.475 per U.S. dollar in 2008. The general strengthening of the peso against the U.S. dollar was attributable to a revival of capital inflows into Asia, sustained foreign exchange inflows from OFW remittances, foreign direct and other investments, and the general weakening of the U.S. dollar against Asian currencies. These trends were offset in part by concerns over the sovereign debt situation in Europe and the Philippine's fiscal position.

The average interest rates for 91-day Treasury bills decreased to 3.7% in 2010 from an average of 4.2% in 2009, 5.4% in 2008 and 3.4% in 2007.

Beginning in the second half of 2007, the short-term funding markets in the United States experienced credit issues, leading to liquidity disruption in various markets. In particular, subprime mortgage loans in the United States experienced increased rates of delinquency, foreclosure and loss. These and other related events had a significant adverse impact on the global credit and financial markets as a whole, which included the bankruptcy filings by, and, the acquisition, restructuring and nationalization of, certain financial institutions. Regulators in the United States, Europe and Asia took steps in response to the unprecedented conditions facing financial institutions in their jurisdictions. Against the backdrop of the global financial crisis, the Philippines has experienced limited exposure to subprime assets and bankrupt financial institutions. Nonetheless, in 2008, the Philippines experienced slower growth rates, a weakening of equity prices, lower values for the peso and increasing inflation. In 2009, the Philippines's economy began to exhibit indications of a recovery, although certain of its economic recovery policies have yet to result in positive effects; however, OFW remittance levels in 2009 exceeded the Philippines's forecasts and supported growth in the economy despite continuing slowdowns in other production sectors, while increased Government spending in an effort to stimulate the economy has resulted in an increasing fiscal deficit.

In 2010, the Philippines continued its recovery despite erratic economic recovery globally. In the second quarter of 2010, certain European nations experienced widening yields on their debt securities, triggering widespread restructuring and necessitating a financial bailout from other nations in the region. Along with most Asian and emerging markets, the Philippines was largely spared from the substantive effects of these events due to minimal trade and financial linkages with the affected nations, but the situation in Europe further highlighted the need for fiscal consolidation and more effective risk management by the Philippines.

In July 2010, the Philippine government announced plans to increase infrastructure development to assist in the development of the Philippine economy. The Government, which ran a budget deficit in 2009 and 2010, aims to stimulate private resources to finance the construction, operation and maintenance of infrastructure and development projects normally undertaken by the Government. To this end, the Government is formulating policies to increase Public-Private Partnerships (“PPPs”) and investment in the Philippines to build and upgrade roads, ports and airports, as well as power and water utilities. A center to promote PPPs was recently created to streamline approval and processing of infrastructure projects. The Government has announced its intention to invite bids for an aggregate of ₱739.8 billion (\$16.82 billion) worth of infrastructure assets in 2011 and 2012. The Government has also established the Philippine Infrastructure Development Fund to encourage and facilitate private investment, and provide long-term financing for PPPs, predominantly in the transport sector.

In its meeting on March 24, 2011, the Monetary Board of the BSP increased its policy rates from 4.00%, to 4.25% for the overnight borrowing rate and from 6.00% to 6.25% for the overnight lending rate. Prior to that time, these rates had not been changed since July 2009, when they were decreased from 4.25% to 4.00% and from 6.25% to 6.00%, respectively.

Commercial bank lending rates have generally eased over the past five years, from an average range of 8.3% to 10.2% in 2006, 6.9% to 8.6% in 2007, 7.5% to 9.5% in 2008, 7.3% to 9.3% in 2009, and 6.6% to 8.7% in 2010. The average range of commercial bank lending rate for the first two months of 2011 was 5.4% to 7.5%, compared to an average range of 6.8% to 8.9% in the first two months of 2010.

Summary Economic Information of the Republic of the Philippines

	2006	2007	2008	2009	2010
GDP (in billions at current market prices) . .	₱ 6,031	₱ 6,649	₱ 7,409	₱ 7,679	₱ 8,513
GDP (in billions at constant 1985 prices) . .	₱ 1,276	₱ 1,367	₱ 1,417	₱ 1,432	₱ 1,537
GDP per capita (in U.S. dollars at current market prices) ⁽¹⁾	US\$ 1,351	US\$ 1,624	US\$ 1,841	US\$ 1,748	US\$ 2,088
GDP growth rate (at constant 1985 prices)	5.3%	7.1%	3.7%	1.1%	7.3%
Consumer Price Inflation rate	6.2%	2.8%	9.3%	3.2%	3.8%
Unemployment rate	8.0%	7.3%	7.4%	7.5%	7.4% ⁽²⁾
Government surplus/(deficit) as % of GDP	(1.1)%	(0.2)%	(0.9)%	(3.9)%	(4.3)% ⁽³⁾
Public sector borrowing requirement in billions ⁽⁴⁾	(79.1)	47.9	(91.0)	(336.4)	N/A
Consolidated public sector financial position in billions ⁽⁵⁾	11.0	21.4	29.2	(251.5)	N/A
	2006	2007	2008	2009	2010
	(Percentages, except as indicated)				
Current account surplus/(deficit) as % of GDP	4.5%	4.9%	2.2%	5.5%	5.3% ⁽⁶⁾
Overall balance of payments position as % of GDP ⁽⁷⁾	3.2%	5.9%	0.1%	4.0%	7.6% ⁽⁶⁾
Gross international reserves (in millions of dollars) ⁽⁸⁾	US\$22,967	US\$33,751	US\$37,551	US\$44,243	US\$62,371

	2006	2007	2008	2009	2010
	(In billions, end of period; except as indicated) ⁽⁹⁾				
Direct domestic debt of the Philippines ⁽¹⁰⁾	₱2,154.1	₱2,201.2	₱2,414.4	₱2,470.0	₱2,717.5 ⁽¹¹⁾
Direct external debt of the Philippines ⁽¹⁰⁾	\$ 34.5	\$ 36.5	\$ 38.0	\$ 41.6	\$ 45.6 ⁽¹¹⁾
Public sector domestic debt ⁽¹²⁾	₱1,913.9	₱2,201.8	₱2,332.0	₱2,695.7	N/A
Public sector external debt ⁽¹³⁾	₱3,029.7	₱2,571.8	₱2,935.1	₱3,000.5	N/A

Sources: NSO; NSCB; Bureau of the Treasury; Department of Finance; BSP.

⁽¹⁾ Amounts in Pesos have been translated to U.S. dollars using the average BSP reference exchange rates for the applicable year.

⁽²⁾ Average of January, April, and July 2010 Labor Force Survey figures.

⁽³⁾ Data for the first nine months of 2010.

⁽⁴⁾ Represents the aggregate deficit of the Philippine government, the Central Bank-Board of Liquidation (the “CB-BOL”), the Oil Price Stabilization Fund and the 14 GOCCs, the debt of which comprises virtually all the debt incurred by GOCCs (the “14 Monitored GOCCs”).

⁽⁵⁾ Comprises the aggregate deficit or surplus of the Philippine government, the CB-BOL’s accounts, the 14 Monitored GOCCs, the Social Security System, the Government Service Insurance System, BSP, the GFIs and the local government units.

⁽⁶⁾ Preliminary data for the first nine months of 2010.

⁽⁷⁾ Overall balance of payments has been revised to reflect: late reports, post-audit adjustments and final data from companies.

⁽⁸⁾ Comprises the holdings by BSP of gold reserves, foreign investments, foreign exchange and SDRs, including BSP’s reserve position in the IMF at period-end.

⁽⁹⁾ Amounts in original currencies were translated to U.S. dollars or Pesos, as applicable, using the BSP reference exchange rates at the end of each applicable period.

⁽¹⁰⁾ Represents debt of the Philippine government only, and does not include other public sector debt. Includes direct debt obligations of the Philippine government, the proceeds of which are on-lent to GOCCs and other public sector entities, but excludes debt guaranteed by the Philippine government and debt originally guaranteed by other public sector entities for which the guarantee has been assumed by the Philippine government.

⁽¹¹⁾ As of November 30, 2010.

⁽¹²⁾ Represents debt of the Philippine government, the 14 Monitored GOCCs, the CB-BOL, BSP and the GFIs.

⁽¹³⁾ Includes public sector debt, whether or not guaranteed by the Philippine government.

BUSINESS

OVERVIEW

SMC is one of the largest companies in the Philippines in terms of market capitalization and is a highly diversified conglomerate, with revenues accounting for approximately 3% of the Philippine gross domestic product in 2010. Originally founded in 1890 as a single brewery in the Philippines, SMC has transformed itself from a market-leading beverages, food and packaging business with a globally recognized beer brand, into a large and diversified conglomerate with additional market-leading businesses and investments in the Philippines' fuel and oil, power, infrastructure, telecommunications, mining and banking industries. As of the date of this Offering Circular, SMC had a portfolio of companies that is interwoven into the economic fabric of the Philippines, benefiting from, as well as contributing to, the development and economic progress of the Philippines.

SMC's Common Shares were listed on the PSE on November 5, 1948, and as of December 31, 2010, SMC had a market capitalization of ₱468.97 billion. SMC's sales, gross profit and Adjusted EBITDA were ₱246,109 million ₱72,203 million and ₱52,536 million, respectively, in 2010. SMC's pro forma sales, gross profit and Adjusted EBITDA, including the results of Petron from January 1, 2010 to December 14, 2010 and the results of SMCGP from January 1, 2010 to July 31, 2010, were ₱474,609 million, ₱97,515 million and ₱71,646 million, respectively, in 2010.

SMC's Corporate Transformation

Established in 1890 as a single brewery in the Philippines, SMC has become a Philippine market leader in its established businesses in the beverages, food and packaging industries with over 16,800 employees and more than 100 production facilities in the Asia-Pacific region as of December 31, 2010. SMC's extensive portfolio of products has grown to include fuel and oil, power, beer, liquor, non-alcoholic beverages, poultry, animal feeds, flour, meat, dairy products, coffee and various packaging products.

In 2007, in light of the opportunities presented by the global financial crisis, the Philippine government's ongoing program of asset and industry privatizations and SMC's strong cash position enhanced by recent divestments and the strong cash flow generated by its established businesses, SMC adopted an aggressive business diversification program. The program channeled the Company's resources into what SMC believes are attractive growth sectors, aligned with the development and growth of the Philippine economy. SMC believes this strategy will achieve a more diverse mix of revenue and operating income, better position the company to access capital, present different growth opportunities and mitigate the impact of downturns and business cycles.

Since January 1, 2008, SMC has made a series of acquisitions in the fuel and oil, power, infrastructure, telecommunications, mining and banking industries, as outlined below:

- *Fuel and Oil:* SMC acquired a 22.0% equity interest in Petron on June 15, 2010, which was increased to 38.2% on October 18, 2010 and further increased to 68.3% on December 15, 2010.
- *Power:* SMC acquired a 27% equity interest in power distributor Meralco on October 26, 2008, which increased to a 33.2% equity interest on August 9, 2010. In addition, SMC purchased a power plant in Limay and has administration rights for three power plants in Sual, Ilijan and San Roque pursuant to IPPA Agreements under which SMC assumed administration on November 6, 2009, June 26, 2010, and January 26, 2010, respectively, and which rights will expire on October 2024, June 2022 and April 2028, respectively. In September 2010, SMC acquired the remaining 25% equity interest in SMCGP, following which it consolidated ownership in SMEC, SPPC, SPDC and Panasia in SMCGP.
- *Infrastructure:* SMC acquired a 35.0% equity interest in PIDC, which is developing the 88.58-kilometer Tarlac-Pangasinan-La Union expressway, on September 11, 2009. SMC also acquired a 93.0% equity interest in TADHC on April 8, 2010, and entered into an agreement to acquire a 51.0% equity interest in Universal LRT, the concession holder for the MRT-7 rail and road project, on October 28, 2010.

- *Telecommunications:* SMC acquired a 32.7% equity interest in the then issued and outstanding capital stock of Liberty on July 8, 2009, which was increased to 41.5% on October 5, 2010. On August 1, 2010, SMC acquired a 100.0% equity interest in BellTel. SMC also acquired a 40.0% equity interest in ETPI in December 2010 by acquiring 100.0% equity interest in AGN, through Vega.
- *Mining:* SMC acquired a 100.0% equity interest in Daguma Agro-Minerals Inc. (Daguma), Bonanza Energy Resources, Inc. (“Bonanza”) and SEPC, the concession holders of certain coal deposits in the Philippines; on January 29, 2010, January 29, 2010 and May 13, 2010, respectively.
- *Banking:* On January 13, 2011, SMC agreed to acquire a 7.2% equity interest in BOC. Upon completion of the acquisition, SMC will hold a 39.9% equity interest in BOC.
- *Ports:* In addition to the above acquisitions, SMC entered into an agreement on January 3, 2011 to acquire a 35.0% equity interest in Manila North Harbor Port Inc. from Harbour Centre Port Terminal Inc.

From January 1, 2008 to December 31, 2010, SMC expended an aggregate of approximately ₱81,773 million implementing its acquisition strategy. In addition, on January 12, 2011, SMC paid ₱14,082 million as part of the payments due for its investment in Meralco.

SMC’s Businesses

Today, SMC is one of the largest companies in the Philippines and is a highly diversified conglomerate. SMC’s new portfolio encompasses the following businesses, which are market leaders in their respective industries:

Beverages — SMC’s beverages business consists of brewing, distilling, selling, marketing and distributing beer, liquor and non-alcoholic beverages. San Miguel sells well recognized beer brands in the Philippines, with a total market share of approximately 94%. Its products include *San Miguel Pale Pilsen*, which is SMB’s flagship beer and is sold throughout the world, *San Miguel Super Dry*, *San Mig Light*, *San Mig Strong Ice* and *San Miguel Premium All-Malt*. Other SMC beers include *Cerveza Negra*, *Red Horse*, *Gold Eagle* and *Oktoberfest Brew*. In addition to its Philippine beer operations, SMB has brewery and sales operations in China, Hong Kong, Thailand, Vietnam and Indonesia and exports to 40 countries. According to Drinks International (UK). SMC is the world’s largest gin seller and the world’s third largest distilled spirit seller by volume with some of the most recognizable brands in the Philippine liquor market, including *Ginebra San Miguel*, *GSM Blue*, *Vino Kulafu* and *Gran Matador Brandy*. SMC also has a growing non-alcoholic beverages business which produces non-carbonated, ready-to-drink tea and fruit juice products, primarily under the *Magnolia* brand. SMC conducts its beverages business through majority owned subsidiaries: SMB for beer and Ginebra for liquor and non-alcoholic beverages.

Food — SMC’s food business holds numerous market leading positions in the Philippine food industry, offering a broad range of high-quality food products and services to both household and food service customers. The business is organized into business clusters: Agro-Industrial (poultry, feeds and fresh meats); Value-Added Meats (processed meats); Milling (flour and flour-based products); DSO (dairy products, spreads, oils and ice cream); and food service, retail and miscellaneous businesses. SMC has some of the best known brands in the Philippine food industry, such as *Magnolia*, *Star*, *Dari Crème*, *Purefoods*, *B-Meg Feeds* and *Monterey*. The food business is conducted through SMC’s subsidiary SMPFC.

Packaging — SMC’s packaging business has one of the largest packaging operations in the Philippines, producing glass, metal, plastic, aluminum cans, paper, flexibles, PET and other packaging products. SMC’s packaging business is the major source for packaging products for SMC’s other businesses. Over the last five years, external sales have grown to more than 80% of the total sales of the packaging business in 2010. SMC’s packaging business supplies its products to major multinational corporations in the Philippines and customers across the Asia-Pacific region, the United States, Africa, Australia and the Middle East. The packaging business is conducted through the Packaging Group.

Fuel and Oil — SMC operates its fuel and oil business through Petron in which SMC holds a 68.3% equity interest. Petron is the largest integrated oil refining and marketing company in the Philippines, supplying more than a third of the country's refined oil requirements and is the largest LPG distributor, with a 33.3% market share in the six months ended June 30, 2010, according to the DOE. Petron's core business involves the refining of crude oil and the marketing and distribution of refined petroleum products, mainly for the Philippine market. Petron possesses the most extensive oil distribution infrastructure in the country with more than 30 depots and terminals and over 1,700 service stations in the Philippines. Petron also exports various petroleum products and petrochemical feedstock, including high sulfur fuel oil, naphtha, mixed xylene, benzene, toluene and propylene, to customers in the Asia-Pacific region.

Power — SMC's power business is a leader in the Philippine power generation industry in terms of installed capacity. SMC administers three power plants, located in Sual (coal), Ilijan (natural gas) and San Roque (hydroelectric), with a combined capacity of 2,545 MWs, pursuant to IPPA Agreements with PSALM and NPC. SMC also owns and operates a fourth power plant, located in Limay (diesel oil) with a capacity of 620 MW. As of December 31, 2010, SMC was one of the largest electricity suppliers in the Philippines and held a 29.2% market share of the total installed power generation capacity for the Luzon power grid and a 21.7% market share of the national grid. SMC also owns a 33.2% equity interest in Meralco, the biggest power distributor and private sector utility in the Philippines, which accounted for almost half of all electricity sales in the Philippines in 2010. SMC's power business is conducted through its wholly-owned subsidiary SMCGP.

Infrastructure — SMC's infrastructure business consists of investments in companies which hold long-term concessions in the Philippines' infrastructure industry. Current projects include TPLEX, Caticlan Airport and Manila's MRT-7 rail and road project. SMC operates with partners in its investments in most of these infrastructure concessions.

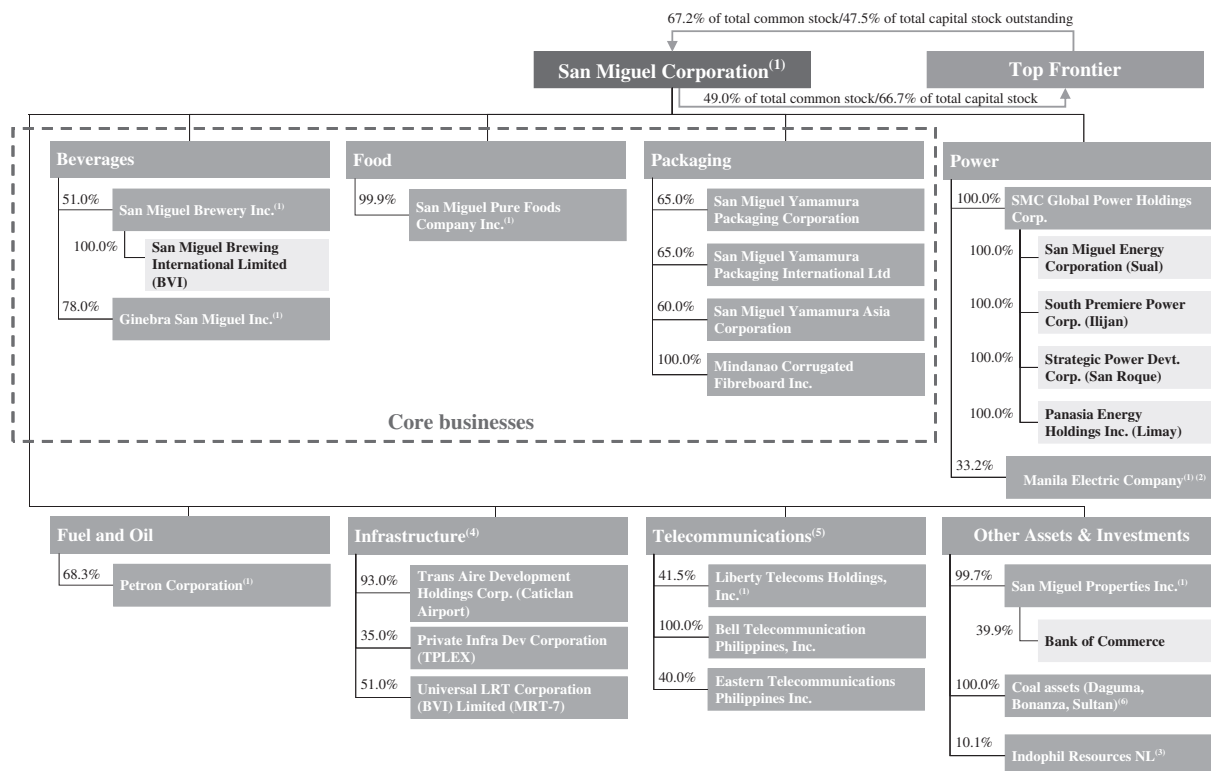
Other Operations and Investments — SMC's other operations and investments business consist principally of interests and investments in coal mining, telecommunications, banking and property development.

The table below sets forth the contribution of each of SMC's businesses to its revenues for the periods indicated and the pro forma contribution of each of SMC's businesses, assuming in each case the business had been held for all of 2010. See "Consolidated Pro Forma Financial Information" for more detailed information on the pro forma effect of SMC's acquisitions.

	2008		2009		2010		2010 Pro Forma	
	Revenues (In millions)	%	Revenues (In millions)	%	Revenues (In millions)	%	Revenues (In millions)	%
Beverages	₱ 78,599	46.8%	₱ 82,735	47.5%	₱ 90,407	36.7%	₱ 90,407	19.0
Food	73,830	43.9	77,220	44.3	80,415	32.7	80,415	16.9
Power	—	—	—	—	45,636	18.5	65,937	13.9
Packaging	15,612	9.3	14,258	8.2	19,268	7.8	19,268	4.1
Fuel and Oil	—	—	—	—	10,383	4.2	218,582	46.1
Infrastructure	—	—	—	—	—	—	—	—
Other Operations and Investments	—	—	—	—	—	—	—	—
Total	<u>₱168,041</u>	<u>100%</u>	<u>₱174,213</u>	<u>100%</u>	<u>₱246,109</u>	<u>100%</u>	<u>₱474,609</u>	<u>100.0%</u>

Corporate Organization

Set forth below is SMC's corporate organizational chart as of the date of this Offering Circular.



⁽¹⁾ Listed on the PSE.

⁽²⁾ 27.0% owned directly by SMC, with the balance of 6.2% indirectly owned through SMCGP.

⁽³⁾ Owned through Coastal View Exploration Corporation. Listed on the Australian Stock Exchange.

⁽⁴⁾ Owned through San Miguel Holdings Corp.

⁽⁵⁾ Owned through Vega.

⁽⁶⁾ Subsidiaries of SMC.

Strengths

In addition to having market leading positions in key industries in the Philippines as discussed above, SMC believes that its principal strengths include the following:

- *Broad exposure to the growing Philippine economy*

The Philippines is the fifth largest economy in Southeast Asia (in terms of GDP as of 2009) with an average real GDP growth of 4.9% over the last five years. According to the World Bank, real GDP growth is expected to continue over the next two years at 4.5%. In addition, the Philippine population is young, comparably literate and growing, which provides the Philippine economy with favorable demographics for further growth.

As one of the largest companies in the Philippines in terms of market capitalization and a highly diversified conglomerate, with revenues accounting for approximately 3% of the Philippine GDP in 2010, SMC is broadly exposed to the Philippine economy through its diverse range of businesses spanning the beverages, food, packaging, fuel and oil, power, infrastructure, telecommunications, property, mining, banking and other industries. SMC's recent acquisitions in the fuel and oil, power,

infrastructure and telecommunications industries align it to key sectors that it believes will benefit from the forecast growth of the Philippine economy.

- *Market leading positions in key Philippine industries*

Many of SMC's businesses are leaders in their domestic Philippine markets.

- *Beverages:* SMC's domestic beer business is one of the largest in the Philippine beer market with a 94% market share by volume in 2010. In the Philippine liquor market, Ginebra is the market leader, with a 51.7% domestic market share by volume. SMC's domestic beverages business also has the leading beverages distribution network in the Philippines.
- *Food:* SMC's food business is one of the largest domestic food producers company in the segments in which it operates, with several market leading positions. According to Nielsen, SMC controls the leading brands in the poultry, feeds, value-added meats, flour and bread spreads segments, including *Magnolia, Star, Dari Creme, Purefoods, B-Meg Feeds* and *Monterey*.
- *Packaging:* SMC's packaging business is the market leader in the domestic packaging industry, with an increasing contribution from sales to third parties that has doubled over the last five years to over 80% of the business. SMC's packaging business has a strong customer base that includes well-known brands such as *Coca Cola, Nestlé, Pepsi Cola, Unilever* and *Kraft*. SMC's packaging business is also the main supplier to the substantial packaging requirements of SMC's beverages and food businesses. Based on internal SMC estimates, the packaging business provided 64.0% of the demand for quality glass containers in the Philippines as of December 31, 2010. The glass and metal segments account for 49% of total sales of the packaging business.
- *Fuel and oil:* Petron is the largest oil refining and marketing company in the Philippines, supplying almost 40% of the Philippines' refined oil requirements. It is the largest LPG distributor with a 33.3% market share for the six months ended June 30, 2010 according to the DOE. Petron operates the most extensive petroleum product distribution network in the Philippines, with more than 30 depots and terminals and over 1,700 service stations.
- *Power:* As of mid-2010, SMC was one of the largest electricity suppliers in the Philippines, with a 29.2% market share of the total installed capacity of the Luzon power grid and a 21.7% market share of the national power grid. SMC has a balanced portfolio of power generation assets that utilizes diversified fuel sources, providing SMC with the flexibility to adapt to changes in the global fuel market. SMC also holds a 33.2% equity interest in Meralco, the Philippines' biggest power distributor and private sector utility, accounting for almost half of all net electricity sales in the Philippines. SMC's energy trading team comprises ex-PSALM traders who were pioneers in wholesale electricity spot market trading.

- *Operating businesses provide sustainable stream of income and cash flows*

SMC's beverages, food and packaging businesses provide SMC with a sustainable stream of income and cash flows. These businesses demonstrated resilience during the global financial crisis and provided SMC with a strong financial base from which to pursue its recent diversification strategy.

In 2008, these established businesses generated ₱19.9 billion of Adjusted EBITDA and ₱7.2 billion of net income with ₱6.4 billion of capital expenditure. In 2009, they generated ₱30.0 billion of Adjusted EBITDA and ₱8.5 billion of net income with ₱6.2 billion of capital expenditure. In 2010, they generated ₱34.6 billion of Adjusted EBITDA and ₱9.3 billion of net income with ₱4.3 billion of capital expenditure. Many of SMC's operating businesses have demonstrated their ability to fund their operations with internally generated operating cash flows.

Some of SMC's newly acquired businesses, such as Petron and the power business, are cash flow positive and are accretive to sales and Adjusted EBITDA of SMC. Assuming Petron and the power business were consolidated from January 1, 2010, SMC had pro forma sales and Adjusted EBITDA of ₱474.6 billion and ₱71.6 billion, respectively, in 2010.

- *Platform for significant future growth*

SMC is well-positioned for significant future growth. In particular, SMC's established businesses in beverages, food and packaging provide for stable growth annually, while its new businesses are expected to contribute further to this growth.

- *Beverages:* SMC's beverages business is well-positioned to benefit from increasing affluence and population growth in the Philippines. SMC believes there are significant opportunities in the premium beer market as the Philippine population becomes more affluent. Additionally, SMC's international beer business is experiencing increased sales through increasing brand recognition in selected overseas markets such as Indonesia, Thailand, Singapore and Hong Kong. SMC intends to expand its liquor business in the southern Philippines and internationally. SMC plans to create rapid deployment task forces, particularly in southern Philippines, where market penetration is low and where there is no existing dealership system. SMC also plans to increase margins by improving the profitability of its non-alcoholic business by rationalizing its sales and distribution network to reduce costs, searching for alternative raw materials and optimizing bottle cost and usage
- *Food:* SMC aims to become the lowest cost producer by securing a stable raw material supply and developing alternative raw materials. SMC also plans to streamline its operations to improve profitability of its established business segments such as poultry, feeds, meat and flour; maximize synergies across operations, and improve margins through outsourcing non-core activities.
- *Packaging:* SMC's packaging business aims to benefit from trade liberalization and globalization in the Asian region, increasing its exports to new markets. In addition, rising environmental awareness provides opportunities for the production of more environmentally friendly products such as heavy metal-free paint glass and recycled PET resin. SMC plans to improve margins by developing alternative sources of raw materials and optimizing recycling efforts to lower its material costs.
- *Fuel and oil:* The Philippines is a net importer of refined petroleum products and is expected to remain dependent on imports. SMC believes that the less urbanized areas in the Philippines are underserved and that there are significant growth opportunities in a growing domestic economy. Petron's focus on the Philippine market and its leading position as the largest refinery operator by sales volume with the largest number of service stations, present good growth opportunities. SMC plans to continue its service station network expansion and seek growth in complementary non-fuel businesses. SMC also plans to increase the production of higher margin products. Petron is currently embarking on RMP-2 which includes further enhancements to the refinery's operational efficiencies, increase in conversion capability and minimize production of lower value fuel oils.
- *Power:* SMC is planning to double its power generating capacity over the next five years, and believes its power business will benefit from both growing demand for electricity in the Philippines, which is forecast to exceed the growth rates of the Philippine GDP, and a shortage in electricity supply, with the industry constrained by aging power generation assets and minimal new capacity. Also, if spot electricity rates move higher as a result of increased demand, SMC's margins are expected to increase.
- *Infrastructure:* SMC believes there are significant opportunities in building or purchasing infrastructure assets in a growing economy that has historically under-invested in infrastructure. In addition, SMC believes its operating licenses will provide strong and stable long-term income streams, as well as serve as a barrier to entry to new entrants to the business.
- *Telecommunications:* SMC believes its recent acquisitions in the telecommunications industry provide it with exposure to an industry that is expecting high growth as the Philippine population becomes more affluent and spends more on higher margin services. In particular, SMC is currently refining its telecommunications business strategy, where it plans to take advantage of opportunities in digitization of businesses, the emergence of mobile platforms for businesses and the provision of

services to consumers. Moreover, companies recently acquired by SMC have a wide bandwidth of spectrum that would enable SMC to be competitive in both current (2G/3G) and future technologies.

- *Potential to extract synergies across businesses*

SMC believes there are significant opportunities to develop and increase synergies across many of its businesses, including:

- *Ancillary business opportunities:* SMC believes it has opportunities within its existing businesses to secure new growth opportunities along the routes of its infrastructure projects by using the relevant land area to conduct business and activities. Potential initiatives of this type include installing SMC-related billboards and advertisements, as well as building service stations, retail outlets, rest stops and kiosks along toll roads.
- *Effective distribution channel:* SMC's extensive retail distribution network provides an effective platform for roll-out of new products and services. For example, Petron's network of over 1,700 service stations provides an effective distribution channel for retail sales for SMC products.
- *Economies of scale:* SMC believes the size and scale of its distribution network operations will provide significant economies of scale and synergies in production, research and development, distribution, management and marketing. SMC's size and scale should also result in substantial leverage and bargaining power with suppliers and retailers.
- *Integration:* SMC plans to continue pursuing vertical integration across its established and strategic businesses, such as supplying the fuel and oil and power requirements of its businesses internally.
- *Strong and experienced management team with an in-depth understanding of the Philippines*

SMC has an extensive pool of experienced managers, and many senior managers have been with SMC for more than 20 years. The management team has a deep understanding and extensive knowledge of the Philippine operating environment and has managed SMC through periods of crisis and instability in the Philippines. The management team has recently successfully directed SMC's diversification strategy, including retaining key management personnel from acquired companies, such as Petron, in order to retain their expertise and leverage their industry experience.

Business Strategies

SMC's principal strategies include the following:

- *Enhance value of established businesses.* SMC aims to enhance the value of its established businesses through pursuing operational excellence, brand enhancement, improving product visibility, targeting regions where SMC has lower market share, implementing pricing strategies and pursuing efficiencies.
- *Continue to diversify into industries that underpin the development and growth of the Philippine economy.* In addition to organic growth, SMC intends to continue to seek strategic acquisition and greenfield opportunities to position itself for the economic growth and industrial development of the Philippines.
- *Identify and pursue synergies across businesses through vertical integration, platform matching and channel management.* SMC intends to create an even broader distribution network for its products and expand its customer base by identifying synergies across its various businesses. In addition, SMC is pursuing plans to integrate its production and distribution facilities for its established and newly acquired businesses to enable additional cost savings and efficiencies.
- *Invest in and develop businesses with market leading positions.* SMC intends to further enhance its market position in the Philippines by leveraging its financial resources and experience to continue introducing new products and services. Potential investments to develop existing businesses include building additional service and micro-filling stations, constructing new power plants and expanding its power generation portfolio and expanding food distribution networks. SMC believes its strong domestic

market position provides an effective platform to develop markets for its expanding product portfolio. SMC plans to continue to invest in and develop businesses it believes have the potential to gain leading positions in their respective markets.

- *Adopt world-leading practices and joint development of businesses.* SMC intends to develop strategic partnerships with global industry leaders, including Kirin in the beverages business and NYG in the packaging business. These partnerships provide marketing and expansion opportunities, and they also potentially provide liquidity and opportunities for SMC to divest minority stakes in its businesses as other opportunities arise.

BEVERAGES BUSINESS

SMC's beverages business had sales of ₱90,407 million in 2010. SMC's beverages business can be divided into beer, liquor and non-alcoholic operations. SMC's beer operations are conducted principally through its 51.0% owned subsidiary SMB, which includes the brewery operations in Hong Kong, China, Vietnam, Thailand and Indonesia. SMB shares are listed and trade on the PSE under the symbol "SMB". SMC's liquor and non-alcoholic operations are conducted through its 78.0% owned subsidiary Ginebra. The following table sets forth certain information with respect to SMC's beer and liquor sales in 2010:

	<u>Sales</u> <u>(In millions)</u>	<u>%</u>
Beer	₱ 67,563	74.7%
Liquor and Non-Alcoholic Beverages	<u>22,844</u>	<u>25.3</u>
Total	<u>₱ 90,407</u>	<u>100.0%</u>

Beer Business

In 2010, SMB's domestic beer operations accounted for approximately 83% of sales and 100% of the operating income of SMC's beer business. SMB markets its beer primarily under the *San Miguel brand*. *San Miguel-branded* beer products include *San Miguel Pale Pilsen*, which is SMB's flagship beer, as well as *San Miguel Super Dry*, *San Mig Light*, *San Mig Strong Ice*, *Red Horse*, *Gold Eagle*, *Cerveza Negra*, *Oktoberfest Brew* and *San Miguel Premium All-Malt*.

Philippine Beer Industry

The Philippines is the third largest beer market in Southeast Asia after Thailand and Vietnam and the sixth largest beer market in greater Asia by consumption. The Philippine beer market is estimated to have grown at a compound annual growth rate ("CAGR") of approximately 5.6% per year from 2008 to 2010, faster than the 1.4% for the global beer market. In 2010, 15.6 million hectoliters of beer is estimated to have been consumed in the Philippines. Euromonitor forecasts that the Philippine beer market is expected to grow by approximately 5% in 2011.

Beer consumption is closely tied to consumer income and tends to grow or contract with the economy. Consumer income has been improving in recent years supported by favourable Philippine economic performance. The Company believes there is a positive correlation between per capita real GDP and beer consumption in the Philippines, as set forth in the following table.

<u>Philippine Region</u>	<u>Real GDP Per Capita 2009 (In thousands)</u>	<u>Beer Consumption Per Capita 2009 (in L)</u>
Mindanao	₱11.9	11.0
Visayas	12.9	13.3
South Luzon Area	12.3	9.5
Central Luzon Area	10.8	12.4
Greater Manila Area	40.8	41.8
National Average	15.5	15.2

The beer market in the Philippines is highly concentrated. According to Canadean, SMC had a 94% share of the market in 2009. The other key local brewery is Asia Brewery Inc., which sells beer brands such as *Beer na Beer* and *Colt 45*. Imported beer comprises a small proportion of the market and its distribution is normally limited to upscale hotels, bars, restaurants and supermarkets in Metro Manila.

The Philippines is composed of over 7,000 islands which makes distribution highly complex and expensive and represents a significant barrier to market entry for new brewers looking to distribute nationally. Canadean forecasts that the Philippine beer market is expected to grow by about 9% in 2010 and 4% in 2011.

Competitive Strengths

SMB believes that its principal strengths include the following:

- *Highly recognizable beer brand domestically as well as in Southeast Asia.* SMB had a total Philippine market share of approximately 94% in 2009, producing all the top four beer brands in the country, namely *San Miguel Pale Pilsen*, *Red Horse*, *San Mig Light* and *Gold Eagle* according to Canadean.
- *Highly efficient distribution system.* SMB has the largest and most efficient distribution system for beer in the Philippines with almost half a million on-premise and off-premise outlets nationwide.
- *Strong cost leadership.* SMB also maintains a strong cost leadership position through high productivity and efficiency, as well as cost control measures, which facilitate pricing flexibility and greater profit growth by maintaining margins.

Business Strategies

SMB's principal strategies include the following:

- *Increase market share.* While SMB already has a very strong position in the Philippine beer market, it intends to increase its market share by pursuing targeted marketing efforts in regions and localities in which it believes its market share is lower than it is for the Philippines as a whole, such as in specific areas in North and South Luzon, as well as in Visayas and Mindanao. SMB intends to accomplish this by selecting specific products in appropriate packaging to compete effectively with rival products and brands. SMB also intends to increase its product visibility in these markets through tactical consumer promotions and improve outlet penetration through persuasive selling and trade incentives. Similarly, SMB intends to increase its share of the overall market for alcoholic beverages. This effort will focus on those specific regions and localities in which liquor sales are higher and, similar to the efforts to increase market share in the beer segment, will include package specific marketing campaigns, persuasive selling and incentives for dealers and retailers. As the population grows more affluent, SMB plans to develop and sell more products for the premium market segment.
- *Increase the overall market for beer.* SMB also plans to increase its sales volume by increasing the total market for beer sales, through market segmentation pricing strategy by keeping products affordable for middle and lower socio-economic sectors in the popular economy market segment, where sales are highly price sensitive, increasing the size of the higher-priced market segments of the beer industry by offering higher-priced and higher-margin products catering to these segments and introducing new products and new package formats to increase consumer interest and overall market

size, as well as address the needs of an increasingly fragmenting market, especially in high growth segments. In addition, SMB intends to intensify its coverage of regions where its presence could be further enhanced.

- *Sustain cost-reduction and efficiency improvement programs.* SMB intends to continue cost-reduction and efficiency improvement programs to further enhance profitability. In the past years, SMB has improved overall profitability through various operational programs.

Domestic Beer Sales

In the Philippines, SMB markets its beer primarily under the *San Miguel* brand. *San Miguel* branded beer products include *San Miguel Pale Pilsen*, which is SMB's flagship beer, as well as *San Miguel Super Dry*, *San Mig Light*, *San Mig Strong Ice* and *San Miguel Premium All-Malt*. Other beers are marketed under the brand names *Cerveza Negra*, *Red Horse*, *Gold Eagle* and *Oktoberfest Brew*, a seasonal beer. SMB also sells *Cali*, the only domestically produced malt-based non-alcoholic drink, available in three variants: *Cali*, *Cali Ice* and *Cali Light*. The quality of SMB's beers has been recognized by a number of organizations. In 2010, the Monde Selection, an independent institute that rates the quality of alcoholic beverages, awarded two Gold awards and three Silver awards to SMB's beers.

SMB's beers compete in the premium/upper premium, upper popular and popular economy market segments in the Philippines. The following table sets forth SMB's major beer brands in the Philippines and the market segments in which they compete.

<u>Market Segment</u>	<u>Brands</u>
Premium/Upper Premium	<i>San Miguel Premium All-Malt</i> <i>Super Dry</i> <i>Oktoberfest Brew</i> <i>Cerveza Negra</i> <i>San Mig Strong Ice</i>
Upper Popular	<i>San Mig Light</i> <i>San Miguel Pale Pilsen</i> <i>Red Horse</i>
Popular Economy	<i>Gold Eagle</i>
Non-Alcoholic	<i>Cali, Cali Ice, Cali Light</i>

The share of SMB's upscale brand sales (which includes the premium/upper premium and upper popular market segments) to total SMB sales has been steadily increasing from 10% in 2005 to 11% in 2010. In contrast, the share of SMB economy brand sales (which includes the popular economy and non-alcoholic market segments) as a percentage of total sales has been decreasing. These trends primarily reflect shifts in consumer preferences given improvements in income, increased urbanization and changes in lifestyle.

International Beer Sales

SMB also has brewery operations in Hong Kong, China, Vietnam, Thailand, and Indonesia through its subsidiary, San Miguel Brewing International Ltd. ("SMBIL"). These breweries have a combined annual capacity of 7.2 million hectoliters and sell their products locally as well as to over 40 countries, including key markets in Taiwan, Japan and the United States. The export operations of all of these breweries, account for approximately 18% of total beer sales volume of SMBIL.

Grupo Mahou San Miguel of Madrid, Spain has the rights to the *San Miguel* brand for beer in Europe, and is not affiliated with either SMB or SMC.

Production and Raw Materials

SMB currently owns and operates five breweries in the Philippines. These breweries are located in the Philippines' three main island groups of Luzon, Visayas and Mindanao, and are located close to the intended end-markets in order to reduce transportation costs.

The following table sets forth the production capacities and utilization rates of SMB breweries as of December 2010:

<u>Brewery</u>	<u>Capacity</u> (In millions of hl)	<u>Utilization Rate</u>
Polo	3.2	81.6%
San Fernando	5.9	80.9%
Mandaue	3.2	85.4%
Bacolod	1.0	83.9%
Davao	<u>2.1</u>	69.4%
Total	<u>15.4</u>	

The Polo Brewery is located north of Metro Manila and serves the Metro Manila and Southern Luzon markets. Established in 1947, it is SMC's oldest operating brewery. The Polo Brewery underwent a modernization program during the 1990s to upgrade its brew house facilities. The San Fernando Brewery is located in Pampanga province north of Metro Manila and serves Central and Northern Luzon. It was built in 1981 and was expanded and upgraded in the late 1980s and early 1990s. The Mandaue Brewery, located on the island of Cebu, serves part of the Visayas region and Mindanao. This brewery was built in 1968 and its facilities were expanded and modernized in the 1990s. The Bacolod Brewery was built in 1990 on the island of Negros and was modernized in 2005 and 2006. It serves Negros and the island of Panay. The Davao Brewery was built in 1995 and serves the Mindanao market. While production at each brewery is typically targeted to serve the geographical area around it, SMB's distribution system can shift production from one brewery to other regions if operational issues or demand changes require.

The main raw materials for brewing beer include malted barley, hops, water and yeast. Adjuncts, such as sugar and non-malted grains including rice, corn grits and food starch from cassava, can also be used in conjunction with malted barley, which is generally more expensive. All of these commodities have experienced, and are expected to continue to experience, price fluctuations.

SMB procures key raw materials for its beer operations through a procurement group that uses standardized procurement procedures. Malted barley and hops are generally sourced from the United States, Canada, Australia and Europe, while new sources in China and South America are being developed. Adjuncts are generally sourced within the Philippines. SMB enters into supply contracts with key raw material suppliers with terms ranging from approximately one month to five years. Each of these contracts typically provide for a pre-determined fixed and formula price for the duration of the contract. In addition, depending on considerations such as price trends and the quality of raw materials, SMB also makes spot purchases on the open market. To ensure the quality of its products, SMB closely monitors the quality of its raw materials.

The following table sets forth SMB's raw material costs for the periods indicated:

	<u>For the Year Ended</u> <u>December 31,</u>		
	<u>2008</u>	<u>2009</u>	<u>2010</u>
	<u>In ₱ per kilogram</u>		
Malt price	30.55	32.36	25.80
Corn price	18.91	19.27	19.95

SMB mostly sells its products in returnable glass bottles of varying sizes and shapes, as well as in aluminum cans and kegs. In 2010, approximately 95% of the glass bottles used by SMB were returned bottles. The returnable glass bottle is by far the most important and popular package for beer in the Philippines, accounting for 99% of SMB's sales in 2010. These returnable glass bottles are used for up to 60 cycles typically over a span of approximately 10 years. Retail outlets selling SMB's products collect deposits on these bottles when customers buy the beer and return the deposit when the bottles are returned. New glass bottles are purchased from time to time to support accelerating sales and to replace broken and scuffed bottles. The existing system for returnable glass bottles shields SMB from rising packaging costs triggered by the

uptrend in fuel and aluminum prices. Cans are less popular mainly because they are more expensive, although the volume of cans has been increasing in recent years with greater availability. Kegs for draft beer, which come in 15, 30 and 50 liter sizes, are limited and represent a decreasing share of the market.

All water supply used by SMB in its production is provided by deep wells, except for water used at the Polo Brewery, which is supplied by Maynilad Water Services, Inc., a privatized third party water company serving parts of Metro Manila.

The following table sets forth the major raw materials and packaging supplies used in SMB's business, the source countries for these items and SMB's typical contract periods for procurement.

Major Raw Materials and Packaging Supplies

<u>Key Materials</u>	<u>Sources</u>	<u>Contract Period</u>
Malted barley	Australia	2 years
	Europe	5 years
	USA, Canada	1 year
Hops	USA	5 years
	Germany	5 years
Adjuncts		
Corn grits	Philippines	3 years
Sugar	Philippines	spot
Food starch (from cassava)	Thailand, Vietnam	spot
Rice	Philippines	1 year
Packaging Materials		
Bottles	Philippines	1 year
Crowns	Philippines	1 year
Aluminum cans	Philippines	1 year
Plastic cases	Philippines	1 year
Cartons	Philippines	1 year
Labels	Philippines, Malaysia	1 year

Due to the high cost of shipping within the Philippines relative to product cost, as well as the importance of maintaining freshness and other distribution considerations, SMB maintains a system of regional breweries rather than a central consolidated brewing facility. Each of SMB's breweries is equipped with automated facilities capable of packaging products in a variety of packages to meet market preferences, including bottles, cans and kegs. Most of those packaging materials are produced by SMC's packaging business.

Research and Development

SMB employs state-of-the-art brewing technology. SMB has approximately 31 experienced brewmasters and additional quality assurance practitioners providing technical leadership and direction to continuously improve and maintain high standards in product quality, process efficiency, cost effectiveness and manpower competence. Research and development activities are primarily undertaken in a pilot plant located in Polo Brewery.

SMB also has a central analytical laboratory, called "CenLab", located in the technical center building of the Polo Brewery. It is equipped with modern equipment necessary for strategic raw materials (hops, malted barley, adjuncts) analysis and validation, beer product evaluation and new raw material accreditation. Analytical methods and validation procedures are constantly reviewed and updated, and these are standardized across all *San Miguel* beer laboratories. CenLab runs proficiency tests for brewery laboratories and malted barley suppliers to ascertain continuous reliability and quality of analytical test results. CenLab is also tasked with ensuring compliance of all systems with international standards, specifically International Organization

for Standardization (“ISO”) 17025-2005. Research and development expenses accounted for approximately 0.1% of SMB’s net sales in 2008, 2009 and 2010.

Domestic Marketing, Sales and Distribution

SMB markets, sells and distributes its beer products principally in the Philippines. Many of SMB’s products have strong market positions in the Philippines. SMB has the most extensive distribution network in the Philippine beverage market. SMB’s beer products are distributed and sold at almost half a million outlets, including off-premise outlets such as supermarkets, grocery stores, sari-sari (“mom and pop”) stores, and convenience stores, as well as on-premise outlets such as bars, restaurants, hotels and beer gardens.

As of December 31, 2010, SMB had 50 sales offices and 500 dealers throughout the Philippines. Generally, it takes five days or less for a bottle of beer to travel from production in the brewery to a sales outlet anywhere in the country. Beer is transported from the breweries by a variety of methods, mainly through third-party haulers and, in certain circumstances, by a fleet of boats contracted by SMB.

Dealers generally provide their own warehouse facilities and trucks, considerably reducing SMB’s own investment requirements. To increase distribution efficiency, SMB has gradually reduced the number of its dealers. SMB has also increased the support that it provides to its dealers, including software support with respect to streamlining logistics, promotional support and financial management training. SMB enters into written distribution agreements with its dealers that specify the territory in which the dealer is permitted to sell SMB’s products, the brands that the dealer is permitted to sell, the performance standards applicable to the dealer, procedures to be followed by the dealer in connection with the distribution rights and circumstances upon which distribution rights may be terminated. SMB’s sales force designs and awards strategic sales territories to dealers based on research of the specific territory covered. Distribution rights, performance standards and sales procedures are developed by SMB and implemented in tandem with dealers to ensure high quality of services. As dealers are given exclusivity over defined geographic areas that SMB actively monitors and enforces, and based on performance, these franchises are heavily sought after by potential dealers.

Marketing Activities

SMB actively pursues marketing initiatives to promote new and existing products, as well as to maintain and enhance brand awareness of its existing products. These initiatives include media advertisements featuring well-known Philippine celebrities, sponsorship of special events, conducting various consumer and trade promotions and other merchandising activities. SMB also uses television, radio and print advertisements, outdoor billboards and posters that can be placed on the walls of retail outlets and restaurants, bars and other on-premise outlets. SMB operates a beer delivery business, “632-BEER,” which provides free beer delivery service for parts of Metro Manila. Advertising and promotion expenses of SMB’s beer operations were ₱3,169 million in 2010, the bulk of which were spent in the Philippines.

SMB holds major events and sponsors numerous music events. *San Miguel Beer Oktoberfest* has been the brand’s flagship event for over three decades. This seasonal festival of beer and activities takes place from September to December at numerous locations simultaneously across the Philippines. Popular bands and celebrities, including San Miguel beer endorsers, are on hand to entertain the crowds. SMB also holds *San Miguel Pale Pilsen’s* nationwide SMB Summerfest, which is an annual get-together of games, concerts and parties at the country’s popular beaches. In addition to *San Miguel Pale Pilsen*, *Red Horse* is also often a major sponsor of concerts, with the brand affiliated with Muziklaban, the country’s biggest annual rock challenge, a band competition. For *San Mig Light*, SMB conducts music party initiatives such as “Party All Night” events. SMB offers Beer Tasting bar tours to upscale outlets for *San Miguel Premium All-Malt*, *San Miguel Super Dry* and *Cerveza Negra*.

Competition

Asia Brewery Inc. is SMB’s largest competitor in the Philippine market. It operates two breweries and also holds the license for *Coors* beer and *Colt 45* in the Philippines. Asia Brewery Inc. competes, mainly on

the basis of price, through its own *Beer na Beer* and *Colt 45* brands. Asia Brewery Inc. also competes with SMB's market-leading high-alcohol beer product, *Red Horse*, with its *Colt 45* and *Manila Beer* brands.

Competition from imported beers is minimal.

SMB competes with producers of other alcoholic beverages, primarily low-priced gin and brandy. In the beer industry — and more generally the alcoholic beverages industry — competitive factors generally include price, product quality, brand awareness and loyalty, distribution coverage, and the ability to respond effectively to shifting consumer tastes and preferences. SMB believes that its market leadership, size and scale of operations, and extensive distribution network create high entry barriers and provide SMB with a competitive advantage.

Liquor Business

In 2010, SMC's liquor operations had sales of ₱22,688 million, accounting for 25.1% of SMC's beverages sales and 9.2% of SMC's total sales. SMC's liquor operations are conducted through its 78.0%-owned subsidiary, Ginebra. Ginebra was founded in 1902 as a family-owned distillery and listed on the PSE in 1995. Ginebra shares trade on the PSE under the symbol "GSMI".

Philippine Liquor Industry

The Philippine liquor market had a CAGR of 7.5% from 451.0 million liters in 2006 to 601.7 million liters in 2010, of which approximately 96.7% consisted of gin, brandy and rum. The following table sets from the growth of the Philippine liquor industry for the periods indicated:

	Total Philippine Liquor Volume (million liters)				
	2006	2007	2008	2009	2010⁽¹⁾
Brandy and Cognac	130.1	153.4	170.0	187.2	205.1
White Spirits	176.0	196.8	205.0	211.6	217.5
Rum	126.6	140.5	154.8	157.2	159.4
Other Spirits	<u>18.3</u>	<u>17.8</u>	<u>19.1</u>	<u>19.4</u>	<u>19.7</u>
Total	<u>451.0</u>	<u>508.5</u>	<u>548.9</u>	<u>575.4</u>	<u>601.7</u>

Source: Euromonitor

⁽¹⁾ Forecast by Euromonitor.

The majority of domestic sales of liquor are made to those segments of the population seeking economy products. While quality and drinkability of liquor are important, popular pricing strategies are essential, especially for new products. Local manufacturers enjoy a competitive advantage in terms of price as demand is highly price sensitive. The performance of the liquor industry is highly dependent on the economy, especially for imported brands.

Domestic brands, namely *Ginebra*, *Tanduay Distillers* and *Emperador Distillers*, continued to dominate the market, accounting for a 96.2% share of total sales volume in 2010. The products sold consist mainly of gin, brandy and rum.

The following table sets forth the major competitors and their approximate market shares in the Philippines liquor market for the periods indicated:

	Market Share of Liquor Company				
	2006	2007	2008	2009	2010
Ginebra.	44.2%	45.7%	51.2%	54.4%	51.7%
Tanduay Distillers Inc.	29.7	31.1	26.3	26.6	26.6
Emperador Distillers Inc.	22.4	19.7	19.2	16.0	17.9
Others.	3.7	3.5	3.3	2.8	3.8
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

According to Euromonitor, sales are expected to grow by a CAGR of 3% in terms of volume over the next five years, driven by population growth and rising foreign visitor arrivals.

Competitive Strengths

Ginebra believes that its principal strengths include the following:

- *Market leading brands.* Ginebra has market leading brands in *Ginebra San Miguel Gin*, *GSM Blue Gin* and *Gran Matador Brandy*.
- *Streamlined distribution network.* Ginebra has a streamlined distribution network with direct shipments to a diversified base of large dealers assigned to specific geographic areas.
- *Strong cost leadership.* Ginebra has established and has led the establishment of a diversified raw material base.

Business Strategies

Ginebra's principal strategies include the following:

- *Expand in southern Philippines and international markets while maintaining market leading position in northern Philippines.* Ginebra is creating rapid deployment task forces, particularly in southern Philippines, where market penetration is low and where there is no existing dealership system. Ginebra plans to expand into new geographic markets overseas through the establishment of off-shore production capabilities via tolling agreements.
- *Secure raw material sources.* Ginebra has embarked on initiatives to search for alternative raw materials to replace molasses which is under threat from increasing prices and decreasing availability as it is used as a raw material for the Philippine government's clean fuel program. Cassava has proven to be a reliable substitute for molasses, with other raw materials including sugarcane juice currently under research. Ginebra will also import more crude alcohol if it is cost efficient to do so.
- *Improve non-alcoholic business.* Ginebra plans to broaden the distribution of non-alcoholic beverages to the "at-work" and schools markets. Ginebra intends to rationalize its sales and distribution network in order to lower costs.

Ginebra Sales

Ginebra is a leader in the Philippine liquor market, and produces, markets and sells some of the most recognizable brands in the Philippine liquor market, including *Ginebra San Miguel*, *GSM Blue*, *Gran Matador Brandy* and *Vino Kulafu*. According to TNS Research, Ginebra is the world's largest gin seller by volume.

Ginebra offers a range of liquor in the premium, popular and economy market segments, including gin, brandy, Chinese wine, rum, vodka, whisky and flavored alcoholic beverages. Ginebra also produces and sells non-carbonated ready-to-drink tea and fruit juices primarily under the *Magnolia* brand.

The quality of Ginebra's products has been recognized by a number of organizations, including Trade Leaders Club and Editorial Office (Spain), Drinks International (United Kingdom), Monde Selection (Belgium), and Club Oenologique International (Paris).

Consumer preferences in the Philippine liquor market vary largely by geographical region. As a general matter, consumers in northern Philippines prefer gin and brandy, while consumers in southern Philippines prefer rum. As brandy is becoming more popular in both northern and southern Philippines, Ginebra launched *Gran Matador Brandy* in 2003. In 2010, *Gran Matador Brandy* accounted for 21% of Ginebra's sales.

Currently, Ginebra is focused on new product development and market diversification. For example, in 2005, Ginebra launched *Solera Gran Reserva*, *Ginebra San Miguel Premium Gin*, *Antonov Vodka*, *St. George Premium Whisky* and *Don Enrique Mixkila* to target the premium and upper popular segments. More recently, Ginebra launched *Antonov Apple*, *Infinit*, *Don Enrique Brandy*, *Vino San Miguel* and *Gran Matador Primo* to cater to the shifting consumer preference towards ready-to-drink flavored alcoholic beverages and beverages with lower alcohol content.

Exports and Overseas Operations

Ginebra's primary export markets are Thailand, Taiwan, Korea, Japan, China and the Middle East. Ginebra is currently evaluating the possibility of exporting to the United States, mainland China and India. Competition in the export markets is intense. Ginebra's competitors include a number of international liquor producers, some of which have greater production, marketing, financial and other resources than Ginebra.

In addition to exports of liquor, Ginebra sells and distributes liquor in Thailand through a joint venture.

Raw Materials and Production

Alcohol is the main raw material used in the production of liquor. Ginebra produces most of its alcohol at its distillery plant in Bago City, Negros Occidental. Alcohol is produced primarily from molasses, which is purchased from a variety of third-party suppliers pursuant to supply contracts as well as on the open market. Recently, as the price for molasses has increased, Ginebra has been considering alternative raw materials from which it can distill alcohol, such as cassava starch milk. In particular, Ginebra recently constructed a cassava starch milk plant in the Philippines to enable it to use this alternative raw material for the production of alcohol.

Ginebra owns one distillery, three liquor bottling plants and one cassava starch milk plant, and has engaged five toll bottlers strategically located throughout the Philippines and one bottling and distillery plant in Thailand. The following table sets forth the production capacity, production volume and utilization rate of each of Ginebra's currently operating distillery and production facilities in 2010:

<u>Facility</u>	<u>Capacity</u> (In millions of hl)	<u>Production</u> (In millions of hl)	<u>Utilization Rate</u>
Distillery			
DBI Distillery Plant	0.70	0.55	78.9%
Thailand Distillery	0.20	0.18	91.0%
Liquor Bottling Plants			
Cabuyao	1.03	0.92	89.2%
Santa Barbara	1.86	1.15	61.8%
Cebu.	0.76	0.27	36.0%

Ginebra's liquor products are primarily packaged in glass bottles. In 2010, SMC's packaging business produced the majority of Ginebra's new glass bottle requirements. In addition to using new glass bottles, Ginebra maintains a network of bottle suppliers in the Philippines that recycles second-hand bottles back to

Ginebra's plants. In 2010, approximately 62.0% of the bottles used by Ginebra were recycled bottles. Even with the additional cost of maintaining a quality control system for the safety of recycled bottles, the cost of reprocessing recycled bottles is approximately half of the cost of new bottles. Because the cost of recycled bottles is lower than that of new bottles, bottling costs for any particular product are generally expected to decrease over time as a result of the increased use of recycled bottles.

Distribution

Ginebra distributes its products by shipping directly to dealers. Ginebra has recently streamlined its distribution network by reorganizing its network of dealers by assigned geographic areas. The reorganization was designed to enhance the efficiency of the distribution network by having fewer, but larger, dealers. As of December 31, 2010, Ginebra had 84 dealers, and no individual dealer accounted for more than 7.0% of Ginebra's total sales in 2010.

Marketing and Competition

Ginebra markets its products through a variety of channels, including television, radio, billboard and print advertisements, as well as special event sponsorships, consumer promotions and trade promotions. Ginebra's advertising and promotion expenses were approximately ₱1,064 million in 2010, accounting for 6.1% of Ginebra's cost of sales in 2010.

As most of Ginebra's products are targeted at the popular and economy market segments, Ginebra's main competitors are Philippine companies. Ginebra's major competitors in this segment include Emperor Distillers Inc. and Tanduay Distillers Inc.

In the premium market segment, Ginebra's major competitors include *Gilbey's*, *Fundador*, *Johnny Walker* and *Absolut*. As Ginebra endeavors to create a niche in the premium market segment with the introduction of premium brand names, Ginebra will continue to rely on its competitive advantages including price, quality and extensive distribution infrastructure.

Regulation and Taxation of Beverages

Philippine national and local laws and regulations require a license to sell alcoholic beverages and prohibit the sale of alcoholic beverages to persons below 18 years of age or within a certain distance from schools and churches. Advertising and marketing of alcoholic beverages is largely unregulated in the Philippines. SMB and Ginebra, however, aim to promote responsible drinking habits through their advertising and marketing programs, and have both formulated and adopted an Advertising & Marketing Code of Ethics for Alcoholic Beverages.

In the Philippines, excise tax represents a significant component of liquor prices, and accounted for 19.0% of Ginebra's cost of sales in 2010. Excise tax is payable by the producer, and the tax rate varies depending on the type of alcoholic beverage being produced, with more expensive products being subject to higher rates. As of December 31, 2010, the excise tax rates applicable to SMB's products ranged from ₱9.64 per liter to ₱19.05 per liter and the excise tax rate applicable to Ginebra's products was ₱14.68 per proof liter. The sale of beer, liquor and non-alcoholic beverages in the Philippines is also subject to a VAT of 12% as of January 1, 2011.

FOOD BUSINESS

SMC operates its food business through SMPFC and its subsidiaries and is a leading player in the Philippine food industry, offering a broad range of high-quality food products and services to both household and food service customers. The performance of SMPFC is closely correlated to domestic economic growth, which is discussed above, as well as to trends and developments in each segment within the industry. SMPFC is listed on the PSE under the symbols "PF" and "PFP".

The table below shows the organization of SMC's food business into clusters and provides each such cluster's contribution to SMPFC's sales in 2008, 2009 and 2010:

	2008		2009		2010	
	Sales (In millions)	% of Sales	Sales (In millions)	% of Sales	Sales (In millions)	% of Sales
Agro-Industrial (poultry, feeds and fresh meats)	₱44,981	63.3%	₱49,069	65.4%	₱52,300	66.0%
Value-Added Meats (refrigerated processed meats)	11,566	16.3	11,234	15.0	11,534	14.6
Milling (flour)	8,199	11.5	7,482	10.0	7,155	9.0
Dairy, Spreads and Oils and Emerging Businesses	6,330	8.9	7,258	9.6	8,281	10.4
Total	<u>₱71,076</u>	<u>100.0%</u>	<u>₱75,043</u>	<u>100.0%</u>	<u>₱79,270</u>	<u>100.0%</u>

Brands include some of the best known and well-regarded brands in the Philippines, such as *Magnolia*, *Purefoods*, *Monterey*, *Star*, *Dari Crème* and *B-Meg*. SMPFC's wide range of food products includes the following:

Business	Major Products
Agro Industrial	
Poultry	Branded fresh-chilled and frozen whole and cut-up chickens, easy to prepare chicken products, customized products for food service customers, supermarket house-brands and live chickens
Feeds	Hog, poultry (layer/broiler), gamefowl, aquatic, duck and other customized feeds
Fresh Meats	Pork and beef carcasses and cuts, lamb cuts, marinated meats and live hogs
Value-Added Meats	Refrigerated processed meats, including hotdogs, cold cuts, hams, bacon, nuggets and other ready-to-eat meal products, as well as canned meats, including corned beef and luncheon meats
Milling	A full range of basic, specialty and customized flour products
Dairy, Spreads and Oils	Bread spreads, cheese, milk, ice cream, jelly-based snacks and cooking oils
Emerging Businesses	Coffee, food distribution service and retail franchise management

As of December 31, 2010, SMPFC owned 28 production facilities and had contracts with 2,068 tolled facilities.

Philippine Food and Agriculture Industry

Food expenditure accounts for about half of total personal consumption in the Philippines. According to NSCB, food expenditure has grown at an average CAGR of approximately 9.5% from ₱1,892.1 billion in 2006 to ₱2,973.9 billion in 2010. The recovery of the local economy from the recession in 2008 and 2009 resulted in increased consumer spending in 2010. Stronger remittances from overseas Filipino workers and better job security for local employees due to an increase in foreign investments also improved consumer confidence and increased personal consumption expenditure in 2010. The following table sets forth the growth of real GDP

per capita, the percentage of GDP accounted for by personal consumption expenditure and food consumption based on data from the NSCB for the periods indicated.

	Personal Consumption and Food Consumption				
	2006	2007	2008	2009	2010
GDP Per Capita (in Pesos at constant 1985 prices)	14,681	15,405	15,686	15,527	16,350
Personal Consumption Expenditure (% of GDP) . .	78.3%	77.4%	78.2%	80.3%	79.0%
Food Consumption Expenditure (% of Personal Consumption Expenditure)	53.7%	53.9%	53.9%	54.4%	54.3%

Competitive Strengths

SMPFC believes that its principal strengths include the following:

- *Many leading brands known for quality.* Over the years, SMPFC has actively developed a strong portfolio of well-known brands, which includes some of the most recognizable food brands in the Philippines. SMPFC believes it has been able to enhance its brand equity by maintaining consistently high product quality, as well as through active and targeted marketing and promotions. SMPFC has also pioneered brand-building efforts not only for traditional branded food products, such as value-added meats and dairy products, but also for feeds, flour, fresh meats and poultry, which are commonly viewed as commodities. SMPFC believes the strong brand names that it has developed provide SMPFC with greater pricing power relative to its competitors. SMPFC enjoys leading market shares in some of the largest and most profitable segments of the food industry, such as poultry, feeds, value-added meats and bread spreads, while maintaining strong second or third place market shares in almost all of its other products.
- *Broad and diverse food product portfolio.* SMPFC offers one of the widest arrays of food products in the Philippines, with products ranging from feeds and flour to meats, milk, coffee and hotdogs. SMPFC believes this diversity allows for a more resilient business model and provides significant growth potential both within and across various product categories. Currently, SMPFC is present in only 50% (by value) of the product categories in the packaged food industry, presenting significant opportunities for SMPFC to expand into other packaged food categories. Moreover, SMPFC's wide range of food products can be consumed at every meal and by all members of the family. As a result, SMPFC believes that it provides its customers with a one-stop food solution and thereby generates significant brand loyalty.
- *Extensive and multi-pronged distribution network across the Philippines.* The Philippine population is widely distributed over 7,000 islands, creating a challenge for food and beverage companies to distribute their products effectively. SMPFC's success in building one of the most extensive distribution networks across the Philippines allows its products to reach every major city. In turn, this creates a strong barrier to entry to the Philippine food market and a significant competitive advantage for SMPFC. In addition to an extensive presence in the traditional modern and general trade distribution platforms, SMPFC has direct distribution capabilities to major food service companies. SMPFC also engages in food service operations itself through its franchising operations, such as Smokey's hotdog carts, Outbox food kiosks and others.
- *Vertically integrated business model.* SMPFC believes its vertically controlled "farm-to-plate" business model provides SMPFC with significant operational flexibility and stable margins. This model allows SMPFC control over the value chain from plantations, feed production, animal growing, to meat processing, and enables SMPFC to deliver fresh, high quality food products to its customers. SMPFC is also able to leverage synergies across its businesses, as well as through its relationship with SMC. For example, SMPFC's feeds business is capable of effectively utilizing beer by-products, such as spent grain and brewer's yeast, and offal and feathers from poultry, as feed ingredients. Although much of the production and distribution of SMPFC's products is outsourced to third parties, SMPFC is actively engaged in setting and maintaining quality standards throughout the production and distribution chain.

SMPFC's business model provides better economies of scale through consolidated raw material sourcing, integrated production, sales and distribution networks and shared brands and support functions across SMPFC's and its contracted facilities.

- *Strong track record of innovation in products and distribution.* SMPFC has a strong track record of launching innovative products and services to address changing consumer needs and preferences. For example, SMPFC has launched several new products, reflective of health and wellness, convenience, flavor and packaging trends. These include: *Magnolia Gold Lite Butter*, *Magnolia No Sugar Added Ice Cream* and the *San Mig Coffee Pro-Health* line with respect to health and wellness; an Asian line of marinated meats, fruit flavored chocolate milk drinks and flavored refrigerated margarine with respect to flavor; *Ulam King* products and chicken nuggets with respect to convenience; and cooking oil in tubes and in-mould labeled packaging for bulk ice cream with respect to packaging trends. In addition, SMPFC continuously develops innovative food retailing formats, with the objective of establishing closer contact with its customers and increasing SMPFC's share in its customers' food budgets. For example, SMPFC introduced Monterey Meat Shops in 1993 as a way to differentiate SMPFC's fresh meats products from its competitors' unbranded products. SMPFC also introduced Magnolia Chicken Stations in 2004, which have been a significant success and have now grown to nearly 400 outlets in just over five years. As of December 31, 2010, there were approximately 690 Purefoods hotdog carts, 160 Smokey's deli hotdog bars, 114 Outbox carts and kiosks, four San Miguel Food Shops and one San Mig Café restaurant. SMPFC has also successfully developed the concept of "paid sampling", where customers can sample hotdog products at strategically located hotdog carts, by launching several retail models to serve as a closer point of contact with consumers and as a trial venue for new product ideas.

Business Strategies

SMPFC's principal strategies include the following:

- *Accelerate growth of SMPFC's branded consumer business to achieve market leadership:* SMPFC intends to continue building brand equity through advertising and promotional activities and launch new products that will complement its existing brands. As part of this strategy, SMPFC has launched a formal company-wide innovation program to drive the introduction of breakthrough products and services. SMPFC also intends to continue to strengthen and expand its distribution capabilities in both traditional trade channels and supermarkets. To reduce volatility in its commodities businesses, SMPFC will continue to grow its meat shops and chicken stations. SMPFC intends to aggressively grow its food service business by marketing customized products and services through food solution packages, including menu analysis and planning, food safety training and recipe and product development.
- *Achieve cost leadership:* SMPFC plans to expand its raw material supply base and identify alternative raw materials. SMPFC has a program to encourage farmers to plant cassava and other crops that can be used as feeds ingredients. SMPFC's research and development team is responsible for identifying cost improvements, while still maintaining product quality. This is achieved by exploring the use of alternative raw materials, from grains and by-products used in SMPFC's feeds products to alternative protein sources and flavors in processed meats. In its poultry and livestock operations, SMPFC has adopted climate-controlled housing to minimize temperature variability, thereby improving animal productivity.
- *Maximize synergies through shared services and organizational integration:* To achieve synergies, SMPFC has organized its businesses into clusters. SMPFC has integrated its poultry and livestock businesses to maximize synergies across functions, as well as to realize certain tax benefits. SMPFC will continue to simplify its organizational structure and standardize its business processes in preparation for future growth. SMPFC expects to establish by 2011 a finance shared service delivery center. This center is intended to serve all of SMPFC's businesses and perform transaction processing activities to improve efficiencies and reduce administrative expenses.

- *Continue and expand the outsourcing of labor intensive and process-oriented operations:* SMPFC intends to continue to reduce its direct labor costs by outsourcing its more labor intensive and process-oriented operations to take advantage of the more competitive wage levels available to outsourcers. SMPFC intends to outsource these lower value-added portions of its value chain, while maintaining control over its more specialized, higher value-added operations.

SMPFC has been, and intends to remain, actively involved in all key aspects of the outsourced portions of its value chain. SMPFC provides ongoing training and technical support to all of its third-party contractors. In addition, SMPFC representatives are assigned to oversee outsourced operations and work closely with third-party management to improve operational efficiencies, while maintaining SMPFC's high product safety and quality standards.

- *Explore New Growth Opportunities:* SMPFC intends to explore several new growth opportunities including those that would enable it to enter into new product categories in which it is not currently present, grow its capacities and competencies in its current markets. SMPFC plans to pursue strategic opportunities in countries such as Vietnam, Indonesia and other Asian countries, to access fast-growing emerging markets in Asia. SMPFC has begun to implement this strategy with its operations in Indonesia and Vietnam. In the medium-term, SMPFC is planning to take advantage of opportunities presented by the liberalization of trade policies in Asia by importing new products into the Philippines that will complement SMPFC's current product portfolio. In the long-term, SMPFC plans to establish regional production bases in lower cost producing countries. SMPFC plans to explore opportunities to coinvest alongside SMC.

Agro-Industrial Cluster

Poultry

Based on internal SMC estimates, the Philippine market for poultry was estimated to be ₱86.13 billion in 2010. It had traditionally been a highly fragmented, primarily backyard industry. However, several major players, including SMPFC, have been successful in introducing modern technologies and processes to the industry, allowing them to consolidate market share to achieve economies of scale.

SMPFC believes it was the largest poultry producer and marketer in the Philippines in 2010 by volume and revenues. In addition, SMPFC enjoys high brand recognition in the Philippines with approximately 42% of the market for broilers (chicken raised specifically for human consumption) in 2010 by volume. SMC's poultry business includes the breeding, producing and marketing of broilers, mostly for retail. SMPFC's broad range of products is sold under the Magnolia Fresh Chicken brand (including fresh-chilled, frozen and cut-up products). In addition, the Magnolia Chicken Stations offer easy-to-cook and ready-to-eat products. SMPFC also sells customized products to food service clients and supermarket house brands, and live chickens to dealers.

SMPFC utilizes both self-owned and third-party owned (tolled) facilities for its poultry production. Approximately 99% of poultry growing output and 95% of processing output come from tolled facilities, allowing SMPFC to outsource production at a lower cost and direct more resources toward improving core competencies. As of December 31, 2010, SMPFC also contracts with approximately 100 breeder farms for grandparent and parent stocks, approximately 20 hatcheries and approximately 40 SMPFC-owned and tolled processing plants. SMPFC's vertically controlled poultry operations also include an extensive network of cold storage warehouses and distribution facilities, both owned and tolled.

SMPFC's poultry business distributes its products to two market segments through a number of different channels in order to maximize market penetration throughout the Philippines:

- commodity segment (including wet markets and supermarkets), which accounts for 59% of the poultry business' total sales and in which prices are less stable; and
- stable-price segment (including chicken stations, major food services chains, exporters and SMPFC's value-added meats business), which accounts for 41% of the poultry businesses' total sales.

In 2004, SMPFC began its “bringing the wet market to the supermarket” strategy which introduced *Magnolia Chicken Stations* to supermarkets. These stations are set up inside supermarkets nationwide and offer more choices of formats, and better customer service and environment. The supermarkets purchase chicken meat from SMPFC, which then prepares and sells the chicken through these *Magnolia Chicken Stations*, which are operated by third-party contractors. As of December 31, 2010, there were 479 *Magnolia Chicken Stations* in operation, generating substantial volume growth for SMPFC’s poultry business. While wet markets are the most popular source of chicken for consumers in the Philippines, *Magnolia Chicken Station* outlets are expected to be a major focus in the coming years, as SMPFC looks to further build on its strong brand reputation and protect market share.

SMPFC’s poultry business faces local competition from numerous smaller, independent broiler producers and a small number of larger integrators. SMPFC believes that one of those larger competitors held less than one-half of SMPFC’s market share in 2010, while another held approximately 6.0% of the Philippine broiler market in 2010. SMPFC also sometimes faces competition from low-priced imports from the United States and Canada, as well as new competitors as a result of frequent supply shortages and high prices in recent years.

Feeds

The Philippine feeds industry comprises three segments: (a) the homemix segment which comprises small to medium-scale farms producing their own feeds; (b) the intra segment which includes large, integrated livestock and poultry farms producing their own feeds; and (c) the commercial segment which produces branded feeds for third parties. The Philippines had an estimated ₱160 billion feeds market in 2010, in which the commercial feeds segment accounted for ₱49 billion. Much like the poultry industry, the Philippine feeds industry has been transformed from a fragmented, backyard industry into a more concentrated and efficient industry with a small number of dominant feedmillers.

SMPFC is the largest producer of feeds in the Philippines, with an estimated market share of 39% of the commercial feeds market in 2010 by volume according to internal SMC estimates, producing feeds for (i) SMPFC’s poultry business, (ii) SMPFC’s fresh meats business and (iii) the commercial feeds market, which accounted for 42.0%, 10.0% and 48.0%, respectively of SMPFC’s feeds business volumes in 2010. SMPFC’s commercial products include hog feeds, layer feeds, broiler feeds, gamefowl feeds, aquatic feeds, branded concentrates and customized feeds sold under various brands including *B-Meg*, *Pureblend*, *Bonanza* and *Jumbo*.

SMPFC is refocusing its marketing efforts on small and medium-sized farms and specialty and customized feeds, and increasing its participation in the aquatic feeds industry. SMPFC is also focusing on raw material cost efficiencies. Raw materials used in SMPFC’s feeds business are mostly provided through SMPFC’s business procurement group, while some local ingredients are sourced directly from suppliers and traders accredited by SMPFC and on the open market. SMPFC developed cassava as a strategic alternative ingredient to corn in animal feeds. The proportion of cassava in animal feeds can be adjusted upward or downward depending on the relative price of corn and other feeds ingredients, which generated a net savings of approximately ₱386 million for SMPFC in 2010. Cassava is safe, relatively low-priced and widely available in the Philippines, with approximately 184,000 metric tons produced in 2010.

To protect against unexpected price increases, SMPFC participates in hedging for price fluctuations in certain imported raw materials such as soybean meal and maintains strategic buying programs for corn. SMPFC also uses by-products from SMB (including brewer’s spent grain and yeast) and SMPFC’s poultry dressing plants (including offal and feathers) as raw materials for feeds production. SMPFC contracts with four tolled rendering facilities and expects to add rendering plants in the future. Compound feeds are manufactured at six SMPFC-owned but third-party operated facilities and 35 third-party owned and operated feeds plants, strategically located throughout the Philippines. Most of these plants are capable of producing pelleted and crumble format feeds, and five plants have extrusion capabilities to produce aquatic floating feeds.

SMPFC owns several research and development facilities which analyze average daily weight gain, feed conversion efficiency and other performance parameters. Results of these analyses are immediately applied to SMPFC's commercial feed formulations to minimize costs and maximize animal growth. These research facilities include a bio assay-focused research facility, a metabolizable energy-focused research facility, a research facility for tilapia, three hog research farms, three broiler research farms, a fry production facility and various hatching facilities for tilapia breeding.

SMPFC's commercial feeds business sells its products through several distribution channels, with 86.0% of products sold through authorized distributors within a defined territory and 14.0% sold directly to hog, poultry and aquatic farm operators. The commercial feeds business has more than 19 sales offices across the Philippines, which are supported by an expert sales team focused on developing new markets.

SMPFC's commercial feeds business currently holds the largest market share in the Philippines, which has approximately 300 registered small players and a small number of larger operators. SMPFC faces increasing competition from foreign feeds manufacturers and competes with five national companies and numerous regional feed mills. While SMPFC caters to all segments of the feeds market, the majority of its sales come from the higher value segments rather than the lower-priced commodities segments.

Fresh Meats

The Philippine fresh meats industry remains highly fragmented notwithstanding certain companies' attempts to modernize the industry. Consolidation of the fresh meats industry is expected to increase in the future as larger players continue to invest in new technologies.

SMPFC's fresh meats business breeds, grows and slaughters hogs and cattle and produces and trades beef and pork products. It sells a wide variety of products in the Philippines under the well-recognized Monterey brand name. In 1993, the fresh meats business introduced Monterey neighborhood meat shops as part of the strategy to differentiate its products from those of its competitors. SMPFC's fresh meats business produces its hogs using a three-site system, which separates breeding, nursery and growing into isolated facilities to minimize losses from disease outbreaks or recurrences.

SMPFC's fresh meats product portfolio includes pork and beef in carcass and primals formats for franchisees, poultry distributors, SMPFC's value-added meats business and SMPFC's food service customers, pork and beef retail cuts sold in membership shopping club outlets operated by S&R and live hogs and cattle sold to traders. Pork, beef and lamb retail cuts and marinated products are sold in Monterey Meatshops through franchisees.

Based on the sow levels in 2010, SMPFC's market share in the Philippine pork industry was estimated to be 2.8%. Revenues in SMPFC's fresh meats business decreased by 14.3% from ₱7,303 million in 2009 to ₱6,258 million in 2010. This was primarily due to the 11.1% decrease in volume caused by an industry-wide hog supply shortage in the first quarter of 2010 and the large influx of imported products into the Philippines compared to 2009.

SMPFC pioneered the use of the vertically controlled pork and beef production system in the Philippines, controlling the entire value chain from selection of genetic stocks to its meat shop operations. Most of the production facilities are third party owned and operated. In 2010, SMPFC owned two hog farms operated by third parties, and contracted with over 400 third party owned and operated farms for breeding, nursery and growing operations, owned three third party operated cattle farms, owned a slaughter plant and contracted ten third party owned and operated slaughter plants.

SMPFC breeds most of its hogs on owned farms and the balance is purchased from hog breeding companies. SMPFC imports 27% of its feeder cattle from Australia and most of its boxed beef from Australia, New Zealand and Brazil. All of the feeds required by SMPFC's fresh meats business are supplied by SMPFC's feeds business.

SMPFC's fresh meats business distributes its products through a variety of channels, including supermarkets, neighborhood meat shops, poultry distributors, live sales and to SMPFC's value added meats

and food service businesses. It adopted a strategy focusing on the modern trade market to accelerate pork sales by introducing a Monty's supermarket meat shop in 1990 and stand-alone Monterey meat shops in neighborhoods in 1993. As of December 31, 2010, approximately 383 meat shops and two third party owned and operated selling stations are in operation across the Philippines. To reduce selling costs, almost all of these meat shops were recently converted to franchised operations and certain functions, such as inventory monitoring and staffing, are now undertaken by qualified operators and franchisees. As part of its strategy to increase sales volumes, improve profitability and customer service in these shops, SMPFC's fresh meats business provides marketing support to franchisees and actively seeks entrepreneurs to become franchisees.

SMPFC's fresh meats business primarily competes with one large competitor, which has its own vertically controlled operations, from breeding to retailing in supermarkets. It also competes with several commercial-scale and numerous small-scale hog farms that supply live hogs to traders, who in turn supply hog carcasses to wet markets and supermarkets. While the majority of fresh meat purchases in the Philippines continue to be made in the more traditional, outdoor wet markets, SMPFC views its competition as being with larger producers selling in the smaller, but more profitable, supermarkets.

Value-Added Meats Cluster

SMPFC's value-added meats business is a key player in three segments of the Philippine processed meats industry: (a) the leader with a 57% market share of the ₱10.6 billion hotdogs segment; (b) a 21% market share of the ₱7.9 billion corned meats segment; and (c) a 11% market share of the ₱5.1 billion luncheon meats segment based on 2010 statistics from Nielsen. SMPFC's value-added meats business produces both refrigerated meats and canned meats. Its refrigerated meat products include hotdogs, bacon, hams, chicken nuggets and a line of local Philippine products, which are sold under the Purefoods, Tender Juicy, Star, Vida, Beefies, Mom's Kitchen and Monterey brands. Canned products, such as corned beef, luncheon meats, sausages, and ready-to-eat viands, are sold under the Purefoods, Chunkee and Ulam King brands.

SMPFC's value-added meats business sources most of its raw materials through SMPFC's business procurement group, which strives to secure prices lower than prevailing market or published rates. The procurement group maintains a pool of SMPFC accredited suppliers for local and imported raw materials, which are regularly audited for quality by a quality assurance team.

SMPFC's value-added meats business owns two meat processing plants in Luzon. The Cavite plant manufactures hotdogs, hams, burgers, bacon, dry sausages, meat toppings, cold cuts and nuggets, and there are plans to expand its production capacity for hotdogs and chicken nuggets. The Marikina plant, where a portion of SMPFC's refrigerated meats and canned products were produced, was severely damaged by Typhoon Ondoy and is not intended to be reopened since it ceased operations in October 2009. SMPFC has instead contracted with additional toll packers to replace its capacity to pre-storm levels. SMPFC has received a substantial portion of the insurance claims for the typhoon damages at the Marikina plant. To augment its production capacity and meet volume demands, SMPFC's value-added meats business maintains toll-manufacturing agreements with various suppliers, one of which operates a halal-accredited manufacturing facility allowing SMPFC to sell halal corned beef products to the Middle East and predominantly Muslim countries.

SMPFC's value-added meats products are distributed by SMPFC's integrated sales operations and food service business. The sales operations group generally distributes products through modern and general trade markets, as well as exports to Asia, North America and Europe. SMPFC's food service business distributes products through food service operators, such as hotels, restaurants, fast food chains, food kiosks and carts. These sales groups are assisted by SMPFC's logistics group, which manages planning, technical logistics services, warehousing and transportation. These distribution functions tap into a variety of distribution channels, including wet markets, supermarkets, groceries, convenience stores and sari-sari stores, as well as institutional food service clients and Filipino communities abroad.

The combined shares of SMPFC's hotdog brands have positioned SMPFC as a market leader in this segment, with a market share of 57% as of June 2010 by sales according to Nielsen. As of December 31, 2010, the corned meats and luncheon meats segments, had market shares of 21% and 11%, respectively by

sales, according to Nielsen. In recent years, SMPFC's value-added meats business has faced increased competition from both established local players, which are employing aggressive pricing and promotion schemes, and from new entrants to the market. To maintain its leadership position, SMPFC has responded by continuing innovation, increasing advertising and promotions, and introducing new and competing product lines.

Milling Cluster

While rice has traditionally been the primary source of carbohydrates in the Philippines, bread and noodles have become increasingly popular alternatives in recent years, which have helped drive growth in the Philippine flour industry. In addition, large bakery chains are expanding rapidly in the Philippines at the expense of smaller, more traditional neighborhood bakeries. These larger chains often place greater emphasis on the quality of the flour they use, providing an opportunity for flour producers to sell customized, higher margin flour products.

SMPFC believes its flour business is the largest producer, seller and distributor of flour in the Philippines by volume with a 17% market share, offering a variety of flour products, including bread flour, noodle flour, biscuit and cracker flour, all-purpose flour, cake flour, whole wheat flour, premixed flour and customized flour. SMPFC has been setting the trend for using customized flours for products such as noodles and pandesal, a soft bread commonly eaten in the Philippines during breakfast. SMPFC's flour products are sold under 17 brand names, and SMPFC enjoys strong brand loyalty among its institutional clients and other intermediaries, such as bakeries. Revenues from SMPFC's flour business were ₱7,660 million in 2010.

SMPFC owns and operates the largest flour milling facilities in the Philippines. The business owns two flour mills, located in Mabini and Tabangao in Batangas, Luzon. Its flour mills have a combined rated milling capacity of 1,660 tons per day. SMPFC's milling system includes two flour blending facilities in Mabini capable of blending flours at a rated capacity of 45 tons per hour, which allows SMPFC to produce its customized flours. The flour business also operates a 46 ton-per-day premix plant, which produces different premix products for both the retail and the institutional markets. SMPFC's production capabilities are further augmented by its flour technology center, the first of its kind in the Philippines. The center develops customized flour blends and new flour-based products and is staffed with trained research and development personnel. SMPFC is adding two additional wheat storage silos and expanding its pre-mix facilities to incorporate more types of wheat into its flour products. It owns and operates two deep water ports with a combined capacity of over 7,500 metric tons per day in Mabini and Tabangao in Luzon next to its two flour milling facilities, generating substantial savings in loading, transporting and unloading costs.

The principal raw material used by SMPFC's flour business is wheat, the majority of which is sourced from the United States and Canada. SMPFC monitors worldwide wheat prices daily to determine its long-term and short-term buying strategies to control costs in its flour business.

SMPFC's marketing strategy focuses on making available the widest array of differentiated flour products in the Philippine market. The flour business' sales team of approximately 30 people contacts customers to determine their specific flour product needs. For customized products, the research and development team and the sales team work with the customers to develop individual formulations, and bakery technicians conduct field baking tests and demonstrations. SMPFC manages a nationwide network of more than 100 distributors, who distribute flour and other bakery ingredients to major flour users as well as to small, backyard users across the Philippines. SMPFC is the largest supplier of flour to big institutional customers like biscuit makers, noodle factories and large bakery chains.

SMPFC's flour business competes on price, quality and distribution, primarily with a small number of large competitors. Currently, most of SMPFC's competitors participate in the basic, or commoditized, market segments. In the future, SMPFC may face increased competition in the higher quality, higher margin segment and from international and regional flour producers. SMPFC's flour business differentiates itself by focusing on value-added flour products developed for specific customers, which provide better margins than basic flour products.

Dairy, Spreads and Oils Cluster

SMPFC's DSO business manufactures and markets a variety of bread spreads, milk, ice cream, jelly-based snacks and cooking oils generating revenues of ₱5,470 million in 2010, with bread spreads make up the largest portion of this business accounting for approximately 72.4%. SMPFC's bread spreads includes butter, refrigerated and non-refrigerated margarines and cheeses sold primarily under its *Magnolia Gold*, *Dari Creme*, *Star* and *Cheezee* brands. SMPFC's dairy products include flavored and unflavored milks under the Magnolia and Chocolait brands, ice cream under the Magnolia brand and jelly snacks and fruit jams under the JellyAce, Sugarland and Magnolia brands. SMPFC's cooking oil products are sold under the *Magnolia* brand.

All of the raw materials required by the DSO business are sourced from third parties with approximately 70.0% of dairy materials such as cheese curds, rennet, cassein, and milk powders imported mostly from New Zealand, and vegetable oils sourced locally.

SMPFC produces bread spreads products at its own facilities, including pasteurization, blending, chilling and packing for bread spreads and cooking, filling, pre-packing and end-packing for cheeses. All manufacturing activities for SMPFC's milk, ice cream, jelly-based snacks and cooking oil lines are outsourced to third party tolling plants (two tollers for milk; one toller for ice cream; two tollers for jelly-based snacks; and three tollers for cooking oil), who are required to meet SMPFC's quality standards. SMPFC manages a variety of support activities for its DSO business, including logistics, research and development, marketing, quality assurance, planning, information management and finance.

The largest distribution channel for the DSO business is supermarkets, and others include groceries, sari-sari stores, market stalls, bakeries, wholesale outlets and convenience stores. San Miguel Integrated Sales serves as the distribution arm of the DSO business for both modern and general trade channels. Food chain and other institutional distribution channels for SMPFC's DSO business include bakeshops, food manufacturing companies, restaurants, hotels, pizza chains, burger joints and hospitals. The majority of the DSO business' distribution channels are in the greater Manila and Luzon areas, which have seen substantial growth in consumption. SMPFC's DSO business recently began further developing regional distribution channels through exports.

In terms of domestic market share, SMPFC's DSO products represented 42% of the butter segment, 83% of the refrigerated margarine segment, 96% of the non-refrigerated cheese segment, 19% of the cheese segment, 10% of the ice cream segment, 28% of the jelly-based snacks segment, 13% of the plain milk segment, 9% of the flavored milk segment and 2% of the cooking oil segment, in each case in terms of volume based on 2010 statistics from Nielsen. SMPFC's DSO business faces intense competition in many of its product segments, particularly milk and cheese including from multinational companies such as Kraft, Nestlé, Unilever and New Zealand Milk, as well as domestic companies such as San Pablo. In recent years, many of SMPFC's competitors have increased advertising and promotional spending to protect their market shares.

Emerging Businesses Cluster

Coffee

SMPFC's coffee business is a joint venture with a Singaporean partner, Super Coffee Corporation Pte, Ltd., and is 70% owned by SMPFC. The joint venture commenced operations in 2005 and sells coffee products under the *San Mig Coffee* brand. In 2010, SMPFC's coffee business had revenues of ₱556 million and an estimated market share of 5.4% by volume in the Philippine coffee mix market in 2010. All of the coffee business' raw materials procurement, manufacturing and pre-packing are handled by SMPFC's Singaporean partner, with certain subsidiaries of SMC managing re-packing and distribution in the Philippines.

Food Services

SMPFC's food services business was established in 2002 and is the largest food services provider in the Philippines. It distributes and markets SMPFC's generic and customized food service products, including value-added meats, fresh meats, poultry, dairy, oil, flour and coffee. The food service business receives a

percentage of the selling price of the products as a development fee. The business' key strategies include selling customized solutions, direct marketing to its customers and focused relationship management. SMPFC's food service business had revenues in 2010 of ₱919 million.

Indonesia Regional Business

SMPFC's business in Indonesia is a joint venture with Penderyn formed in 1995 that produces a variety of halal-certified and non-halal processed meats for the Indonesian market. The joint venture is 75.0% owned by SMPFC. SMPFC's Indonesian business had revenues in 2010 of ₱789 million, and its share of the Indonesian chilled processed meats market was approximately 27.7% by volume in 2009, according to Euromonitor.

Vietnam Regional Business

The majority of Vietnam's pork production comes from small traditional farms. Pork accounts for 73% of all meat consumed in Vietnam, with consumption increasing significantly over the last 15 years as incomes have risen rapidly. The Vietnam food business is a joint venture between SMPFC, which holds 51%, and Hormel, which holds 49%. SMPFC acquired its 51% interest in the Vietnam business from SMC in July 2010, prior to which SMPFC provided management services to the Vietnam food business. The Vietnam food business primarily engages in live hog farming and producing feeds and fresh and processed meats and generated revenues of ₱974 million in 2010.

PACKAGING BUSINESS

SMC's packaging business began operations in 1938 with the establishment of a glass plant that supplied glass bottles for SMC's beer and non-alcoholic beverage products. SMC's packaging business is conducted through the Packaging Group. SMYPC owns and operates 14 domestic packaging facilities and is 65% owned by SMC and 35% owned by NYG, one of the largest Japanese glass and plastic packaging corporations. SMYPIL is the controlling stockholder of 12 international packaging facilities in China, Vietnam, Malaysia, Australia, New Zealand and Indonesia. SMYPIL is also 65% owned by SMC and 35% owned by NYG. SMYAC is a domestic glass packaging subsidiary and is 60% owned by SMC and 40% owned by NYG. In addition, SMC manufactures paper corrugated cartons through Mincorr, a wholly-owned subsidiary of SMC.

The Packaging Group is the largest packaging operation in the Philippines in terms of sales, with diversified businesses producing glass, metal, plastic, paper, flexible, PET and other packaging products. The Packaging Group is a major source of packaging products for SMC's other business segments. The Packaging Group also supplies packaging products to customers in the Asia-Pacific region, the United States, Africa, Australia and the Middle East, as well as to major multinational corporations in the Philippines, including Coca Cola Bottling Company, Nestlé Philippines and Pepsi Cola Products Philippines. In 2010, the Company's packaging business had sales of ₱19,268 million.

Philippine Packaging Industry

The glass packaging segment in the Philippines is estimated to be a ₱9 billion market, with the Packaging Group accounting for about 60% of all glass containers in the Philippines. Approximately 20% to 25% of bottles used in the country are imported, which presents a further opportunity for the Packaging Group. Major beverage and spirits customers of the Packaging Group are expected to grow at an estimated annual average of about 3% to 4% over the next five years. According to Euromonitor, glass packaging volume in packaged food is expected to have a CAGR of 4% from 2010 to 2014 due to a shift from glass to lightweight, unbreakable and more affordable packaging types. The glass packaging industry will also likely benefit from the creation of a free trade area amongst ASEAN nations, which could strengthen the financial capacities of the glass packagers/manufacturers in the region. Among the likely positive impact of the free trade area will be the ability for local glass packagers, such as the Packaging Group, to expand their business in the region.

Metal packaging used mainly for packaged food and beverages is approximately a ₱3.7 billion per annum segment of the Philippine packaging industry. The Packaging Group believes that it has an 80% market share

of the metal closures and aluminum beverage cans segment in 2010. Plastics packaging, mainly in the form of plastic crates and pallets, as well as poultry flooring, is a ₱1.7 billion per annum market, 68% of which is supplied by the Packaging Group. The plastics packaging segment is closely linked to the Philippines' economic growth and is therefore expected to grow with the Philippine economy. Similarly, the growth of the carton industry, which is valued at ₱22.5 billion per annum, has been statistically correlated with GDP growth in the Philippines. Mincorr accounts for about a 7.5% market share in the carton industry in 2010.

Flexible packaging is considered to be the most affordable type of packaging and is therefore used across many consumer products segments during difficult times. It is used extensively for packaging confectionery, dried processed food and sweet and savoury snacks. Volume is expected to increase over the long term. The flexible packaging segment is estimated to be ₱14.4 billion, with the Packaging Group accounting for a 5% market share in 2010.

Competitive Strengths

The Packaging Group believes that its strengths include the following:

- *Market leader.* The Packaging Group is a market leader in all its product formats in the domestic packaging industry, such as glass containers, plastic crates and pallets, metal closures and aluminum cans.
- *State-of-the-art manufacturing facilities.* The Packaging Group maintains state-of-the-art manufacturing facilities including the only food grade PET recycling facility in Asia and adopts best practices in manufacturing and quality procedures.
- *Synergies from partnerships with key global packaging companies.* The Packaging Group gains synergies from its partnerships with global packaging players such as NYG, Fuso, Kaito and United Resource Recovery Corporation.

Business Strategies

The Packaging Group's strategies include the following:

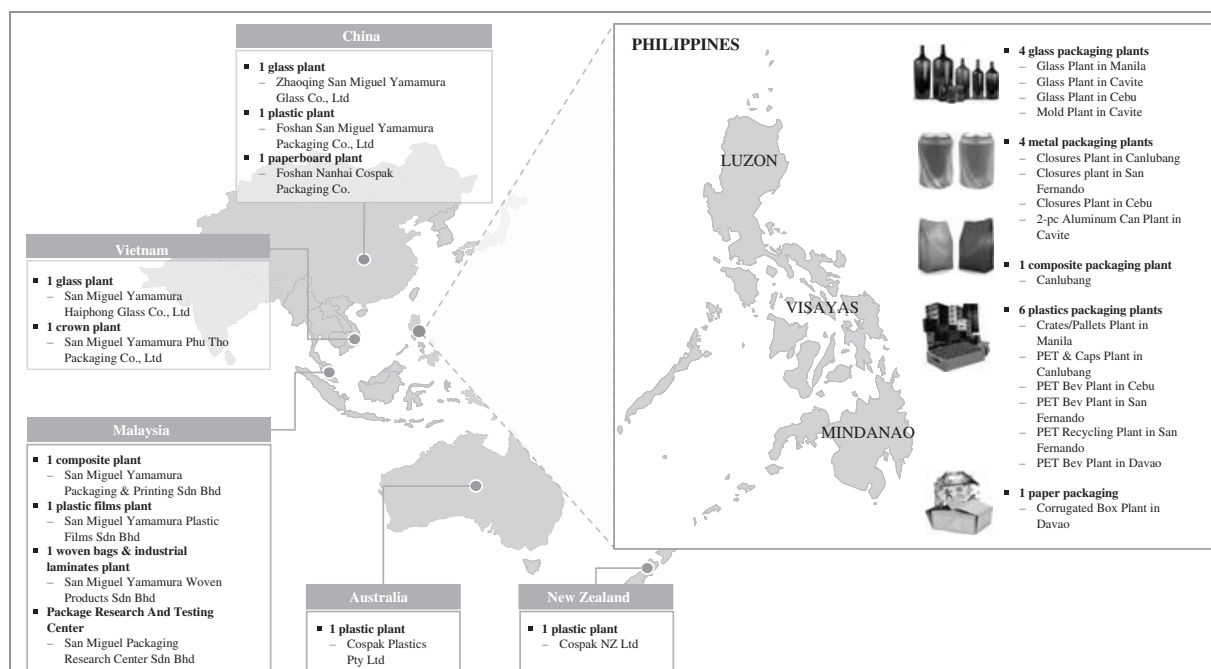
- *Total packaging solutions.* The Packaging Group intends to increase adoption of the total packaging solutions approach by proactively offering solutions that range from traditional packaging products to associated graphics design, conceptualization, consultancy, toll filling and logistical requirements.
- *Network and client optimization.* The Packaging Group intends to optimize and leverage on its significant regional network of facilities and alliances as a gateway to enter into new markets. It is also evaluating opportunities with its international clientele on potentially providing packaging services to them in markets where these customers have a presence and are new to the Packaging Group. There is also a focus on entering into longer term contracts with key customers to enhance earnings visibility.
- *Product diversification.* The Packaging Group plans to enter new markets and market segments with new products in personal care (plastic tubes), pharmaceuticals (child resistant caps, plastic pharmaceutical bottles, blister packs), semi-conductors and electronics (anti-static bags), paint (pails), and food and beverages (food tubs, thermo cups, lug caps, deep draw caps and various converted can ends).
- *Marketing environmentally friendly products.* The Packaging Group expects the future consumer trend towards environmentally friendly products and environmentally sound manufacturing systems. Hence, the Packaging Group plans to increase investments into eco-friendly facilities, processes and products such as the PET recycling plant, use of scrap laminates as fillers in pallets, toluene-free flexible packaging and accreditation with various international standards and agencies. In recent years, the Packaging Group has been improving and upgrading its manufacturing facilities to a standard higher than established government regulations. Significant investments have been spent, for example, in the Packaging Group's electrostatic precipitator, a pollution-abating device that cost more than ₱100 million.

The Packaging Group's businesses include the following product type:

- *Glass:* Based on internal SMC estimates, the Packaging Group's glass business supplies accounted for approximately 64% of the demand for quality glass containers in the Philippines in 2010. This business is the largest supplier in the glass packaging industry segment and serves many of the country's leading beverage, food and healthcare companies.
- *Metal:* The Packaging Group's metal business is the second largest business in the Packaging Group. It manufactures metal caps, crowns, resealable caps and two piece aluminum beverage cans for a wide spectrum of industries that include beer, soft drinks and food.
- *Composites/Flexible Packaging:* The Packaging Group's composites/flexible packaging business manufactures flexible packaging such as anti-static/ESD bags, plastic films, industrial laminates, trademarked Envirotuff radiant barrier and woven bags. Its customers include companies in the food, beverages, personal care, chemical and healthcare industries.
- *PET:* The Packaging Group's PET business produces PET preforms and bottles, plastic caps and handles, and offers filling services, serving the beer, liquor, non-alcoholic beverages, food, pharmaceutical, personal care and industrial applications industries.
- *Paper:* The Packaging Group's paper packaging business produces corrugated cartons and partition boxes. In addition, it also manufactures corrugated cartons and other paper-based packaging products through its wholly-owned subsidiary, Mincorr. The paper packaging business serves a broad range of beverage, food and agricultural industries.
- *Plastics:* The Packaging Group's plastics business produces bread and food trays, industrial containers, crates, pallets, poultry flooring, pails and tubs to companies in the beer and beverages industries as well as chicken and agricultural industries.

Production

The Packaging Group owns and operates four glass packaging plants, four metal packaging plants, one composite packaging plant, six plastics packaging plants and one paper packaging plant. The plants are strategically located throughout the Philippines. It also owns and operates ten overseas packaging facilities: three in China (producing glass, plastic and paperboard packaging products), two in Vietnam (glass and metal), three in Malaysia (composite, plastic films and woven), one in Australia (plastic), one in New Zealand (plastic) and a research center in Malaysia. The plant facilities of the Packaging Group are shown on the following page.



FUEL AND OIL

SMC operates its fuel and oil business through its 68.3% ownership of the common stock of Petron. Petron is listed on the PSE under the symbols “PCOR” and “PPREF”, and is the largest integrated oil refining and marketing company in the Philippines, with an overall market share of approximately 38% of the Philippine domestic oil market in terms of sales volume based on industry data for 2010 from the DOE. Petron’s core business involves the refining of crude oil and the marketing and distribution of refined petroleum products, mainly for the Philippine market. Petron also exports various petroleum and petrochemical feedstock, including high sulfur fuel oil, naphtha, mixed xylene, benzene, toluene and propylene, to customers in Asia-Pacific countries such as China, Taiwan, Singapore, Japan, South Korea and Vietnam. Petron also engages in the businesses of insurance, retail marketing and leasing, and intends to make further investments in power generation assets relating to the refinery, refinery upgrades and retail network expansion to support its core business.

Philippine Petroleum Industry

Philippine petroleum demand is projected to grow by 2% per annum over the medium-term, largely driven by transport fuels (i.e., diesel, gasoline and jet fuel). Demand for transport fuels, which represented approximately 55% of domestic demand in terms of volume in 2010, is expected to remain high, supported by sustained consumer spending, growth in vehicle sales, development in air transport industry with airlines’ route expansions and increasing demographic trends (i.e., population growth and increasing urbanization). The Philippine government’s actions to stimulate the economy through increased infrastructure projects are also expected to spur growth in oil demand. On the supply side, finished product imports continue to gain prominence with the entry of many importers/traders due to deregulation in the oil industry and Chevron’s closure of its refinery in 2003.

Due to a shortage of domestic production, the Philippines has relied on, and is expected to continue to rely on, imports for a substantial amount of refined products. The Philippines is a net importer of major white products such as diesel, gasoline and LPG, imports of which grew by 31.9%, 21.5% and 19.3% year-on-year in 2009, respectively, partially as a consequence of the collapse in oil prices in the second half of 2008 which made refined product importation less risky than crude importation. The table below sets forth the total demand for refined products compared with net imports for the periods indicated.

<u>Demand and Net Imports</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Total Demand (MB) ⁽²⁾	100,930	104,755	101,199	107,298	111,808
Net Imports (MB)	41,046	45,712	48,307	57,843	54,123
Net Imports as % of Total Demand	40.7%	43.7%	47.8%	53.9%	48.4%

Source: DOE.

⁽²⁾ MB = thousand barrels.

The table below sets forth the breakdown by product of petroleum demand in the Philippines by volume in 2010:

<u>Product</u>	<u>% of Total Volume</u>
Diesel	40.3%
Gasoline	22.1
Fuel oils	16.0
LPG	11.2
Kerosene/Jet Fuel	9.6
Others.	0.8
Total	<u>100.0%</u>

Source: DOE.

Petron, as the largest domestic refiner, is well positioned to take advantage of the growing domestic demand and trade imbalance in refined products in Philippines, given its focus on the Philippine market, its planned network expansion and its focus on higher value white products.

Competitive Strengths

Petron believes that its strengths include the following:

- *Leader in the Philippine Oil Industry.* Petron has an overall market share of 38% of the Philippine oil market in terms of sales volume, and is a market leader in the Philippines in terms of sales volume in the retail, industrial and LPG market segments and a strong second as compared with the market shares of the two other major oil companies, in the lubricants and greases market segment based on industry data for 2010 from the DOE. Petron believes its strong market position and the resulting size and scale of its operations provide significant economies of scale in production, research and development, distribution, and managerial and marketing functions.
- *Largest Integrated Oil Refinery in the Philippines.* Petron owns and operates the largest integrated oil refinery in the Philippines with a crude distillation capacity of 180,000 bpd. The refinery commenced commercial operation in 1961. There is only one other operational refinery in the country, which is owned by Shell, with a capacity of 110,000 bpd. Petron believes that operating the largest refinery in the Philippines allows it to take advantage of economies of scale in its production and crude oil procurement and that the refinery's integrated production, storage, transportation and power generation facilities provide it with competitive advantages.
- *Production capabilities of high margin products.* Petron has made substantial investments to upgrade its refinery, including the completion of its PetroFCC unit, propylene recovery unit, mixed xylene plant and benzene-toluene extraction unit. This has allowed Petron to produce higher margin products, such as propylene from LPG streams, mixed xylene, benzene and toluene from gasoline streams.
- *Extensive and Efficient Nationwide Distribution and Marketing System.* Petron's distribution system consists of its own strategically located depots, terminals and sales offices and effective management of third party service providers. The archipelagic nature of Philippine geography and the relative difficulty of transporting products to the country's substantial rural population make Petron's distribution system particularly valuable, as it enables Petron to efficiently distribute products throughout the Philippine

archipelago. Petron also has a network of more than 1,700 retail service stations, 85 convenience stores and over 164 quick-serve restaurants and service station lessees as of December 31, 2010, which provides Petron with a secure distribution outlet while also allowing it to tap demand effectively in both fuel and non-fuel products in growth areas outside the major urban centers. Petron's extensive distribution and marketing infrastructure creates a barrier against entry for new market participants and allows it to maintain a leading position in the Philippine oil industry.

Business Strategies

Petron's strategies include the following:

- *Focus on the Domestic Market.* Petron intends to maintain its position as the leader in the Philippine oil industry by (i) increasing its retail outlets for fuels and LPG to capture industry growth and improve market penetration; (ii) introducing new products with differentiated and superior qualities; (iii) developing and expanding its logistical facilities, including the addition of new aviation facilities in tourist destinations; (iv) building more LPG re-filling and auto-LPG facilities; (v) continuing to expand its non-fuel businesses by establishing additional Treats convenience stores and leasing additional service station spaces to food chains, coffee shops and other consumer services to provide "value conscious" customers with a one-stop full service experience; and (vi) intensifying its dealer and sales personnel training to support any increases in sales volume. In line with these plans, Petron intends to establish approximately 1,700 additional service stations and micro-filling stations in Philippine urban and rural areas in the next five years.
- *Increase and Diversify Production of Higher Margin Products and Leverage on Existing Partnership.* Over the years, Petron has invested in upgrades to its refinery, including the mixed xylene plant, the PetroFCC unit, the propylene recovery unit and the benzene-toluene extraction unit. These petrochemical units have enhanced its refinery's product value by approximately ₱8 per liter to ₱11 per liter (US\$30/bbl to US\$40/bbl) over alternative products such as LPG and gasoline. Petron intends to continue to evaluate technology options for the upgrade of its refinery, aiming to further minimize production of lower margin fuel oil and increase production of higher margin products, such as petrochemicals, gasoline and diesel. Petron also expects to evaluate opportunities for venturing into the production of downstream petrochemicals, such as the processing of propylene, ethylene, xylene, benzene or toluene into derivatives or finished products. Petron will also continue to expand into the blending and export of fuel additives, leveraging on its technology and business partnership with a leading global additives supplier which gives Petron exclusive distributorship to that supplier's Asia-Pacific customers.
- *Optimize Power, Steam and Production Costs Efficiencies.* Petron intends to pursue cost-effective opportunities to enhance efficiency and reduce production costs through supply chain improvements and enhancements to its existing facilities, through initiatives such as: (i) optimizing its crude mix to produce more profitable products from the existing refining configuration and expanding its crude supply sources in addition to its major crude oil suppliers, Saudi Aramco and Petroliam Nasional Berhad; (ii) reducing inventory levels by sourcing feedstock from suppliers located closer to the refinery; (iii) enhancing receiving and storage facilities to attain greater sourcing flexibility and support new growth areas; (iv) managing crude freight costs and availability of terminal-compliant vessels with contracts of affreightment that guarantee cost competitiveness with the spot market; and (v) reducing distribution costs through rationalization of the depot network, joint operations with other companies, optimized utilization of its marine and tank truck fleet, and transportation sharing synergies with third parties. In addition, Petron, through its associate, Limay Energen Corporation, is building a new cogeneration power plant for the refinery to replace some of the refinery's existing power and steam generators. The new cogeneration power plant will utilize more efficient technology and generate power at lower costs, and is expected to completely fulfill the refinery's current and future electricity and steam requirements.

- *Selective Synergistic Acquisitions.* In addition to organic growth, Petron will continue to consider selective opportunities to expand domestically through strategic acquisitions consistent with its focuses on the domestic market, increased production of higher margin products and creation of operational synergies. For example, in March 2010, Petron acquired a 40% equity interest in Petrochemical Asia (Hong Kong) Ltd (“PAHL”), a company that indirectly owns a polypropylene plant. Through PAHL, Petron expects to have a share of the incremental value derived from converting propylene produced at the refinery into polypropylene resin, a product that has experienced significant demand in the plastics industry.

Petron’s products were sold in the following distribution markets in 2010:

	<u>Volume (barrels)</u>	<u>% of Total Volume</u>
Industrial	21,152,152	43.8%
Reseller (retail service stations).	16,972,517	35.2
LPG.	4,312,558	8.9
Exports	5,176,020	10.7
Lubes & Greases	242,844	0.5
Supply Sales	432,357	0.9
Total.	<u>48,288,448</u>	<u>100.0%</u>

Production and Facilities

Petron owns and operates a petroleum refinery complex located in Limay, Bataan, which has a crude distillation capacity of 180,000 bpd. The refinery has three crude distillation units, a vacuum pipestill unit, a petrofluidized catalytic cracking unit, a propylene recovery unit, a continuous catalyst regeneration platformer unit, a powerformer unit, two naphtha hydrotreaters, two LPG treaters, an isomerization unit, a mixed xylene recovery unit, a benzene-toluene extraction unit, a kerosene mercox treater, two gas oil hydrotreater units, a sulfur recovery unit, a caustic regeneration unit, waste water treatment facilities, eight steam generators, five turbo generators, flare and safety relieving facilities, bulk asphalt receiving facilities, several crude storage tanks, as well as several refined petroleum products storage tanks. The refinery also has its own piers and two offshore berthing facilities, one of which is used for receiving crude and can accommodate very large crude carriers.

The refinery is capable of producing a broad range of petroleum products such as LPG, gasoline, kerosene, jet fuel, diesel and fuel oil. In 2000, the refinery expanded into petrochemical production with the commercial operation of its mixed-xylene plant. The refinery started producing propylene in 2008 with the commissioning of its PFCCU and propylene recovery unit, which is designed to produce 140,000 tons per year of polymer-grade propylene. The benzene-toluene extraction unit completed in May 2009 is designed to produce benzene and toluene at a capacity of 30,000 and 130,000 tons per year, respectively.

Petron also completed a fuel additive blending plant in the Subic Freeport Zone in July 2008 with a capacity of 12,000 MT a year, which serves the fuel additive requirements of a leading global additives manufacturer in the Asia-Pacific region and operates as that manufacturer’s exclusive blender for customers.

In March 2010, Petron acquired a 40% equity interest in PAHL, a company with ownership of a polypropylene plant located in Mariveles, Bataan, with an option to increase its equity interest up to 51%.

On January 3, 2011, Petron entered into a share sale and purchase agreement with Harbour Centre Port Terminal Inc. for the purchase of 35% of Manila North Harbour Port Inc.’s outstanding and issued capital stock.

Refining Process Quality Improvements

Petron has been implementing various programs and initiatives to achieve key performance indices on reliability, efficiency and safety in its refinery. These programs include the Reliability, Availability and

Maintenance (“RAM”) program and the Profit Improvement Program, which were developed and implemented in coordination with KBC Market Services, an international consultant. The RAM program resulted in improved operational availability and lower maintenance cost through higher plant reliability and a longer turnaround cycle of four to five years from the previous two years. The Profit Improvement Program likewise significantly improved white products recovery, particularly diesel and LPG.

Petron’s Continuous Improvement Program was one of the finalists for the 2008 Peoples’ Program of the Year award sponsored by the People Management Association of the Philippines. In 2009, Petron’s refinery achieved its Integrated Management System (“IMS”) certification issued by TÜV-SÜD-PSB, an internationally recognized certification and inspection body. The IMS is an integration of three management systems: (1) Quality ISO 9001:2000, (2) Environment ISO 14001:2004, and (3) Health and Safety OHSAS 18001:2007. The benefits of an IMS for Petron’s refinery include: standardized and more systematized quality, environmental, health and safety work procedures, instructions and practices; improved quality, productivity, environment, health and safety performance through continual improvement and compliance with legal requirements; customer satisfaction; and hazard and injury free working environment, and environmentally friendly operations.

Operating Sites

Petron leases 122 parcels of lands for service stations and depots from New Ventures Realty Corporation (“NVRC”). Expenses relating to the NVRC leases totaled ₱221 million in 2010. Petron also leases lands for its service stations from other parties. Payments under these leases totaled ₱388 million in 2010. As of February, 2011, there were 760 Petron related service station leases covering Luzon, Visayas and Mindanao.

NVRC is 40% owned by Petron and 60% owned by the Petron Employee Retirement Fund. NVRC purchases and sells properties suitable for use as service stations, bulk plants or sales offices.

Petron, through NVRC, recently entered into commercial leases with the Philippine National Oil Company (“PNOC”) for parcels of land being occupied by its refinery, depots, terminals and certain service stations. These transactions included the renewal of Petron’s lease with PNOC for the continued use of the Refinery land for another 30 years starting January 1, 2010 (renewable upon agreement of the parties for an additional 25 years). These lease agreements provide for upward escalation adjustments of the annual rental rates. Expenses relating to the PNOC leases totaled ₱52 million in 2010.

Petron has also initiated negotiations with PNOC for the early renewal for another 30 years of leases for 22 terminals depots and 68 service stations that will expire in August 2018.

Raw Materials and Utilities

The main raw material used in Petron’s production process is crude oil. Petron acquires crude oil from foreign sources, through a combination of short-term purchase contracts and spot market purchases. In 2010, Petron purchased approximately 74% of its total crude oil supply requirements from Saudi Aramco under a crude oil supply agreement. Pricing under this agreement is determined through a formula that is linked to international industry benchmarks. Payment for Saudi Aramco crude shipments is on open account basis secured by an irrevocable standby letter of credit consistent with Saudi Aramco’s standard practice for its customers in Asia. The contract is automatically renewed annually unless either Petron or Saudi Aramco decides to terminate the contract upon at least 60-days notice prior to its expiration date. As of the date of this Offering Circular, neither Petron nor Saudi Aramco has given notice of non-renewal.

In 2010, Petron also purchased approximately 6% of its total crude oil from Petroliam Nasional Berhad (Petronas) pursuant to its current contract for Malaysian crude oil. Pricing is determined through a formula that is linked to international industry benchmarks. The contract is renewable annually subject to the mutual agreement of the parties. Other crude oils like Sakhalin Vityaz, ESPO, Sokol, Qatar Marine, Lower Zakum, Oman and Labuan were purchased on spot basis from different companies.

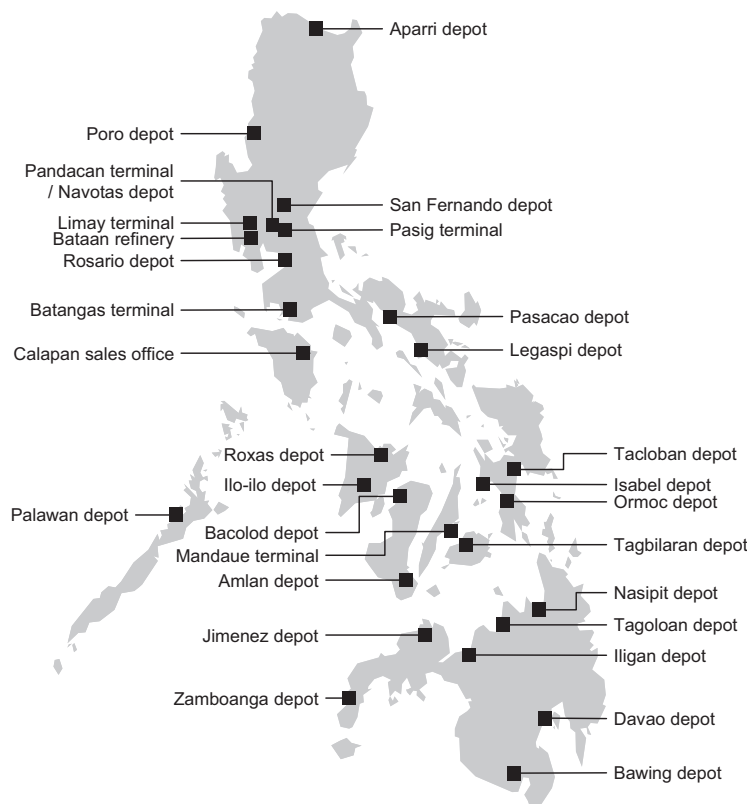
Although Petron’s refinery is configured to process predominantly light Middle East crudes, it is capable of processing other types of crude oil. In line with its crude optimization strategy, Petron is exploring

utilization of various types of crude oil, other than those supplied by Saudi Aramco and Petronas, to provide additional value to Petron.

For low sulfur fuel oil (“LSFO”), Petron imports the bulk of its requirements from Singapore under a term supply contract and occasional spot LSFO purchases are sourced from different companies. LSFO is used for blending with refinery production of fuel oil to produce regular fuel oil grade for the domestic market and for Refinery fuel to meet emission control standards. Petron also markets LSFO to other local industrial accounts. Petron also has a term contract for the supply of group I base oils (SN500, SN150 and BS150). This contract is renewable annually and pricing is based on a formula computed based on an international standard price benchmark for base oils. The group I base oils are Petron’s main feedstock for the production of automotive, industrial and marine lubricants. Petron is the sole buyer of all the ethanol produced by San Carlos Bioenergy, Inc. pursuant to a supply contract based on a formula price. The balance of Petron’s ethanol requirements is sourced from imports. Ethanol is blended with gasoline to comply with the current requirement under the Biofuels Act (the “Biofuels Act”) that bioethanol shall comprise at least 5% of the total annual volume of gasoline fuel sold by every oil company.

Petron also imports LPG, aviation gasoline, asphalt and some gasoline blending components. These imports are necessary as Petron does not produce asphalt and aviation gasoline, while its production of LPG is insufficient to meet domestic demand. Occasional imports of diesel, finished gasoline and jet fuel are also necessary during the refinery’s maintenance. Pricing is usually based on Mean of Platts Singapore.

The principal utilities required for Petron’s production process are water, electricity and steam. Deep wells (ground water) provide Petron’s refinery’s water requirements. Petron purchases approximately 40% of its refinery’s electricity requirements from the national grid. The balance is generated within the refinery from its existing generators. Petron, through its associate, Limay Energen Corporation, is also building a new cogeneration power plant for its refinery. Petron expects to enter into a product offtake supply agreement with Limay Energen Corporation for the purchase of electricity at market prices, which Petron believes will be lower than electricity purchased from the national grid. Upon completion, the new cogeneration power plant will have a power generation capacity of 70 MW and steam generation capacity of 400 metric tons per hour (MTH), which will completely fulfill the refinery’s additional electricity and steam requirements of approximately 22 MW and 174 MTH, respectively. The new cogeneration power plant will be connected to the national grid, and Petron expects that any excess power generated by the new power plant will be sold on the grid.



In the retail market, Petron has more than 1,700 retail service stations to distribute products to motorists and public transport operators all over the Philippines as of December 31, 2010, representing approximately 34% of the industry's total gasoline station count of more than 5,000. Approximately 55% of these stations are located in Luzon where demand is highest. Petron has three types of retail service station operating structures, namely: company-owned-company-operated service stations ("COCO"), company-owned-dealer-operated service stations ("CODO") and dealer-owned-dealer-operated service stations ("DODO"). For COCOs, Petron buys or leases the land and also owns and operates, through Petron Marketing Corporation, the service station structures and equipment. Similarly, for CODOs, Petron buys or leases the land and owns the service station structures and equipment, but third party dealers operate the CODOs. For DODOs, third party dealers operate the service station, buy or lease the land, build service station structures according to Company specifications, and lease the service station equipment from Petron. Of the more than 1,700 retail service stations of Petron, less than 1% are COCOs, approximately 33% are CODOs, and approximately 67% are DODOs and micro-filling stations.

In the industrial market, Petron services approximately 43% of the Philippine industrial civil sector, which includes major manufacturing, aviation, power and marine accounts. Overall, Petron has more than 1,200 direct industrial account customers.

Petron is one of the biggest market participants in the LPG market. Petron has set up more than 500 branch stores through its Gasul dealers as of December 31, 2010. It has also gained headway in the field of alternative fuels through its auto-LPG program, Petron Xtend, of which auto-LPG facilities are already installed in 21 service stations nationwide.

In lubes and oils, Petron has a network of 15 car care centers, 26 Petron sales centers, 14 lubes and specialties centers, and four motorcycle centers nationwide to augment lubricants and greases sales as of December 31, 2010.

Petron is also expanding into blending and export of fuel additives, leveraging on its technology partnership with a global fuel additives supplier. Petron also provides technical services to its partner's customers, and is able to tap its customer base in Asia to broaden the market for Petron's own lubricant brands.

Petron also exports various petroleum products and petrochemical feedstock such as high sulfur fuel oil, naphtha, mixed xylene, benzene, toluene and propylene to customers in Asia-Pacific countries, particularly China, Singapore, Taiwan, Japan, Vietnam and South Korea. These products are sold through accredited traders under term or spot contracts. Petron awards these contracts based on a tender process by which the accredited traders submit proposals, and the contract is awarded based on Petron's determination of the best proposal based on quantity, quality, timing, price and credit worthiness.

Petron has airport installations at the Ninoy Aquino International Airport in Manila, and airports in Laoag, Mactan, General Santos, Cagayan de Oro, Puerto Princesa, Iloilo, Zamboanga and Davao. These installations provide storage of aviation fuels as well as refueling services for various aircraft.

Capital Expenditures

Petron has upgraded its refinery and expanded its service station network over the past several years, and intends to continue to increase investments in these areas in order to optimize operational efficiency, reduce costs and increase market share. Specifically, Petron currently intends to (i) implement RMP-2 which will enable the Refinery to further enhance its operational efficiencies and capability to convert low margin fuel oil into a broader range of higher value white products (such as gasoline and diesel) and petrochemical products, (ii) build a new cogeneration power plant for its refinery, and (iii) continue expansion of its service station network. Petron intends to finance these plans with a combination of equity and debt to be determined at the time of financing.

Petron's estimated capital expenditures for 2011 are approximately ₱31.3 billion, allocated as follows: approximately 49.9% for the implementation of RMP-2, approximately 24.0% for the cogeneration power plant project and approximately 8.6% for service station network expansion. Petron expects to continue to make substantial capital expenditures after 2011 to complete the major projects described above and for other purposes. These capital expenditures are expected to be funded by a combination of internally generated cash flow and external financing sources. Petron's capital expenditures may change as projects are reviewed or contracts entered into and are subject to various factors, including market conditions, the general state of the Philippine economy, Petron's operating performance and cash flow and Petron's ability to obtain financing on terms satisfactory to management.

Upon the successful completion of RMP-2, Petron expects that it will be able to increase production of higher value white products and petrochemical products, which should increase sales revenue and improve margins. Upon the completion of RMP-2, Petron should also be able to produce petcoke, which can be used as fuel for the new refinery cogeneration power plant, lowering Petron's power generation costs, and improving utilization, processing and energy efficiency. Petron also expects that, upon completion of RMP-2, the refinery will be on par with more advanced refineries in the region, thereby improving the refinery's competitiveness.

Petron is undertaking a cogeneration power plant project next to its refinery to replace some of the refinery's existing power and steam generators through Energen, a joint venture between Petron and Two San Isidro SIAI Assets Inc. The new cogeneration power plant will utilize more efficient technology and generate power at lower costs. Upon its planned construction in 2012, the new cogeneration power plant will have a 70MW power generation capacity and a 400 MTH steam generation capacity which will completely fulfill the refinery's current and expected future and steam requirements.

In addition, to support growth in domestic sales, Petron intends to establish approximately 1,700 additional service stations and micro-filling stations in Philippine urban and rural areas in the next five years.

Competition

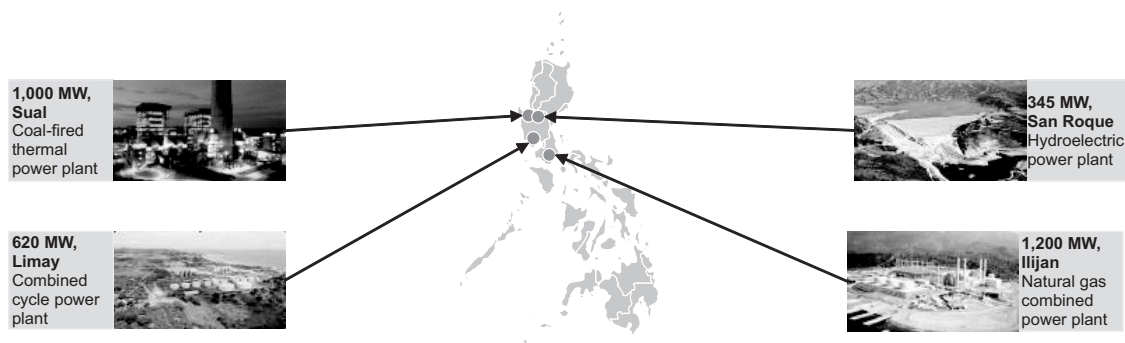
Petron operates in a deregulated business environment, selling its products to individual, commercial and industrial customers. The enactment of the Downstream Oil Industry Deregulation Act in 1998 (“Oil Deregulation Act”) effectively removed the rate-setting function of the Philippine government through the then Energy Regulatory Board, leaving price-setting to market forces. It also opened the oil industry to free competition.

The Philippine oil industry is dominated by three major oil companies: Petron, Shell and Chevron (formerly Caltex Philippines), which, based on industry data for 2010 from the DOE, together constitute 77% of the domestic market based on sales volume. Petron is the leader in the Philippine oil industry, with an overall market share of approximately 38% of the domestic oil market, ahead of the other two major oil companies in the Philippines, which have market shares of approximately 27% and approximately 12%, respectively, in each case in terms of sales volume based on industry data for 2010 from the DOE. Deregulation has seen the entry of more than 90 other industry market participants, rendering the petroleum business more competitive. Petron and Shell operate the only refineries in the country. The rest of the industry market participants are importers of finished petroleum products or purchase from other market participants in the local market. In the Philippines, Petron competes with other industry market participants on the basis of price, product quality, customer service, operational efficiency and distribution network, with price being the most important competitive factor. Providing total customer solutions has increased in importance as consumers became more conscious of value. Petron participates in the reseller (service station), LPG, industrial and lube sectors, through its network of service stations, terminals and bulk plants, dealers and distributors nationwide.

In the reseller sector, competition is most dynamic among the major firms, as seen through the construction of service stations by Shell, Chevron, as well as Total Philippines, in major thoroughfares. The small market participants also continue to grow, with station count increasing from 695 in 2001 to over 1,700 service stations at the end of 2010. New market participants in the reseller sector, and Liqueigaz particularly in the LPG sector, continue to resort to aggressive pricing and discounting in order to expand market share. The number of LPG importers increased from three, prior to deregulation, to about seven, with new entrants having more flexible and bigger import receiving capacities. Collectively, the new LPG market participants are leading the LPG sector with 48.7% of market share as of December 31, 2010. In the industrial sector, the major market participants continue to invest heavily in order to increase market share and tap new markets. In the lubricants sector, intense competition among over 50 brands, including big names like Castrol, Mobil, Shell and Caltex, continues. Brands compete for limited shelf space, which has led to the penetration of previously unutilized markets such as auto-dealerships in malls. In the convenience store business, Petron competes with other gas marts such as Shell Select and 7-Eleven in Chevron service stations, as well as with traditional stand-alone convenience stores such as 7-Eleven and Mini-Stop.

POWER BUSINESS

Location of the power plants



SMC operates its power business through the subsidiaries of its wholly-owned subsidiary, SMCGP, namely, SMEC, SPPC, SPDC and Panasia. SMCGP is a leader in the Philippine power generation industry in terms of installed capacity. Incorporated in 2008, SMCGP, through its subsidiaries, has successfully bid for the privatization of four electrical power generation plants in the Philippines. SMCGP administers a portfolio of three operating power plants under IPPA Agreements with a combined capacity of 2,545 MW. In addition, SMCGP owns and operates a fourth power plant through Panasia, a 620 MW oil-fired combined cycle power generation plant located at Limay, Bataan. As of December 31, 2010, SMCGP had total assets of ₱238,591 million and revenues in 2010 of ₱45,636 million.

Philippine Power Generation Industry

The Philippine electric power industry has a strong and transparent regulatory framework governed by EPIRA, which was enacted in 2001 to ensure the provision of safe, reliable, and affordable electricity to the entire country.

As part of the reforms mandated by the EPIRA, the Philippine government, through PSALM, has been privatizing its generation assets and capacity since December 2003. Various power participants (both local and foreign) have shown strong interest and participation in the privatization process. The competition amongst various bidders and the prices paid for the recently privatized assets reflect strong investor confidence in the Philippine power industry.

According to the DOE's Power Development Plan, 2009-2030, power consumption in Luzon, Visayas, and Mindanao is expected to require a total of 3,050 MW, 250 MW, and 800 MW of additional capacity, respectively, by 2018. Of these projected required capacities, approximately 600 MW, 638 MW, and 100 MW are expected to be provided by committed power projects in Luzon, Visayas, and Mindanao, respectively.

Economic growth remains the key driver of energy demand. With 2011 GDP growth target of 7.0% to 8.0% set by the National Economic Development Authority (NEDA), peak demand is expected to increase. DOE expects peak demand to increase at an average annual growth rate of 4.3% in Luzon, by which time aggregate peak demand is expected to reach 10,393 MW.

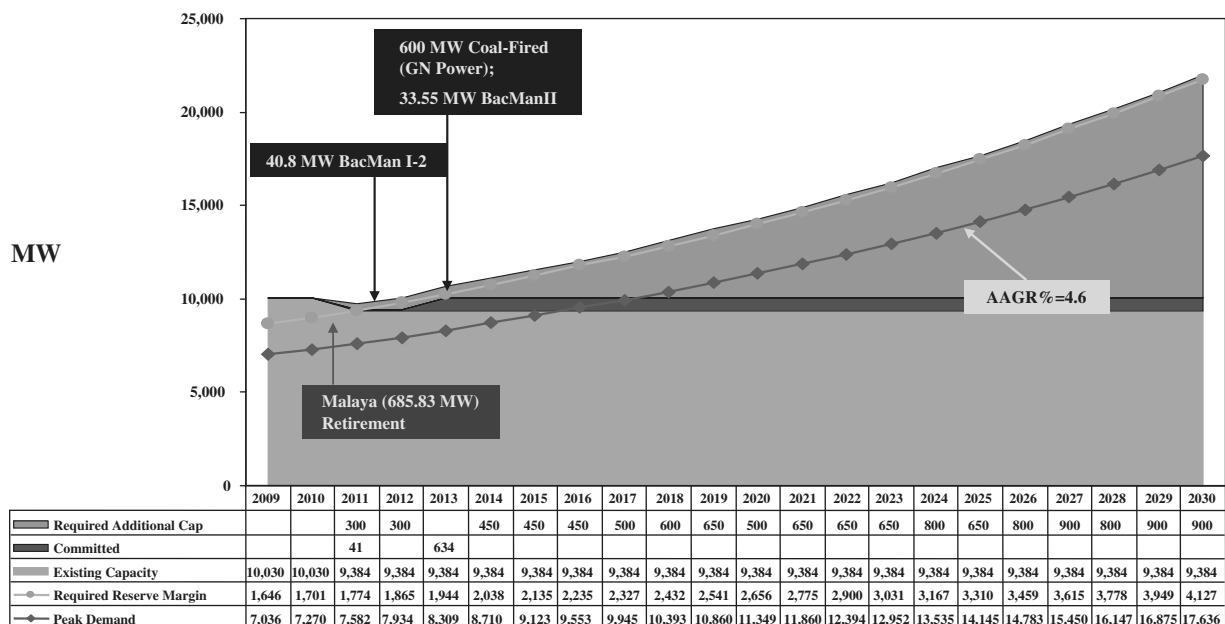
In 2009, electricity consumption of residential and commercial customers in Luzon grew by 4.6% and 3.8%, respectively. The growth can largely be attributed to the opening of new shopping malls in rural centres and surge in the business process outsourcing industry.

The following tables and graphs summarize the power supply and demand outlook from 2009 to 2030 in the Philippines based on the DOE's Power Development Plan, 2009-2030:

Grid	Dependable Capacity (MW)⁽¹⁾	Peak Demand (MW) 2008	Average Annual Growth Rate (%)	Committed Capacity (MW)	Critical Period	Required Additional Capacity (MW) 2009-2030	Indicative New Capacity (MW) 2009-2030
Luzon	10,030	6,822	4.5	600	2011	11,900	3,449
Visayas	1,505	1,176	4.6	638	2009	2,150	182
Mindanao . . .	1,682	1,228	4.6	101	2010	2,500	581
Philippines . .	13,217	9,226	4.6	1,339		16,550	4,211

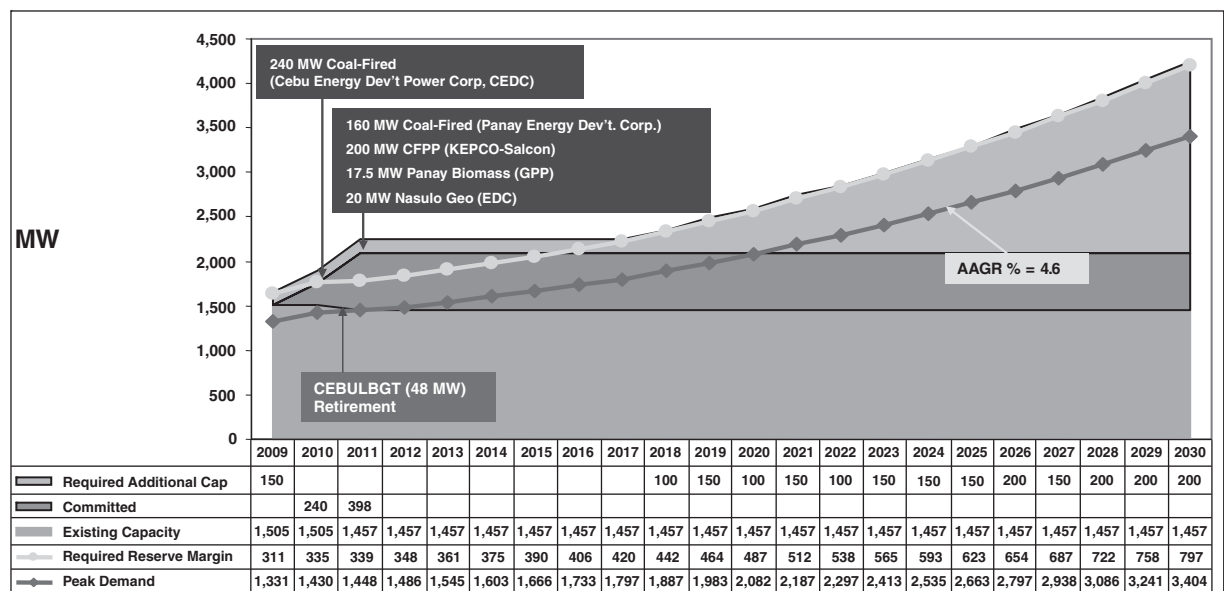
⁽¹⁾ Maximum capacity a power plant can sustain over a specified period as modified for seasonal limitation and other plant-specific factors such as required maintenance.

Luzon Power Supply and Demand Outlook: 2009-2030



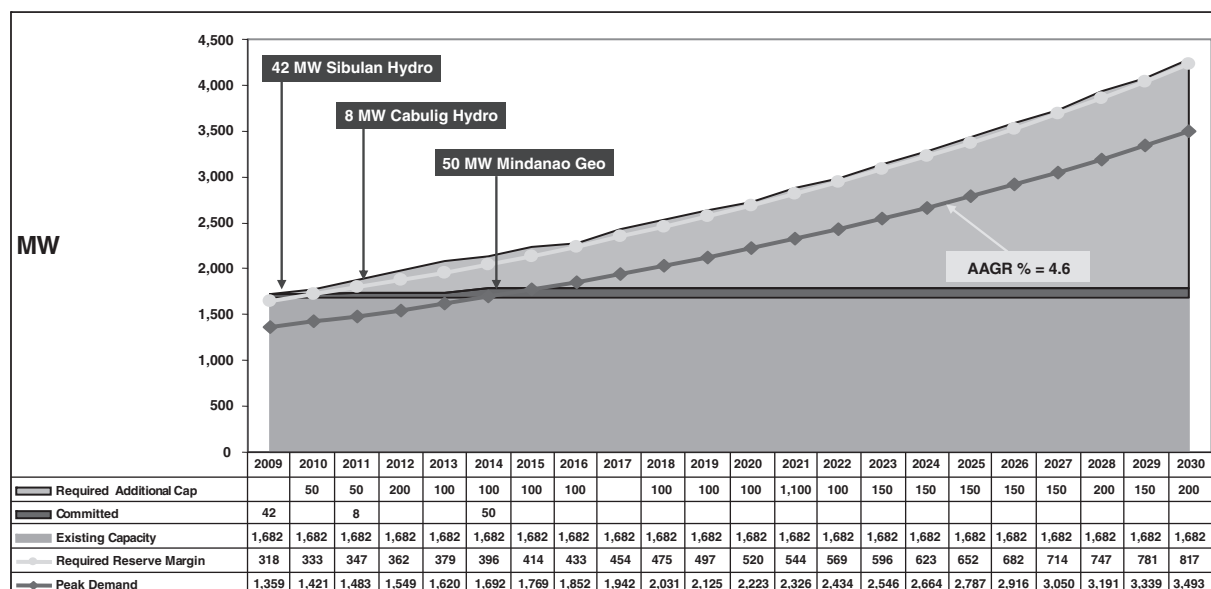
Source: Power Development Plan, 2009-2030, DOE

Visayas Power Supply and Demand Outlook: 2009-2030



Source: Power Development Plan, 2009-2030, DOE

Mindanao Power Supply and Demand Outlook: 2009-2030



Source: Power Development Plan, 2009-2030, DOE

SMC believes this increase in demand will lead to electricity shortages, which will increase prices in the WESM and thereby enabling SMCGP to sell electricity at higher prices, as well as providing opportunities to build new generation capacity to meet the projected shortage.

Philippine's total average effective electricity rates as of December 2009 was estimated at ₱7.2491/KWh, an increase of ₱1.4766/KWh compared to December 2008 average effective electricity rate mainly as a result of the increase in basic generation rates in the three grids. Generation costs comprised 46.2% of Electric Cooperatives' national average effective electricity rates followed by distribution costs of 23.0%.

The table below summarizes the average effective electricity rates in the Philippines by grid in December 2009 as compared to December 2008:

Grid	Electric Cooperatives		Private Distribution Utilities		National Average	
	Dec 2008	Dec 2009	Dec 2008	Dec 2009	Dec 2008	Dec 2009
Luzon	6.7746	8.1182	6.0307	7.3408	6.40265	7.7295
Visayas	6.2131	8.0478	5.3272	6.8148	5.77015	7.4313
Mindanao	5.3920	6.4694	4.8670	5.2195	5.12950	5.8445
Philippines	6.1266	7.5452	5.4184	6.9530	5.77250	7.2491

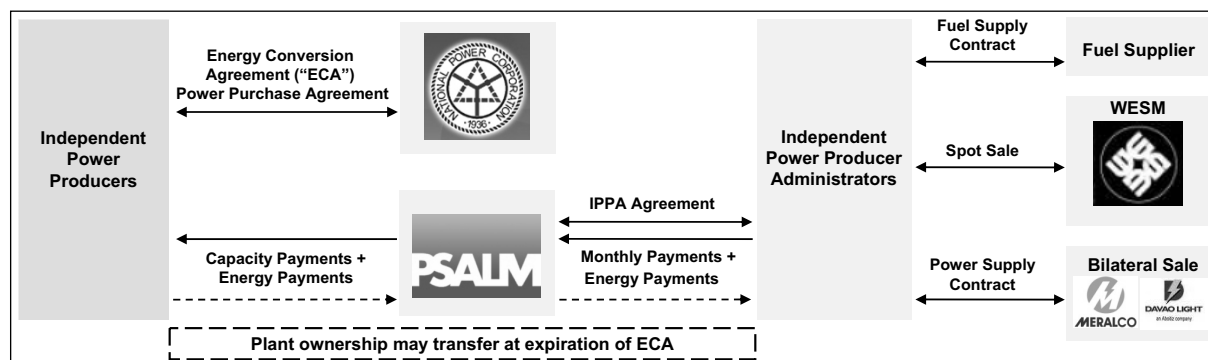
IPPA Framework

PSALM, together with NPC, has ECAs or other PPAs in place with various IPPs in the Philippines. Under the EPIRA, PSALM is required to achieve, through open and competitive bidding, the transfer of the management and control of at least 70% of the total power output of the IPP plants under contract with NPC to IPPAs pursuant to IPPA Agreements, such as those held by SMCGP.

Under IPPA Agreements, the IPPAs have the right to sell the electricity generated by such IPP in the wholesale electricity spot market and also by entering into PSCs with specific customers and will, in general, manage procurement of the fuel supply to the associated IPP. IPPAs pay PSALM a fixed monthly payment and a variable energy or generation fee the amount of which depends on the dispatch and performance of the IPP. IPPA Agreements provide relief for IPPAs such as SMCGP in the event the associated IPPs are unable to dispatch for a certain period of time not due to the fault of the IPPA. PSALM/NPC in turn pays the IPPs

capacity and energy payments based on their respective ECAs or PPAs. In some cases, IPPA Agreements provide the IPPA with the right to acquire ownership of the power plants or generation facilities from the IPPs at the end of the terms of the ECAs or PPAs. Under SMCGP's IPPA Agreements, SMCGP has the right to acquire the Sual Power Plant in October 2024, the Ilijan Power Plant in June 2022 and the San Roque Power Plant in May 2028, or on some earlier date due to certain events such as changes in applicable law or non-performance by the IPP.

Set forth below is a general illustration of the IPPA framework.



(1) The Ilijan Power Plant and the San Roque Power Plant do not have fuel supply agreements.

(2) SMCGP is only responsible for fuel supply in the Sual Power Plant.

The IPPA framework is intended to provide successful bidders a way to enter and trade in the WESM for a minimal capital outlay without the expense of building a new power plant and for IPPAs to enjoy the benefits normally attributed to owners of power generation plants, including controlling the fuel and its dispatch, trading, and contracting of the power plant, without maintenance costs or capital upgrades, which remain with the IPPs. Also, many of the risks of owning a power plant are explicitly managed through the contract. If there is an extended outage at the power generation plants, for example, there is up to a 50% discount on the monthly fees, and PSALM bears the force majeure risks to the power generation plants. The IPPA framework also permits an IPPA to assume NPC's role as an offtaker of power generated by IPPs without affecting NPCs underlying agreements with the IPPs.

IPPAs are permitted to trade in the WESM, and are also free to enter into bilateral contracts and seek other markets for the balance of their contracted capacities and power, as well as enter into other forms of financial hedging instruments if desired to manage their position in and exposure to the market.

Competitive Strengths

SMCGP believes that its principal strengths include the following:

- **Size.** SMCGP is currently the largest and strategically critical electricity supplier on the Luzon grid, accounting for 29.2% of the market share of the total installed power generation capacity for the said grid. Its main competitors are the Lopez Group which ranks second with a market share of 28%, and the Aboitiz Group with 23.9%. The Luzon grid accounts for at least 75% of the total Philippine power capacity.
- **Diverse range of fuels.** Power generation plants administered by SMCGP as the IPPA and the Limay Power Plant which it operates use a diverse range of fuels, namely coal, natural gas, diesel (bunker) and hydro power, which reduces the impact of sudden price increases and supply shortages.
- **Strong professional relationships with key regulatory bodies.** SMCGP believes that it has a professional relationship with the DOE and the ERC, the key power industry regulatory bodies in the Philippines, as well as with other key government offices and agencies.

Business Strategies

SMCGP principal strategies include the following:

- *Actively manage the power generation assets to maximize value creation, while playing a critical role in ensuring electricity supply security for the Philippines.* SMCGP intends to actively manage its revenues and optimize the operations of its power generation assets in order to achieve a balanced mix of electricity sales via (a) contractual arrangements with electricity customers including distribution utilities, industrial and commercial customers and electricity cooperatives and (b) sales into the WESM. SMCGP believes that this approach will provide the certainty and predictability of revenues from contracted sales while capturing revenue upside from the wholesale market particularly when electricity supply and demand dynamics result in attractive wholesale market prices.
- *Actively pursue vertical integration.* SMCGP intends to continue to expand into businesses that complement its power generation operations (i.e. coal mine projects). As part of this strategy, SMCGP (through SMEC) acquired equity interests in three companies holding the concession rights to various coal mines in May 2010: Daguma, Bonanza and SEPC. Although these mines will not provide fuel to the Sual Power Plant, SMCGP believes that, upon commencement of operations, the mines will provide SMCGP an indirect hedge against coal prices and provide it with opportunities to develop mine mouth power projects. In addition, SMCGP will seek opportunities to acquire further coal mines. SMCGP also currently purchases oil for its Limay Power Plant from Petron, a subsidiary of SMC, and has an equity stake in Meralco, which is one of its significant offtakers. SMC believes that such vertical integration will provide SMCGP with a competitive advantage in the Philippine electricity market.
- *Expand generation portfolio.* SMCGP intends to continue to expand its generation portfolio, primarily in the Philippines, to add value to its asset base and diversify its revenue stream and fuel base. This includes actively pursuing opportunities to acquire power generation assets that add value to its existing business, including certain power generation assets that are expected to be privatized by the Philippine government, such as the 640 MW Unified Leyte geothermal power plants, the 149 MW Naga power plant, the 650 MW Malaya thermal power plant, the 140 MW Casecnan multipurpose power facility and the 728 MW Caliraya-Botocan-Kalayaan hydropower facilities, as well as those owned by other IPPs that may be put up for sale. In addition, SMCGP believes that the Visayas region of the Philippines faces severe power shortages in the immediate-term and that Mindanao already faces severe shortages. Consequently, SMC expects that demand for electrical power in both Visayas and Mindanao will continue to grow and therefore SMCGP seeks opportunities to expand its portfolio into these regions. Given the power supply situation in the Philippines, SMC intends to install 3,000 MW of new capacity. All new power plants are expected to be based on clean-coal technology which are able to use coal sourced from SMC's own mining assets in Mindanao.
- *Continue the strategy of alliances and partnerships with key stakeholders.* SMCGP has a strong relationship with its shareholder, SMC and intends to manage its relationships with its current offtakers and fuel suppliers in order to continue to benefit, from the strong contractual frameworks for its power generation assets. SMCGP intends to continue to build and maintain relationships with other key stakeholders, such as financing institutions, insurers, contractors, fuel suppliers, local government units and communities where it operates, as well as with non-government and community-based organizations.

SMCGP receives income from the sale of electricity by its three administered power generation facilities and its Limay Power Plant to a variety of customers, including Meralco, electric cooperatives, industrial customers and the WESM. In 2010, the three power plants for which SMCGP has IPPA Agreements generated 9,963 giga-watt hours ("GWh") of electricity and the Limay Power Plant generated 1,125 GWh of electricity. As of December 31, 2010, SMCGP's attributable installed capacity (excluding the Limay Power Plant) was powered 39.3% by coal, 47.1% by gas and 13.6% by hydro power.

The table below summarizes certain operating metrics in respect of the four power generation facilities owned or administered by SMCGP:

Project	Placed in Service	Date SMCGP Assumed Operations	Operator	Installed Capacity (MW)	Fuel	Energy Generation (GWh) ⁽¹⁾		Capacity Utilization (%)		Availability Factor (%)	
						2009	2010	2009	2010	2009	2010
Sual	10/25/1999	11/6/2009	TeaM Energy	2 × 500 ⁽²⁾	Coal	503.1	5,177.6	38.9	59.1	85.3	83.3
Ilijan	6/5/2002	6/26/2010	KEPCO	2 × 600	Gas	—	4,197.5	—	79.6	—	84.0
San Roque . . .	5/1/ 2003	1/26/2010	Marubeni-Kansai Electric	345	Hydro-electric	—	587.6	—	21.1	—	100.0
Limay ⁽³⁾	4/1993	1/18/2010	Alstom Philippines Inc.	620	Oil	—	1,124.6	—	26.1	—	92.6

⁽¹⁾ SMCGP assumed administration of the Ilijan Power Plant on June 26, 2010 and the San Roque Power Plant on January 26, 2010 and assumed operation of the Limay Power Plant on January 18, 2010.

⁽²⁾ Installed capacity is 2 x 647 MW, but contracted capacity is 2 x 500 MW.

⁽³⁾ Not included in the power plants operated by SMCGP pursuant to IPPA Agreements.

The table below sets forth the gross profit, and Adjusted EBITDA of SMCGP for 2010:

	2010
Gross profit (₱ millions)	17,259.2
Adjusted EBITDA (₱ millions)	21,727.2

In addition, SMCGP, through the subsidiaries of SMEC, Daguma, Bonanza and SEPC, owns various coal properties that are in the exploration phase, which are set forth in more detail in “— Other Operations — Coal Mining”.

SMCGP, through its subsidiaries, derives a substantial portion of its revenue from PSCs with established offtakers. The DOE forecasted in its Power Development Plan, 2009-2030 that peak demand will grow at an average annual rate of 4.3%, 4.9% and 5.2% per year between 2009 and 2018 in Luzon, Visayas and Mindanao, respectively, with aggregate peak demand expected to reach 10,393 MW, 1,887 MW and 2,031 MW by 2018 in Luzon, Visayas and Mindanao, respectively. SMCGP expects these factors, and the scarcity of new capacity expected to come online over the next two to three years, to support dispatch for it as well as other existing generators.

The following table sets forth offtake arrangement pursuant to PSCs for the Sual Power Plant and the Ilijan Power Plant. PSCs are contracts pursuant to which IPPAs sell electricity to offtakers. The San Roque Power Plant and the Limay Power Plant are “peaking plants”, a term used to refer to power plants selling only on the spot market and not pursuant to PSCs. As such, the San Roque Power Plant and the Limay Power Plant have no offtakers.

<u>Power Plant</u>	<u>Customer</u>	<u>% of Total Volume Sold in 2010</u>	<u>Expiration of PPA</u>
<u>Sual</u>			
	Meralco ⁽¹⁾	12.23	December 25, 2011
	Angeles Electric Corporation	7.45	August 25, 2011
	Pampanga II Electric Cooperative	6.82	October 25, 2011
	Clark Distribution Corporation	5.45	March 25, 2012
	Pangasinan III Electric Cooperative	5.41	December 25, 2012
	SFELAPCO	0.05	September 25, 2011
	Central Pangasinan Electric Cooperative	4.97	April 25, 2011
	Peninsula Electric Cooperative	5.22	December 25, 2012
	Subic Enerzone Corporation	4.11	March 25, 2011
	Tarlac Electric, Inc.	4.50	June 25, 2011
	Ilocos Sur Electric Cooperative	3.85	November 25, 2011
	Hanjin — SBMA	3.86	March 25, 2011
	Isabela I Electric Cooperative, Inc.	3.88	January 25, 2012
	Northern Cement Corporation	3.19	February 25, 2012
	Ilocos Norte Electric Cooperative, Inc.	3.06	July 25, 2011
	Pampanga III Electric Cooperative, Inc.	2.85	December 25, 2012
	NPC Alliance Corporation	1.88	November 25, 2011
	Stronghold Steel Corporation	1.53	April 25, 2012
	Melters Steel Corporation	1.37	December 25, 2011
	Consolidated Industrial Gas Inc.	1.20	December 25, 2011
	Consort Land, Inc.	0.35	June 25, 2011
	Lepanto Consolidated Mining Co.	0.78	June 25, 2011
	SMC — Beverage Packaging Specialist	0.59	August 25, 2011
<u>Ilijan</u>			
	Meralco (under a transition supply contract)	22.50	December 25, 2011
	Meralco (under a customer choice program)	26.62	December 25, 2011
	Meralco — Ecozone	36.00	December 25, 2011
	Meralco — Sunpower	2.78	December 25, 2011
	Remaining uncontracted capacity — WESM	12.10	

⁽¹⁾ Under a Transition Supply Contract with NPC

SMCGP's Power Generation Facilities

Sual

The Sual Power Plant is a 2 x 647 MW coal-fired thermal power plant located in Sual, Pangasinan on the Lingayen Gulf that commenced commercial operations in October 1999, and is the largest coal-fired thermal power plant in the Philippines in terms of installed capacity. The Sual Power Plant was built by CEPA Pangasinan Electric Limited pursuant to an ECA with NPC under a 25-year Build-Operate-Transfer (“BOT”) scheme that expires on October 24, 2024. In 2007, Team Sual Corporation (“TeaM Energy”), which is a joint venture between Marubeni Corporation and Tokyo Electric Power Corporation, acquired the Sual Power Plant.

SMCGP, through its wholly-owned subsidiary SMEC, assumed administration of the Sual Power Plant on November 6, 2009 in accordance with an IPPA Agreement (the “Sual IPPA Agreement”) entered into with PSALM. Under the Sual ECA, PSALM is obligated to remunerate the Sual Power Plant’s IPP for the electricity the IPP produces.

Sual IPPA

PSALM, NPC and SMEC entered into the Sual IPPA Agreement pursuant to which SMEC has the right to manage, control, trade, sell or otherwise deal in the electrical generation capacity of the Sual Power Plant

and must supply and deliver, at its own cost, fuel required by the power plant and necessary for it to generate the electricity required to be produced by TeaM Energy under the Sual ECA. In addition, SMCGP must pay fixed monthly payments comprising both a U.S. dollar and Peso component. These fixed monthly payments are reduced proportionately in any month that the Sual Power Plant is unable to produce power for an entire day (a “Non Delivering Day”) (for reasons not attributable to SMCGP) and reduced further in proportion to the number of Non Delivering Days in that month. In addition, SMEC must pay monthly energy fees that are periodically adjusted for inflation and that consist of (i) a fixed base energy rate for power actually delivered by the Sual Power Plant comprising both a U.S. dollar and Peso component plus (ii) a variable energy rate for power actually delivered by the Sual Power Plant, in U.S. dollars only, that takes into account the cost and efficiency of fuel supplied to the Sual Power Plant as well as the efficiency (unit heat rate) of the Sual Power Plant, which is measured on an annual basis.

The Sual IPPA Agreement also requires SMEC to maintain a performance bond in favor of PSALM equivalent to US\$58.0 million, and perform the obligations of NPC in its PSCs, including the obligation to procure electricity at its own cost to meet deficiencies, in cases where the Sual Power Plant is unable to supply the contracted power.

Under the Sual IPPA Agreement, SMEC has the right to acquire the Sual Power Plant in October 2024, which is the end of the cooperation period between NPC and TeaM Energy under the Sual ECA, or on some earlier date due to certain events such as changes in law or non-performance by TeaM Energy under the Sual ECA.

In 2010, SMCGP made payments to PSALM under the Sual IPPA Agreement of ₱1,728 million and US\$36.0 million.

Power Offtakers

The Sual Power Plant’s PSCs require its offtakers to take or pay for, within a contract year, a mutually agreed minimum energy quantity (“MEQ”). Such offtakers may exceed the MEQ, but any consumption in excess of the MEQ may be subject to additional charge.

The pricing for PSCs assigned by PSALM to SMEC is based on the prevailing rate structure of NPC as approved by the ERC. Currently, the NPC rate structure consists of two basic charges and two cost adjustment mechanism charges. The basic charges, which are based at a premium over NPC’s costs structure as of its 2007 audited financial statements, consist of the generation charge designed into time-of-use rates and the franchise and benefits to host communities charge. These are fixed charges and remain constant regardless of the movements in the prices of the different fuels used by NPC in generating electricity, as well as movements in foreign exchange rates and inflationary effects.

The cost adjustments, on the other hand, pertain to (a) the deferred accounting adjustment charges under the Generation Rate Adjustment Mechanism and the Incremental Currency Exchange Rate Adjustment or (b) the Automatic Cost Adjustment Mechanism charge under the Automatic Cost Recovery Mechanism. The Generation Rate Adjustment Mechanism and Incremental Currency Exchange Rate Adjustment deferred accounting adjustment charges allow for the recovery of incremental costs (or the refund of savings), if any, pertaining to previous months’ actual operations and any new level of deferred accounting adjustment may only be implemented upon prior application to and approval by the ERC. On the other hand, the Automatic Cost Adjustment Mechanism is a month-to-month adjustment implemented automatically by PSALM/NPC subject to review, evaluation, confirmation and approval by the ERC.

For power offtake agreements entered into by SMEC directly with new offtakers on a bilateral basis (or with those offtakers under previously assigned offtake agreements which have expired), pricing is based on a reasonable return over the cost structure of SMEC and benchmarked to NPC’s basic rates. The components for pricing comprise a Basic Energy Rate, also on a time-of-use basis, and a monthly Basic Energy Rate Adjustment charge similar to NPC’s Automatic Cost Adjustment Mechanism charge. The components for the Basic Energy Rate Adjustment include adjustments for fuel, foreign exchange and inflation costs. Any changes

to the level of the Basic Energy Rate and/or the Basic Energy Rate Adjustment are not affected by movements in NPC's charges.

Fuel Supply

The following table sets forth certain information about the supply of coal to the Sual Power Plant as of the date indicated.

<u>Quantity of Coal Purchased</u>	<u>As of December 31, 2010</u>
Metric Tons (thousands)	2,266
Average calorific value (kcal/kg)	6,133.59
₱ (in millions)	11,611.00
Average Price per Metric Ton (₱)	5,123.27

SMEC has entered into a coal supply agreement with PT Bumi Resources tbk, through Top Coal Trading Corporation, for the supply and delivery of coal to SMEC, which SMEC in turn supplies to the Sual Power Plant. The agreement is effective until December 2014, subject to renewal for a further five years as may be mutually agreed between the parties.

Under the coal supply agreement, Bumi Resources was required to supply a total of 33 shipments, each comprising 65,000 metric tons during 2010. However, for the years 2011 to 2014, the amount of coal to be supplied by Bumi Resources will depend on SMEC's election in accordance with the provisions of the coal supply agreement.

Pricing under the coal supply agreement is subject to adjustment based on certain standards applicable to the quality or grade of the coal delivered by Bumi Resources. For the years 2011 to 2014, Bumi Resources and SMEC are required to negotiate on an annual basis and mutually agree upon the price for the coal supplied by Bumi Resources for the following year, failing which, the price to be used will be equivalent to the Global Coal Newcastle Monthly Index of the month prior to the date of the shipment multiplied by 1.04 until such time as the coal price for the relevant contract year is settled between the parties.

Operations and Maintenance

Under the Sual ECA, TeaM Energy is required, at its own cost, to be responsible for the management, operation, maintenance, including the supply of consumables and spare parts, and the repair of the Sual Power Plant until the date of transfer to NPC (or to SMEC, as the case may be). TeaM Energy is required to use its best endeavors to ensure that during such period the Sual Power Plant is in good operating condition and capable of converting fuel supplied by SMEC under the Sual IPPA Agreement into electricity in a safe and reliable manner.

Ilijan

The Ilijan Power Plant commenced commercial operations on June 5, 2002, and is located on a 60-acre site at Arenas Point, Barangay Ilijan, Batangas City. The Ilijan Power Plant was constructed and is owned by KEPCO Ilijan Corporation ("KILCO") pursuant to a 20-year ECA with NPC under a BOT scheme that expires on June 4, 2022. NPC supplies natural gas to the Ilijan Power Plant from the Malampaya field in Palawan. The Ilijan Power Plant consists of two blocks with a rated capacity of 600 MW each. The power plant can also run on diesel oil stored on site.

On April 16, 2010, SMC successfully bid for the appointment to be the IPPA for the Ilijan Power Plant and received a notice of award on May 5, 2010. On June 10, 2010, SMC and SPPC, a wholly-owned subsidiary of SMC GP, entered into an assignment agreement with assumption of obligations whereby SMC assigned all of its rights and obligations with respect to the Ilijan Power Plant to SPPC, which assumed administration of the Ilijan Power Plant on June 26, 2010 in accordance with an IPPA Agreement with PSALM ("Ilijan IPPA Agreement").

Ilijan IPPA

PSALM, NPC and SPPC entered into the Ilijan IPPA Agreement, pursuant to which SPPC has the right to manage, control, trade, sell or otherwise deal in the electrical generation capacity of the Ilijan Power Plant. SPPC must pay fixed monthly payments comprising both a U.S. dollar and Peso component. In addition, SPPC must pay monthly generation payments comprising a “must pay” amount for electricity sold up to a given volume (the “Must Pay Volume”) and a variable amount for electricity sold in excess of the Must Pay Volume. The “must pay” amount in a given month is the sum of:

- 80% of the statutory rate SPPC charges Meralco for supplying electrical power under the offtake agreement between SRPC and Meralco for the given month multiplied by a factor equal to the volume sold (the “T1 Volume”), where the T1 Volume cannot exceed the Must Pay Volume; and
- 80% of the price for the electrical power sold to WESM during the month, multiplied by a factor equal to the Must Pay Volume less the T1 Volume, where such factor may not be less than zero.

The variable amount of the monthly generation payment is payable for electricity sold in excess of the Must Pay Volume for that month and is calculated as a base rate plus an index based on the cost of natural gas, the U.S. dollar/Peso exchange rate and the efficiency of the Ilijan Power Plant.

The Ilijan IPPA Agreement also requires SPPC to maintain a performance bond in favor of PSALM equivalent to US\$60 million, and perform the obligations of NPC in its PSCs, including the obligation to procure electricity at its own cost to meet deficiencies, in cases where the Ilijan Power Plant is unable to supply the contracted power.

Under the Ilijan IPPA Agreement, SPPC has the right to acquire the Ilijan Power Plant in June 2022, which is the end of the cooperation period between NPC and KILCO under the Ilijan ECA, or on some earlier date due to certain events such as changes in law or non-performance by KILCO under the Ilijan ECA.

During the period from June 26 to December 31, 2010, SMCGP made ₱1,314.3 million and US\$27.5 million payments to PSALM under the Ilijan IPPA Agreement.

Power Offtakers

The Ilijan Power Plant PSCs generally require its offtakers to take or pay for, within a contract year, a mutually agreed MEQ, and such offtakers are permitted to exceed 20% of their MEQ. Any power taken in excess of 20% of the MEQ is subject to a premium on the base tariff rate imposed by SPPC.

For PSCs assigned by NPC to SPPC in respect of the Ilijan Power Plant, the pricing structure is similar to that provided under the PSCs assigned by NPC to SPPC in respect of the Sual Power Plant. Likewise, pricing for PSCs entered into by SPPC with new offtakers on a bilateral basis for the Ilijan Power Plant (or with those offtakers under previously assigned PSCs which have expired), is based on the Basic Energy Rate and the Basic Energy Rate Adjustment structure discussed above in “— Sual — Power Offtakers”.

Fuel Supply

NPC is responsible for securing the natural gas and diesel fuel supply to the Ilijan Power Plant. Under a fuel supply and management agreement with Shell Exploration B.V. and Occidental Philippines, Inc., NPC supplies natural gas to the Ilijan Power Plant through a 480 km undersea pipeline from the Camago-Malampaya field in Palawan to the Shell refinery in Tabangao. From there, the natural gas is transported through a 16-inch-diameter onshore pipeline running 15 km to the power plant.

Operations and Maintenance

KILCO currently owns and is responsible for the operations and maintenance of the Ilijan Power Plant for 20 years effective from June 5, 2002. KILCO is majority owned by Korea Electric Power Corporation, with its partners, Mitsubishi Corporation and Team Energy. KILCO is a stock corporation incorporated in the Philippines, in accordance with the Corporation Code and the Foreign Investment Act of 1991 (the “FIA”).

Under the Ilijan ECA, KILCO shall operate the Ilijan Power Plant in accordance with the operating criteria and guidelines provided therein, including output of 1,200 MW guaranteed net contracted capacity, base load operation, spinning reserve capability, a minimum stable load of not more than 30% of the unit rated generating capacity, and a ramp rate of not less than 5% of the rate unit generator capacity per minute.

San Roque

The 345 MW San Roque multi-purpose hydroelectric power plant in San Manuel, Pangasinan commenced operations on May 1, 2003 and is a peaking plant that was constructed by a consortium composed of Marubeni Corporation, Sithe Philippines Holdings, Ltd., and Italian-Thai Development Public Company Limited, pursuant to a PPA with NPC under a BOT scheme (the “San Roque PPA”).

The San Roque Power Plant utilizes the Agno River for power generation and irrigation and contributes to flood control and water quality improvement for the surrounding region, and comprises three power generation units of 115 MW each. The San Roque Power Plant provides an annual power generation of 1,065 GWh from the 345 MW hydroelectric power plant, the irrigation of approximately 34,450 hectares of agricultural land, storage of water that would otherwise flood the Pangasinan plains, and improvement of water quality of the Agno River which, otherwise, would pollute the downstream rivers.

On December 15, 2009, SPDC, a wholly-owned subsidiary of SMCGP, successfully bid for the appointment to be the IPPA for the San Roque Power Plant and received a notice of award on December 28, 2009. SPDC assumed administration of the San Roque Power Plant on January 26, 2010 in accordance with an IPPA Agreement with PSALM (the “San Roque IPPA Agreement”). PSALM remains responsible under a PPA with the San Roque Power Plant’s IPP to remunerate the IPP for the electricity it produces.

San Roque IPPA

PSALM, NPC and SMCGP (through SPDC) entered into the San Roque IPPA Agreement pursuant to which SMCGP has the right to manage, control, trade, sell or otherwise deal in the electrical generation capacity of the San Roque Power Plant, while NPC, which owns and operates the dam and related facilities thereof, may be requested to obtain and maintain water rights necessary for the testing and operation of the power plant. SPDC is required to assist PSALM so that the San Roque Power Plant can draw water from the Agno River required by the power plant and necessary for it to generate the electricity required to be produced under the San Roque PPA with San Roque Power Corporation (“SRPC”). In addition, SPDC must pay fixed monthly payments comprising both a U.S. dollar and Peso component. These fixed monthly payments are reduced when there is a Non Delivering Day for reasons not attributable to SPDC. In addition, SPDC has a Must Pay Volume of ₱1.30 per kWh.

The San Roque IPPA Agreement also requires SPDC to maintain a performance bond in favor of PSALM equivalent to US\$20.0 million and perform the obligations of NPC in its PSCs, including the obligation to procure electricity at its own cost to meet deficiencies, in cases where the San Roque Power Plant is unable to supply the contracted power.

Under the San Roque IPPA Agreement, SPDC has the right to acquire the San Roque Power Plant in May 2028, which is the end of the cooperation period between NPC and SRPC under the San Roque PPA, or on some earlier date due to certain events such as changes in law or non-performance by SRPC under the San Roque PPA.

During the period from January 26 to December 31, 2010, SMCGP made payments to PSALM under the San Roque IPPA Agreement of ₱1,094.4 million and US\$22.8 million.

Power Offtakers

Since the San Roque Power Plant is a peaking plant, all of its output is traded on the WESM and SPDC has no PSC with any party. Under the terms of the San Roque PPA, power is delivered to SMCGP at the delivery point (the high voltage side of the step-up transformers) located at the perimeter fence of the

San Roque Power Plant site. SMCGP is responsible for contracting with the National Grid Corporation of the Philippines (“NGCP”) to wheel power from the delivery point.

Water Rights

The generated output energy of the San Roque Power Plant is limited by the Irrigation Diversion Requirements set by the National Irrigation Administration. Water allocation is usually dictated by rule curve that is derived from historical data of river flows and water demands. A rule curve shows the minimum water level requirement in the reservoir at a specific time to meet the particular needs for which the reservoir is designed. The rule curve must generally be followed except during periods of extreme drought and when public interest requires. In general, the rule curve dictates the following:

- *Water Level Above The Upper Rule Curve* — All demands for water supply and irrigation are met and electricity can be generated at the full capacity of the turbine units. Excess inflow is discharged through the spillway. Water released through the spillway is controlled and regulated by the NPC Dam Office personnel.
- *Between Upper And Lower Rule Curves* — All demands for water supply and irrigation are satisfied. Generation of electricity is limited to the released water for water supply and irrigation. Further water releases for power generation are allowed provided that the auxiliary units are utilized first before main units.
- *Water Level Below Lower Rule Curve* — The remaining water in the reservoir is reserved for water supply and irrigation. Generation of electricity is limited to these water releases. No further water release for power generation is allowed.

In 2010, the water level in the San Roque Power Plant dam has consistently been below the rule curve. However, the National Irrigation Administration has permitted the San Roque Power Plant to continue operations during this time due to downstream irrigation requirements, as well as the need to enable the San Roque Power Plant to produce the minimum power generation required under the San Roque PPA.

Generally, the output energy of San Roque Power Plant is high during planting seasons, which covers the months of December through April (dry planting season) and July through September (wet planting season). The water releases from the dam, and thus, power generation, during the dry planting season is much higher due to the absence of rain. The water rights of NPC are used by the San Roque Power Plant and NPC, until the date of transfer of the San Roque Power Plant to NPC (or SPDC, as the case may be), must obtain such renewals or extensions as may be required to maintain the water rights in full force and effect at all times. NPC derives its water rights from a permit granted by the National Water Resources Board.

Operations and Maintenance

SRPC is responsible for the operations and maintenance of the San Roque Power Plant for 25 years effective May 1, 2003. SRPC is owned by Marubeni and Kansai-Electric and is a stock corporation incorporated in the Philippines, in accordance with the Corporation Code and the FIA.

Under the San Roque PPA, SRPC is responsible for the management, operation, maintenance and repair of the San Roque Power Plant at its own cost until transfer to NPC (or SPDC, as the case may be). As operator, SRPC is entitled to conduct the normal inspection, regular maintenance, repair and overhaul for a period of 15 days for each unit comprising the San Roque Power Plant. In addition, SRPC has the right to enter into contracts for the supply of materials and services, including contracts with NPC; appoint and remove consultants and professional advisers; purchase replacement equipment; appoint, organize and direct staff; manage and supervise the power plant; establish and maintain regular inspection, maintenance and overhaul procedures; and otherwise run the power plant within the operating parameters set out in the San Roque PPA. The operating fee is the product of the contracted capacity for the contract year in kW, which is nominated annually, multiplied by ₱250 per kW per month. This fee is in addition to the capital recovery fee and covers the fixed operating and maintenance costs of the power structures and equipment.

Limay

The Limay Power Plant is an oil-fired combined cycle power plant located in Bataan, which is approximately 145 kilometers west of Manila that commenced operations in April 1993. It is a 620 MW combined cycle power plant that was constructed by a consortium consisting of ABB Power, Kawasaki Heavy Industries and Marubeni Corporation under a BOT scheme. On August 26, 2009, SMEC submitted the winning bid to PSALM for the privatization of the Limay Power Plant and in November 2009, SMEC assigned its rights to the Limay Power Plant to Panasia, another wholly-owned subsidiary of SMCGP. The power plant was turned over by PSALM on January 18, 2010 and Panasia assumed operations on February 17, 2010. The land on which the power plant is situated site covers 0.2 sq. km and is owned by Pacific Central Properties, Inc., a wholly-owned subsidiary of SMC.

Power Offtaker

The Limay Power Plant is a peaking plant hence all its output is traded on the WESM and Panasia has no PSC with any party for power generated by the Limay Power Plant.

Fuel Supply

The following table sets forth certain information about the supply of oil to the Limay Power Plant as of the date indicated.

<u>Quantity of Oil Purchased</u>	<u>December 31, 2010</u>
Kiloliters	313,144.21
₱ (millions)	8,045.39
Average Price per Kiloliter (₱)	25,692.29

The Limay Power Plant uses a mixture of intermediate fuel oil and distillate fuel oil, both of which are supplied by Petron on a purchase order basis through a 1.5 km pipeline.

Operations and Maintenance

Panasia entered into an Operation and Maintenance Service Contract with Alstom Philippines, Inc., which is responsible for the operations and maintenance of the Limay Power Plant. The agreement provides that Alstom Philippines Inc. shall undertake the full operation and maintenance of the Limay Power Plant, except for major overhauls, and consideration thereof is entitled to compensation based on a fixed fee denominated in Pesos and Euros. The term of the agreement with Alstom Philippines Inc. was from February 18, 2010 until February 16, 2011, and has been extended until August 16, 2011.

Meralco

SMC holds 370,022,727 common shares of Meralco, representing an approximately 33.2% interest in the issued and outstanding common shares of Meralco. Meralco is the Philippines' largest distributor of electrical power and is the only distributor of electric power for Metro Manila. Meralco holds the power distribution franchise for a 9,337 square kilometer area covering 31 cities and 80 municipalities in the Philippines. Meralco's common shares are listed on the PSE.

SMC's interest in Meralco is accounted for using the equity method and is classified as part of investments and advances on SMC's consolidated balance sheet, as described elsewhere in this Offering Circular in the amount of ₱45,309 million. The value of the Meralco investment based on the closing market price for Meralco common stock as of December 31, 2010 was approximately ₱84,365 million.

Related Coal Investments

SMCGP, through Daguma, Bonanza and SEPC, has invested in certain coal mining assets in the Philippines. Such assets are in a preliminary stage of exploration and no results as to their actual viabilities are

available as of the date of this Offering Circular. SMCGP's mines are not expected to provide fuel for any of SMCGP's power plants since the Sual Power Plant runs on high-performance coal, and high-performance coal is not found naturally in the Philippines. SMCGP aims to utilize its resource companies as a hedge for its power generation operations and, if possible, to supply raw materials for its future power plants.

Daguma, Bonanza and SEPC coal reserves will be developed with all due consideration to environmental and social laws, and with the pursuit of industry best practices.

Competition

SMCGP is one of the largest electricity suppliers in the country, with a 21.7% market share of the power supply of the national grid, and a 29.2% market share of the Luzon grid as of mid-2010. Its main competitors are the Lopez Group, which ranks second with a market share of 20.8% of the national grid and 28% of the Luzon grid; and the Aboitiz Group, coming in third with a market share of 17.8% of the national grid and 23.9% of the Luzon grid. The Lopez Group holds significant interests in First Gen Corporation and Energy Development Corporation, while the Aboitiz Group holds interests in Aboitiz Power Corporation, which has interests in several power generation companies.

With the Philippine government committed to privatizing the majority of PSALM-owned power generation facilities and the establishment of WESM, SMCGP's generation facilities will face competition from other power generation plants that supply the grid during the privatization phase. Multi-nationals that currently operate in the Philippines and could potentially compete against SMCGP in the privatization process include Korea Electric Power Corporation, Marubeni, TEPCO, AES and Sumitomo. Several of these competitors have greater financial resources, and have more extensive operational experience and other capabilities than SMCGP, giving them the ability to respond to operational, technological, financial and other challenges more quickly than SMCGP. SMCGP will face competition in both the development of new power generation facilities and the acquisition of existing power plants, as well as competition for financing for these activities. The performance of the Philippine economy and the potential for a shortfall in the Philippines' power supply have attracted many potential competitors, including multinational development groups and equipment suppliers, to explore opportunities in the development of electric power generation projects within the Philippines. Accordingly, competition for and from new power projects may increase in line with the long-term economic growth in the Philippines.

Insurance

Pursuant to SMCGP's IPPA arrangements, the IPPs associated with the IPPA power plants are responsible for maintaining insurance for all of the facilities, equipment and infrastructure for SMCGP's power plants, with the exception of the dam and spillway of the San Roque Power Plant, for which NPC retains responsibility for insuring. For the Limay Power Plant, it is SMCGP's policy to obtain insurance coverage for its operating assets and employees that is in line with industry standards and good business practices.

The Limay Power Plant, as well as the operations thereof, is covered by an insurance policy issued by Prudential Guarantee and Assurance, Inc., which is fully reinsured with reputable reinsurers with a rating of A- (or higher) according to S&P. The insurance for the Limay Power Plant covers property damage and machinery breakdown for an amount up to ₱26.4 billion and business interruption for an amount up to ₱3.2 billion.

INFRASTRUCTURE BUSINESS

SMC has made investments in the Philippines' infrastructure industry through its wholly-owned subsidiary, San Miguel Holdings Corp. ("SMHC"), consisting of investments in concessions for toll roads, an airport and a light rail system, certain details of which are set forth in the table below:

	<u>% SMC Ownership Interest</u>	<u>Expected Project Cost⁽³⁾</u> (In millions)		<u>Concession Length</u>
Concession				
TPLEX	35% ⁽¹⁾	₱21,600	US\$480.0	35 years
Caticlan Airport	93% ⁽²⁾	₱ 2,500	US\$ 55.6	25 years
MRT-7 Rail and Road Project	51%	₱69,300	US\$1,540	25 years

⁽¹⁾ SMC has an option to increase its shareholding to 51%.

⁽²⁾ SMC is expected to be diluted to 88.5% on April 30, 2011 pursuant to the share purchase agreement.

⁽³⁾ At an exchange rate of ₱45.00 : US\$1.00.

Philippine Infrastructure Industry

The Philippine government has advocated improving infrastructure in the country in recent years. The Philippine government set a total infrastructure investment target of 4.5% of total GDP for years 2006 to 2010, of which almost half was earmarked for transportation and 28% was to be sourced from the private sector. In the Philippine government's 2011 budget, public works received one of the highest budget allocations at ₱100.8 billion, of which approximately 19% or ₱19.6 billion was allocated to the construction of roads and bridges.

More recently, the Philippine government has accelerated investing in infrastructure under its Comprehensive and Integrated Infrastructure Program. Within the Comprehensive and Integrated Infrastructure Program, the Philippine government established a program called the Public-Private Partnership ("PPP"), in which they will partner with the private sector through contractual agreements in order to deliver public infrastructure and public services. The program involves the participation and support of government financial institutions, government owned and controlled corporations, local government units and the private sector.

Multiple options are available for the private sector to participate in these PPP programs, such as BOT, Build-Own-Operate, and Build-Lease-Transfer. Most infrastructure sectors, such as toll roads, airports, ports, and railways, are covered by the PPP.

Various forms of support are to be provided by the Philippine government to promote PPP. For example, a PPP center was established to help facilitate implantation of the PPP, monitor and evaluate development and implementation and integrate the project into government planning and budgeting. The private sector is also entitled to fiscal incentives under the Omnibus Investment Code, subject to eligibility criteria and additional tax incentives, exemptions or reliefs that local government units may provide.

Competitive Strengths

- *Synergies with SMC's established businesses.* SMC may be able to use its existing businesses for business opportunities along the routes of the development sites operated by infrastructure businesses. Examples include possible SMC-related billboards or other advertisements, as well as the building of service stations, retail outlets, rest stops and kiosks along toll roads.
- *Brand strength and size.* SMC is among the largest and most widely recognized companies in the Philippines with a continuing commitment in the involvement for the development of the country.
- *Ability to finance acquisitions.* Infrastructure projects require long term financing. SMC has an advantage in financing its PPP projects due to its long operating history as a publicly listed company

and the trust built up with investors, its size and balance sheet strength and its recognition in the international capital markets.

Business Strategies

- *Focusing on the improvement of infrastructure projects in the Philippines.* SMC believes there are significant opportunities in building and participating in infrastructure projects in a growing economy that has historically under-invested in infrastructure. SMC believes its long term operating licenses will provide it with strong and stable income streams.
- *Potential to extract synergies across businesses.* Areas and projects being developed by SMC's infrastructure business present opportunities for SMC's other businesses. For example, the TPLEX, Caticlan Airport and MRT-7 rail and road projects are expected to complement and present opportunities for SMC's fuel and oil, power, and telecommunications businesses, as well as improve the distribution network for SMC's food and beverages business.

Operations

TPLEX

The Philippine government, through the National Economic Development Authority, which administers the National Economic Plan, has proposed and is implementing a 20-year plan to significantly expand the expressway/tollway system from and around Metro Manila. A significant part of that plan is the construction of an 88.58 km two-lane toll expressway from Tarlac, through Pangasinan to La Union, north of Manila. TPLEX is expected to be integrated with other major expressways (including the North Luzon Expressway and Subic-Clark-Tarlac Expressway) to expand the road/expressway network in Luzon by 325 kilometers. Construction commenced on the expressway in October 2010. The initial Tarlac to Carmen section (48.7 kilometers) is projected to be completed by August 2012, with revenue collection projected to commence immediately thereafter, while the remainder of the expressway is projected to be completed by August 2014.

In August 2009, SMC made its first infrastructure investment by acquiring a 35% equity interest in PIDC. PIDC holds the 30-year build-transfer-operate concession for TPLEX. PIDC is a joint venture among D.M. Consunji, Inc. (33.3%), D.M. Wenceslao & Associates, Inc (11.7%) and eight other contractor shareholders. D.M. Consunji, Inc. has constructed large projects in the Philippines for over 50 years, including hotels, malls, convention centers, the Skyway Stage II and the LRT 1 Metro Rail Transit North Extension. SMC has an option to increase its interest in PIDC to 51% in the event the other shareholders do not subscribe to additional capital calls by PIDC up to ₱4.5 billion, and as a matter of right upon the increase of paid-up capital of PIDC to ₱6.5 billion.

The project cost for the development of TPLEX is estimated at ₱21.6 billion, which will be funded by a combination of debt (45.8%), equity (40.8%) and Philippine government subsidy (13.4%) which is available at the start of construction of Stage 3 of TPLEX, which consists of the Urdaneta to Rosario section of the tollway. By way of support, the Philippine government will pay PIDC on a progress billing basis ₱2.9 billion as a subsidy for the completion of Stage 3 of the TPLEX project. SMC's current equity funding commitment (including equity interest acquisition cost) is ₱2.28 billion, with ₱806 million having already been provided. SMC's equity funding may increase to ₱3.32 billion upon the exercise of its option to increase its interest in PIDC to 51%.

Caticlan Airport

SMC, through SMHC, acquired a 93.0% equity interest in Caticlan International Airport Development Corp. (subsequently renamed Trans Aire Development Holdings Corp. ("TADHC")). TADHC holds a 25-year build-rehabilitate-operate-transfer concession granted by the Philippine government through the Department of Transportation and Communication ("DOTC"). to develop and operate Caticlan Airport. The remaining 7.0% equity interest is to be held by Akean Resorts Corporation, a non-affiliated entity.

Akean Resorts Corporation has agreed to transfer to TAHDC in April 2011 several parcels of land necessary for the project in exchange for preferred shares of TAHDC, which will increase its equity interest in TAHDC to 12.0%.

Caticlan airport is the principal gateway to Boracay Island, a popular resort for passengers traveling from Manila. Due to a short runway, the airport currently is able to accommodate only turbo propeller airplanes. The airport has experienced rapid growth in passenger volumes in the last decade. Currently, approximately 700,000 tourists pass through Caticlan airport each year.

The planned expansion of the airport is expected to be completed in a number of stages and involves:

- renovating the existing terminal;
- upgrading and extending the runway, which is currently 950 meters long and 30 meters wide, to 2,100 meters long and 60 meters wide to accommodate larger international and domestic aircraft. Land will need to be reclaimed for the extension of the runway;
- conducting extensive landscape remediation to lower hills at one end of the runway;
- replacing the current 550 square meter terminal with a new 9,180 square meter passenger and cargo terminal and constructing a maintenance building, a fire station and an aircraft hangar;
- improving road networks around Caticlan airport and its facilities,
- upgrading air traffic control systems; and
- enhancing security at the Caticlan airport through perimeter fencing.

The renovation of the existing terminal building is expected to be completed by the second quarter of 2011. The acquisition of rights-of-way for the project, as well as the preparation of the Master Development Plan, is on-going, and are expected to be completed by the second quarter of 2011. The detailed design and engineering process is expected to commence immediately thereafter, and is expected to be completed by the end of 2011. Runway extension and construction of the new terminal is expected to commence after the completion of the detailed design and engineering process.

The project is expected to cost ₱2.5 billion, with ₱750 million of equity funding and ₱1,756 million of debt funding. SMC's projected equity funding requirement for the project, excluding equity interest acquisition costs, is all of ₱750 million, as the minority stake is to be held in the form of preferred shares.

The concession agreement is valid for 25 years, ending in 2034, and contemplates an increase in passenger and aeronautical fees from the current fee of ₱20 per passenger to ₱500 per passenger in 2014. All fee increases are limited to a maximum equivalent to the terminal fees at Manila's Ninoy Aquino International Airport.

MRT-7 Rail and Road Project

On November 8, 2010, SMC acquired a 51% equity interest in Universal LRT, which holds the concession for MRT-7, a planned expansion of the metro rail system in Manila, home to over 10 million inhabitants. MRT-7 is one of several rail extension projects to the existing metro rail system which services Metro Manila. It is expected to take three and a half years from the fourth quarter of 2011 and includes a 22 km six-lane asphalt highway that will connect the North Luzon Expressway to the intermodal transport terminal in San Jose del Monte and a 22 km mostly elevated MRT with 14 stations that will start from San Jose del Monte and end at the integrated LRT-1 / MRT-3 / MRT-7 station at EDSA. Universal LRT has the right to operate and manage the system on behalf of the Philippine government for 25 years while gradually transferring ownership of the system to the Philippine government in proportion to payments of semi-annual capacity fees. Under the build-gradual transfer-operate-maintain-and-manage scheme, the Philippine government will pay US\$2.69 billion over 20 years through amortized payments based on a parametric formula. The project is estimated to cost US\$1.5 billion, which is to be funded 25% by equity and

75% by debt. SMC's projected equity funding requirement for the project is US\$191 million (excluding equity interest acquisition costs).

OTHER OPERATIONS AND INVESTMENTS

Top Frontier

On January 6, 2010 SMC acquired 49.0% of the outstanding common shares of Top Frontier. SMC paid a deposit for the future subscription for 100.0% of the preferred shares of Top Frontier on January 7, 2010, and these preferred shares were issued to SMC on October 22, 2010 after the Philippine SEC approved Top Frontier's application for an increase in its authorized capital stock.

At the time of the investment, the Selling Shareholder agreed with SMC to further SMC's strategic direction to diversify into power, infrastructure, telecommunications, mining and related industries. As agreed by both Selling Shareholder and SMC, the composition of the Board and management of SMC will not be changed following the investment. The investment by SMC in the Selling Shareholder was approved by the Board premised on the Selling Shareholder's undertaking to maintain policies of SMC and to pursue an orderly sale of Common Shares held by the Selling Shareholder in order to broaden SMC's shareholder base.

Copper and Gold Mining

SMC, through Coastal View Exploration Corporation, a wholly-owned subsidiary of SMHC, acquired on October 8, 2010 a 10.1% equity interest in Indophil Resources NL which holds a 37.5% beneficial ownership in Sagittarius Mines Inc. (with Xstrata Copper owning the remaining 62.5%). Sagittarius Mines Inc. holds a 40% controlling equity stake in a joint venture to explore, develop and operate the Tampakan mine in South Cotabato. According to the Annual Report of Indophil Resources NL dated December 31, 2010, the mine is estimated to have 2.4 billion metric tons of mineral resources when measured at a 0.3% copper cut-off grade, of 0.3% copper and 0.2 grams per ton gold. If proven, the mine would be one of the world's largest underdeveloped copper-gold deposits, potentially the Philippines' largest mine and the world's fifth largest copper mine by 2016.

Sagittarius Mines Inc. submitted a Mine Project Feasibility Study to the Philippine government on April 8, 2010, which is currently being reviewed.

Telecommunications

SMC has made investments in the Philippine telecommunications industry through acquisitions of stakes in Liberty, BellTel and ETPI.

Liberty

SMC, through Vega, a wholly-owned subsidiary of SMC, owns 41.5% of Liberty in partnership with Qatar Telecom (32.7%) and White Dawn Solutions Holdings, Inc. (18.4%), with the remaining shares owned by the public. Liberty is a telecommunications carrier offering services including nationwide telephone service, data communications, inter-exchange carrier services and international voice and data connectivity services. Liberty's operating licenses are valid until 2014. Liberty launched "wi-tribe", a 4G wireless broadband services in the Philippines in February 2010 and had 46,000 subscribers as of December 2010. Liberty is listed on the PSE with a market capitalization of approximately ₱5.46 billion as of April 1, 2011.

BellTel

SMC, through Vega, acquired a 100% equity interest in BellTel by acquiring 100% of its parent companies, namely, Two Cassandra-CCI Conglomerates, Inc., Perchpoint Holdings Corp. and Power Smart Capital Limited. BellTel is a full-service telecommunications company which is licensed to provide voice, data and video-telecommunications solutions throughout the Philippines. BellTel's telecommunication license authorizes it to provide data services throughout the Philippine archipelago and telephony to all central business districts and special economic zones. BellTel was one of the first companies to deploy

point-to-multipoint fixed wireless access technologies delivering multiple product offerings. BellTel has also entered into strategic alliances with operators of underutilized telecommunications infrastructures, such as hybrid fiber-coaxial and fiber optic networks, giving it several cost-effective last mile options for rapid service deployment. In addition, BellTel holds licenses in the 1.8, 3.5 and 2.6 Ghz spectra, which enable it to provide a wide array of wireless broadband products and services. BellTel had revenues of ₱100.65 million in 2010.

BellTel is a grantee of a franchise to install, operate and maintain local exchange networks and wireless local loop (WLL) in several areas including special economic zones, inter-exchange networks, nationwide VSAT network, international gateway facilities and cellular mobile telecommunications network.

ETPI

SMC, through Vega, indirectly owns a 40.0% equity interest in ETPI through its 100% ownership of AGN. ETPI is a provider of voice, data and internet services, which has historically focused on the corporate market. ETPI had revenues of ₱1.0 billion in 2010.

Philippine Telecommunications Industry

The Philippine wireless market has experienced rapid growth over the past ten years, with the number of wireless subscribers increasing from 1.7 million in 1998 to approximately 75.5 million in 2009, according to the Yankee Group. This represents an overall penetration of approximately 83% in 2009. Wireless subscriber growth in the Philippines has been influenced by the unique topography of the Philippines (over 7,000 islands), which favours the provision of voice communication through wireless rather than fixed line communication systems. Wireless communication has also been dominated by prepaid service because it allows customers who cannot meet the credit standards for post-paid service to obtain wireless service. More than 98% of total subscribers have a prepaid connection and this mix is expected to be stable for the foreseeable future based on the accessibility of electronic loading and a strong distribution network. Wireless data services, primarily SMS or text messaging, have further contributed to the popularity of wireless communication in the Philippines. In addition, SMS usage in the Philippines is significantly higher than in most other countries according to a study conducted by Acision from 2008 to 2009.

Within the telecommunications market, the Philippine Long Distance Telecommunications Company (“PLDT”) and Globe Telecom Inc. are major competitors holding an approximate combined market share of 99%. Prior to the recent acquisition of Digital (SunCellular) by PLDT, PLDT controlled approximately 14% of the market in subscribers. In addition to these two companies, there are also other niche players such as Digitel (which launched its wireless service under the brand name Sun Cellular), Bell Telecom, Inc. and Bayantel.

The Philippine internet and broadband markets are expected to develop rapidly over the next few years. According to BMI, it is estimated that the number of internet users in the Philippines will increase from about 22 million in 2010 to about 42 million in 2014, and an increasing percentage of these are expected to be broadband users as product recognition and affordability improves.

Property Development

Established in 1990 initially as the corporate real estate arm of SMC, SMPI is, today, an established developer of residential and commercial real estate in the Philippines. SMPI is a listed company on the PSE which is 99.68% owned by SMC and is primarily engaged in the development, sale and lease of real property. SMPI is also engaged in leasing and managing SMC’s real estate assets. SMPI’s development track record includes economic to middle-income housing (Buenavista Homes in Cebu and The Legacy in Paranaque City), high end residential (San Miguel Village) and landmark commercial buildings (San Miguel’s corporate headquarters and the Ortigas Center). SMPI had net tangible assets of ₱8.7 billion as of December 31, 2010.

Banking

On January 13, 2011, SMPI agreed to acquire a 7.2% equity interest in BOC. Upon completion of the acquisition, SMPI is expected to hold a 39.9% equity interest in BOC. BOC is a commercial bank which offers deposit and treasury products, foreign exchange, trust products and services, business and consumer loans, cash management and channel services to individuals and businesses through its network of 119 branches and 175 automated teller machines in the Philippines. BOC supports the banking requirements of SMC, its employees, business partners, suppliers and dealers and also has a tie-up with SMPI to provide home loans for potential customers. As of December 31, 2010, BOC had ₱106.48 billion in total assets and total loans of ₱35.87 billion.

EMPLOYEES

As of December 31, 2010, SMC had 16,682 fulltime employees. Substantially all of SMC's employees are based in the Philippines, Australia and other areas in the Asia-Pacific region. As of December 31, 2010, the approximate number of SMC employees in each of SMC's businesses is set forth below:

	<u>No. of Employees</u>
Beverages	6,019
Food and Agribusiness	3,700
Power Generation	33
Packaging	3,318
Infrastructure	16
Fuel and Oil (Petron)	1,340
Other Operations and Investment	<u>2,256</u>
Total	<u><u>16,682</u></u>

As of December 31, 2010, approximately 24% of SMC's employees are parties to various collective bargaining agreements between SMC and a total of 39 labor unions representing employees of SMC's businesses. Since 1995, SMC has not experienced any strikes or work stoppages. SMC considers its relationship with its employees to be good.

SMC had adopted an Employee Stock Purchase Plan and a Long-Term Incentive Plan for Stock Options to provide incentives and rewards to eligible employees who contribute to the success of SMC. Under the Employee Stock Purchase Plan, 80,396,659 shares (inclusive of stock dividends declared) of SMC's unissued shares were reserved for employees of SMC until 2010. All permanent Philippine-based employees of SMC, who had been employed for a continuous period of one year prior to the subscription period, were allowed to subscribe to the shares covered by the Employee Stock Purchase Plan at a 15.0% discount to the market price equal to the weighted average of the daily closing prices for three months prior to the offer period. A participating employee could acquire at least 100 shares of stock through payroll deductions. An extension of the plan beyond 2010 has been submitted to the Board for its consideration.

SMC executives are granted options to subscribe for Common Shares reserved for issuance under the Long-Term Incentive Plan, which is administered by the Executive Compensation Committee of the Board. A total of 54,244,905 Common Shares are reserved for issuance under the plan at a price equivalent to the fair market value of the Common Shares as of the date of the grant, with adjustments depending on the average stock prices of the prior three months.

SMC and a majority of its subsidiaries have funded, noncontributory, defined-benefit retirement plans covering all of their permanent employees. Retirement costs charged by SMC to operations were ₱422 million and ₱65 million in 2008 and 2009, respectively. SMC had a retirement benefit of ₱371 million in 2010. Retirement costs charged by SMC's subsidiaries were ₱435 million, ₱529 million and ₱656 million in 2008, 2009 and 2010, respectively.

HEDGING TRANSACTIONS

SMC's outstanding derivative instruments such as commodity and currency options, forwards and swaps are intended mainly for risk management purposes. SMC uses derivatives to manage its exposures to foreign currency, interest rate and commodity price risks arising from SMC's operating and financing activities.

INSURANCE

SMC has several all-risk policies that cover its facilities and inventories against a variety of risks, including, among others, liability arising from fire, lightning, catastrophic perils (typhoon, flood, earthquake, volcanic eruption), explosion, civil commotion, riot/strike, malicious damage, other perils. Certain policies cover machinery breakdown, terrorism and sabotage, and business interruption for selected facilities.

In addition to the all-risk policy, SMC maintains various general liability and product liability insurance policies covering its Philippine and international operations. The products liability insurance policy insures against injuries to third parties for all of SMC's products that are exported.

SMC also has marine cargo insurance policies to cover domestic and international shipment of goods and equipment. All insurance policies are procured at the SMC level except for Petron and certain international companies. The SMC policies are secured with leading Philippine insurance companies that are generally re-insured with Class "A" international re-insurance companies.

LEGAL PROCEEDINGS

SMC and its subsidiaries are parties to a variety of legal proceedings arising out of the ordinary course of business, including legal proceedings with respect to labor, product liability and other matters. SMC and its subsidiaries are vigorously defending all litigation pending against them. While the results of litigation cannot be predicted with certainty, SMC believes that the final outcome of these proceedings will not have a material adverse effect on its financial condition and results of operations.

Legal Proceedings Involving SMC

In March 1986, SMC agreed to purchase Common Shares registered in the names of the CIIF companies (as defined in "Share Ownership") pursuant to a stock purchase agreement, with payment to be made in four installments. After the first installment was paid, the Philippine Presidential Commission on Good Government ("PCGG"), which is authorized to recover certain assets of the late Philippine President Ferdinand Marcos, sequestered all of the CIIF companies' Common Shares, including those that had been sold to SMC. For more information regarding the sequestration, see "Share Ownership". In 1990, SMC entered into a compromise agreement with the CIIF companies and United Coconut Planters Bank (the administrator of the CIIF), pursuant to which the sale of Common Shares covered by the first payment installment was recognized as valid as among those parties. As a result, in 1991, SMC converted 25.45 million Common Shares previously registered in the names of the CIIF companies into treasury shares. In September 2000, the Philippine Supreme Court upheld a resolution of the Philippine Anti-Graft Court (*Sandiganbayan*) that required SMC to deliver the 25.45 million treasury shares to the PCGG and pay PCGG the corresponding dividends. After consultation by SMC with its financial and legal advisors regarding this resolution of the Anti-Graft Court, SMC did not deliver the 25.45 million treasury shares to PCGG. SMC is currently involved in a number of legal proceedings in the Philippines contesting the 2000 resolution of the Anti-Graft Court. See note 26 to SMC's Financial Statements included elsewhere in this Offering Circular.

In April and May 2004, SMC was assessed by the Bureau of Internal Revenue of the Philippines ("BIR") for deficient excise tax payments in the amount of ₱907 million for one of its beer products for the period from November 1999 to January 2004. SMC contested the assessment before the Philippines Court of Tax Appeals in September 2004, and, as of the date of this Offering Circular, the case is currently pending. At this stage of the proceedings, it is not possible to predict the outcome or likely outcome of the dispute, or the final costs of resolving the dispute.

Legal Proceedings Involving Petron

Assessments Involving Tax Credit Certificates

In 1998, BIR issued a deficiency excise tax assessment against Petron. The assessment relates to Petron's use of ₱659 million worth of tax credit certificates to pay certain excise tax obligations from 1993 to 1997. The tax credit certificates were transferred to Petron by suppliers as payment for fuel purchases. The BIR is appealing the ruling of the Philippine Court of Tax Appeals that, as a fuel supplier to companies registered with the Board of Investments of the Philippines, Petron is a qualified transferee of the tax credit certificates. As of the date of this Offering Circular, the case is still pending. Petron also had other cases pending with the BIR relating to tax credit certificates, some of which are duplicative of the tax credit certificates in the pending case above, and which in the aggregate together with those in the pending case above, amount to ₱911 million, excluding any interest and penalties.

Pandacan Terminal Operations

In November 2001, the City of Manila enacted City Ordinance No. 8027 ("Ordinance 8027") reclassifying the areas occupied by the oil terminals of Petron, Shell and Chevron from industrial to commercial. This reclassification made the operation of oil terminals in Pandacan, Manila illegal. However, in June 2002, Petron, Shell and Chevron entered into a Memorandum of Understanding ("MOU") with the City of Manila and the DOE, agreeing to scale down operations to reduce the economic impact of Ordinance 8027. In December 2002, the Social Justice Society ("SJS") filed a petition with the Supreme Court of the Republic of the Philippines seeking enforcement of Ordinance 8027. In April 2003, Petron filed a petition with the Regional Trial Court ("RTC") to annul Ordinance 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, the Mayor of Manila ceased implementation of Ordinance 8027.

The City of Manila subsequently issued the Comprehensive Land Use Plan and Zoning Ordinance ("Ordinance 8119"), which granted Petron and other non-conforming establishments a seven-year grace period to vacate.

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 8027. On March 12, 2007, Petron, Shell and Chevron filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision.

In its February 13 resolution (the "February 13 Resolution"), the Supreme Court also declared Ordinance 8027 valid, dissolved all existing injunctions against the implementation of Ordinance 8027, and directed Petron, Shell and Chevron to submit their relocation plans to the RTC. Petron, Shell and Chevron have sought reconsideration of the February 13 Resolution. In compliance with the February 13 Resolution, Petron, Shell and Chevron have submitted their relocation plans to the RTC.

In May 2009, the Mayor of Manila approved Ordinance No. 8187 ("Ordinance 8187"), which repealed Ordinance 8119, and permitted the continued operations of the oil terminals in Pandacan.

In June 2009, petitions were filed with the Supreme Court seeking the nullification of Ordinance 8187 and enjoining its implementation. As of the date of this Offering Circular, these petitions remain pending.

Oil Spill Incident in Guimaras

On August 11, 2006, *M/T Solar I*, a third-party owned vessel contracted by Petron to transport approximately two million liters of industrial fuel oil, capsized 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 *M/T 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 DOTC, and is awaiting resolution. Petron believes that while the SBMI can impose administrative penalties on vessel owners and crew, it has no authority to penalize other parties, such as Petron, who are charterers.

Bataan Real Property Tax Cases

Petron has three pending real property tax cases with the Province of Bataan, arising from three real property tax assessments. The first case relates to an assessment by the Municipal Assessor of Limay, Bataan in 2006, for ₱86.4 million relating to Petron's isomerisation and gas oil hydrotreater facilities which benefit from, among others, a five-year real property tax exemption under the Downstream Oil Industry Deregulation Act of 1998 based on Board of Investments-issued Certificates of Registration for the facilities.

The second case relates an assessment made by the Municipal Assessor of Limay, Bataan in 2006, for ₱17 million relating to the leased foreshore area on which the pier of Petron's refinery is located. The Bataan Provincial Treasurer issued a Final Notice of Delinquent Real Property Tax in 2007 requiring Petron to pay ₱2,168 million in real property taxes on the alleged ground that Petron has been delinquent in paying such taxes since September 30, 2007.

The third case relates to a real property tax assessment by the Provincial Assessor. This assessment cited Petron's non-declaration or under-declaration of machineries and equipment in its refinery for real property tax purposes and its failure to pay the corresponding taxes for the 13-year period between 1994 and 2007.

While Petron has contested the assessments by filing appeals with the Local Board of Assessment Appeals ("LBAA"), the Bataan Provincial Treasurer, acting on the basis of the Final Notice of Delinquent Real Property Tax, issued in respect of the third case, announced a public auction of Petron's assets for October 17, 2007. Petron obtained an injunction from the RTC, stopping the public auction until the RTC made a final resolution with regard to the case on November 5, 2007.

The Bataan Provincial Treasurer successfully obtained from the LBAA an order dismissing the appeal filed by Petron before the LBAA in December 2007. On an appeal by Petron in August 2008, the Central Board of Assessment Appeals remanded the case to the LBAA for factual determination, effectively granting Petron's appeal and reversing the LBAA's dismissal of the case.

In August 2010, the LBAA dismissed Petron's appeals contesting the three assessments discussed above. Petron has appealed the dismissal of these cases contesting the three assessments.

REGULATION

Various laws and government agencies in the Philippines regulate different aspects of SMC's businesses.

SMC

Regulation of SMC as a Publicly Listed Company

Pursuant to the Securities Regulation Code, the Philippine SEC regulates the Philippine securities market, including securities exchanges, securities trading, securities brokers and dealers, and public companies. The Securities Regulation Code prescribes disclosure and governance requirements for public companies. Likewise, public companies whose securities are listed on the PSE must comply with the relevant disclosure, continuing listing and trading regulations imposed by the PSE.

As part of the continuing listing requirements imposed by the PSE, at least 10% of a listed company's issued and outstanding shares, exclusive of any treasury shares, must at all times be held by the public. A listed company that does not comply with the prescribed minimum public ownership may be subject to the imposition of additional annual listing maintenance fees, calculated based on the percentage shortfall in the public float and the period of non-compliance. If such non-compliance persists, the PSE may impose a trading suspension on the listed company's securities and delisting procedures may be initiated by the PSE against such listed company.

The minimum public float prescribed by the PSE is different from minimum public float requirements imposed under special laws for other regulated entities, such as entities engaged in power generation, telecommunications and banks. In such cases, the minimum public float prescribed under such laws will govern.

Foreign Investment Laws and Restrictions

Retail Trade Liberalization Act

Philippine Republic Act No. 8762, otherwise known as the Retail Trade Liberalization Act of 2000 ("R.A. 8762"), was enacted into law on March 7, 2000. R.A. 8762 liberalized the Philippine retail industry to encourage Filipino and foreign investors to forge an efficient and competitive retail trade sector in the interest of empowering the Filipino consumer through lower prices, high quality goods, better services, and wider choices. Prior to the passage of R.A. 8762, retail trade was limited to Filipino citizens or corporations that are 100% Filipino-owned.

"Retail Trade" is defined by R.A. 8762 to cover any act, occupation, or calling of habitually selling direct to the general public any merchandise, commodities, or goods for consumption. The law provides that foreign-owned partnerships, associations and corporations formed and organized under the laws of the Philippines may, upon registration with the Philippine SEC and the Philippine Department of Trade and Industry ("DTI") or in case of foreign-owned single proprietorships, with the DTI, engage or invest in the retail trade business, in accordance with the following categories:

- Category A — Enterprises with paid-up capital of the equivalent in Pesos of less than US\$2.5 million shall be reserved exclusively for Filipino citizens and corporations wholly-owned by Filipino citizens.
- Category B — Enterprises with a minimum paid-up capital of the equivalent in Pesos of US\$2.5 million may be wholly-owned by foreigners except for the first two years after the effectiveness of R.A. 8762 during which period foreign participation was limited to not more than 60% of total equity.
- Category C — Enterprises with a paid-up capital of the equivalent in Pesos of US\$7.5 million or more may be wholly-owned by foreigners, provided, that in no case shall the investments for establishing a store in Categories B and C be less than the equivalent in Pesos of US\$830,000; and
- Category D — Enterprises specializing in high-end or luxury products with a paid up capital of the equivalent in Pesos of US\$250,000 per store may be wholly-owned by foreigners.

No foreign retailer is allowed to engage in retail trade in the Philippines unless all the following qualifications are met:

- A minimum of US\$200 million net worth in its parent corporation for categories B and C, and US\$50 million net worth in its parent corporation for category D;
- Five retail branches or franchises in operation anywhere around the world unless such retailer has at least one store capitalized at a minimum of US\$25 million;
- Five-year track record in retail; and
- Only nationals from, or judicial entities formed or incorporated in, countries which allow the entry of Filipino retailers, shall be allowed to engage in retail trade in the Philippines.

The implementing rules of R.A. 8762 define a foreign retailer as an individual who is not a Filipino citizen, or a corporation, partnership, association, or entity that is not wholly-owned by Filipinos, engaged in retail trade. The DTI is authorized to pre-qualify all foreign retailers, subject to the provisions of R.A. 8762, before they are allowed to conduct business in the Philippines.

Foreign Investment Act of 1991

The FIA liberalized the entry of foreign investment into the Philippines. Under the FIA, in domestic market enterprises, foreigners can own as much as 100% equity except in areas specified in the Eighth Regular Foreign Investment Negative List (the “Negative List”). This Negative List enumerates industries and activities which have foreign ownership limitations under the FIA and other existing laws. Among SMC’s current businesses and activities, land ownership, telecommunications, banking, mining and the operation of public utilities are nationalised activities.

In connection with the ownership of private land, the Philippine constitution states that no private land shall be transferred or conveyed except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least 60% of whose capital is owned by such citizens. Likewise, under the Philippine constitution, only citizens of the Philippines or corporations or associations organized under the laws of the Philippines at least 60% of whose capital is owned by such citizens may be granted a franchise to operate a public utility, which includes telecommunications.

For the purpose of complying with nationality laws, the term Philippine National is defined under the FIA as any of the following:

- a citizen of the Philippines;
- a domestic partnership or association wholly-owned by citizens of the Philippines;
- a corporation organized under the laws of the Philippines of which at least 60% of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines;
- a corporation organized abroad and registered to do business in the Philippines under the Corporation Code, of which 100% of the capital stock outstanding and entitled to vote is wholly-owned by Filipinos; or
- a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine National and at least 60% of the fund will accrue to the benefit of Philippine Nationals.

For as long as the percentage of Filipino ownership of the capital stock of the corporation is at least 60% of the total shares outstanding and voting, the corporation shall be considered as a 100% Filipino-owned corporation. A corporation with more than 40% foreign equity may be allowed to lease land for a period of 25 years, renewable for another 25 years.

Local Government Code

The Philippine Republic Act No. 7160 (the “Local Government Code”) establishes the system and powers of provincial, city, municipal, and *barangay* governments in the country. The Local Government Code general welfare clause states that every local government unit shall exercise the powers expressly granted, those necessarily implied, as well as powers necessary, appropriate, or incidental for its efficient and effective governance, and those which are essential to the promotion of the general welfare.

Local government units exercise police power through their respective legislative bodies. Specifically, the local government unit, through its legislative body, has the authority to enact such ordinances as it may deem necessary and proper for sanitation and safety, the furtherance of the prosperity, and the promotion of the morality, peace, good order, comfort, convenience, and general welfare of the locality and its inhabitants. Ordinances can reclassify land, order the closure of business establishments, and require permits and licenses from businesses operating within the territorial jurisdiction of the local government unit.

SMC’S BEVERAGE BUSINESS

The FDDC Act

The Foods, Drugs and Devices, and Cosmetics Act, as amended by the Food and Drug Authority Act of 2009 (the “FDDC Act”), establishes standards and quality measures in relation to the manufacturing and branding of food products to ensure the safe supply thereof to and within the Philippines. The Food and Drug Administration (the “FDA”) is the governmental agency under the Department of Health (the “DOH”) tasked to implement and enforce the FDDC Act.

The FDDC Act prohibits, among others, (i) the manufacture, importation, exportation, sale, offering for sale, distribution or transfer, non-consumer use, promotion, advertisement or sponsorship of any food products which are adulterated or misbranded or which, although requiring registration pursuant to the FDDC Act, are not registered with the FDA; and (ii) the manufacture, importation, exportation, transfer or distribution of any food product by any person or entity without a license to operate from the FDA. Any person found in violation of any of the provisions of the FDDC Act shall be subject to administrative penalties or imprisonment or both. Furthermore, the FDA has the authority to seize such food products found in violation of the FDDC Act as well as ban, recall and withdraw any food product found to be grossly deceptive, unsafe, or injurious to the consuming public.

Pursuant to FDDC Act, food manufacturers are required to obtain a license to operate as such. Under existing regulations of the FDA, registration with the FDA of locally produced food products for local market distribution is optional, except where such food products are intended to be advertised to the public. For imported food and food products, however, registration is mandatory.

To ensure the safe supply of food products to and within the Philippines, the DOH has promulgated guidelines on current good manufacturing practices in manufacturing, packing, repacking or holding food. These guidelines, which are continually updated by the DOH to align with similar international standards, embody the minimum operating standards, procedures and requirements prescribed by the DOH in respect of the operations and facilities of those establishments engaged in the manufacture, packing, repacking or holding of food products.

The Consumer Act

The Consumer Act of the Philippines (the “Consumer Act”) seeks to: (i) protect consumers against hazards to health and safety; (ii) protect against deceptive, unfair and unconscionable sales acts and practices; (iii) provide information and education to facilitate sound choice and the proper exercise of rights by the consumer; (iv) provide adequate rights and means of redress; and (v) involve of consumer representatives in the formulation of social and economic policies.

The provisions of the Consumer Act are principally enforced by the DTI. However, with respect to food products, the DOH is the government agency responsible for the implementation of the said law.

The Consumer Act regulates such matters as (i) consumer product and safety; (ii) the production, sale, distribution and advertisement of food, drugs, cosmetics and devices as well as substances hazardous to the consumer's health and safety; (iii) fair, honest consumer transactions and consumer protection against deceptive, unfair and unconscionable sales acts or practices; (iv) practices relative to the use of weights and measures; (v) consumer product and service warranties; (vi) compulsory labeling, and fair packaging; (vii) liabilities for defective products and services; (viii) consumer protection against misleading advertisements and fraudulent sales promotion practices; and (ix) consumer credit transactions.

The Consumer Act establishes quality and safety standards with respect to the composition, contents, packaging, labeling and advertisement of products and prohibits the manufacture for sale, offer for sale, distribution, or importation of products which are not in conformity with applicable consumer product quality or safety standards promulgated thereunder. The Consumer Act also prohibits any false, deceptive or misleading advertisement for the purpose of inducing the purchase of consumer products. An advertisement is considered false, deceptive or misleading if it does not conform to the law or is misleading in a material respect. Specific advertising requirements are prescribed for food.

Any person found to be in violation of the provisions of the Consumer Act shall be subject to administrative penalties or imprisonment or both. As part of its authority under the Consumer Act, the DOH has the authority to order the recall, ban, or seizure from public sale or distribution of food products found to be injurious, unsafe or dangerous to the general public.

Excise taxes on alcoholic products, such as beer and liquor

The National Internal Revenue Code of 1997 (the "Tax Code") provides for excise taxes on alcohol products, including distilled spirits, wines and fermented liquor. In general, excise taxes on alcohol products accrue upon the production of such products, and must be paid before removal thereof from the production site. For imported brands or products, the excise tax is paid upon arrival in the Philippines at the port of entry.

Under the Tax Code, excise tax rates increased every two years from January 1, 2005 until January 1, 2011. The last scheduled increase took effect on January 1, 2011, and, as of the date of this Offering Circular, no other additional increases are scheduled under existing laws.

To enforce the provisions of the Tax Code on the collection and payment of excise taxes on alcohol products, establishments subject to such taxes are required to obtain a permit to sell such products from the BIR.

Excise Taxes on Distilled Spirits

Excise taxes on distilled spirits, such as whisky, brandy, rum, gin and vodka, are based on the alcohol content or proof liter (a proof liter is a liter of 100% proof alcohol), as follows:

Distilled Spirits	Per proof liter
1) If produced from the sap of nipa, coconut, cassava, camote or buri palm or from the juice, syrup or sugar of the cane;	₱14.68
2) If produced from raw materials other than those enumerated in the preceding paragraph, and the net retail price (excluding the excise and value-added taxes) per bottle of 750 ml. volume capacity is:	
a. Less than ₱250.00	₱158.73
b. ₱250.00 up to ₱675.00	₱317.44
c. More than ₱675.00	₱634.90

Excise Taxes on Fermented Liquor

Excise taxes on fermented liquor, such as beer, lager beer, ale and porter, are determined per liter of volume capacity in relation to the net retail price (excluding the excise tax and VAT thereon), as follows:

Fermented Liquors	Per proof liter
1) Fermented liquors, where the net retail price (excluding excise and value-added taxes) per liter of volume capacity is:	
a. Less than ₱14.50	₱10.41
b. ₱14.50 up to ₱22.00	₱15.49
c. More than ₱22.00	₱20.57
2) Fermented liquors brewed and sold at microbreweries or small establishments such as pubs and restaurants, regardless of the net retail price	₱20.57

SMC'S FOOD BUSINESS

As a producer of various food products, SMC's food business is subject to regulation by the FDA and the DOH under the FDDC Act and the Consumer Act. In addition, SMC's food business is subject to the laws discussed below.

The Livestock and Poultry Feeds Act

The Livestock and Poultry Feeds Act and its implementing rules and regulations (the "Livestock and Poultry Feeds Act"), regulates and controls the manufacture, importation, labeling, advertising and sale of livestock and poultry feeds. The Bureau of Animal Industry is the governmental office under the Department of Agriculture (the "DA") tasked to implement and enforce the Livestock and Poultry Feeds Act.

Under the Livestock and Poultry Feeds Act, any entity desiring to engage in the manufacture, importation, exportation, sale, trading or distribution of feeds or other feed products must first register with the Bureau of Animal Industry. There must be a separate registration for each type and location of feed establishment. Furthermore, the Livestock and Poultry Feeds Act provides that no feeds or feed products may be manufactured, imported, exported, traded, advertised, distributed, sold, or offered for sale, or held in possession for sale in the Philippines unless the same has been registered with the Bureau of Animal Industry. There must also be a separate registration for each type, kind, and form of feed or feed product. Feeds and feed products produced through toll manufacturing shall be registered with the company that owns the same. All commercial feeds must comply with the nutrient standards prescribed by the DA. Registration of feed and feed products and feed establishments is required to be renewed on a yearly basis.

The Livestock and Poultry Feeds Act also provides branding, labeling and advertising requirements for feeds and feed products and the establishment of in-house quality control laboratories by manufacturers and traders of feed and feed products. Any person found in violation of the provisions of the Livestock and Poultry Feeds Act shall be subject to administrative penalties or imprisonment or both.

The Meat Inspection Code

The Meat Inspection Code of the Philippines (the "Meat Inspection Code") establishes quality and safety standards for the slaughter of food animals and the processing, inspection, labeling, packaging, branding and importation of meat (including, but not limited to, pork, beef and chicken meat) and meat products. The National Meat Inspection Service ("NMIS"), a specialized regulatory service attached to the DA, serves as the national controlling authority on all matters pertaining to meat and meat product inspection and meat hygiene to ensure meat safety and quality from farm to table. It has the power to accredit meat establishments and

exporters, importers, brokers, traders and handlers of meat and meat products. On the other hand, the different local government units, in accordance with existing laws, policies, rules and regulations and quality and safety standards of the DA, have the authority to regulate the construction, management and operation of slaughterhouses, meat inspection, and meat transport and post-abattoir control within their respective jurisdictions, and to collect fees and charges.

The Meat Inspection Code covers all meat establishments (including, but not limited to, slaughterhouses, poultry dressing plants, meat processing plants and meat shops) where food animals are slaughtered, prepared, processed, handled, packed, stored, or sold. It requires the inspection of food animals before they are allowed for slaughter in licensed private slaughterhouses in which meat or meat products thereof are to be sold. A post-mortem examination is also required for carcasses and parts thereof of all food animals prepared as articles of commerce which are capable of use as human food. Only meat or meat products from meat establishments that have passed inspection and have been so marked may be sold or offered for sale to the public.

The Meat Inspection Code provides for labeling, branding and packaging requirements for meat and meat products to enable consumers to obtain accurate information and ensure product traceability. It also requires all meat establishments to (i) comply with the Animal Welfare Act of 1998 for the adequate protection of food animals awaiting slaughter and all pollution control and environmental laws and regulations relating to the disposal of carcasses and parts thereof; and (ii) adopt good manufacturing practices and sanitation standard operating procedures for the production, storage and distribution of its meat products. Any person found in violation of the provisions of the Meat Inspection Code shall be subject to administrative penalties or imprisonment or both. Furthermore, any carcasses, parts of carcasses or products of carcasses found to have been prepared, handled, packed, stored, transported or offered for sale as human food not in accordance with the provisions of the Meat Inspection Code, shall be confiscated and disposed of at the expense of the person found to be in violation thereof.

The Price Act

The Price Act covers basic necessities such as fresh pork, beef and poultry meat, milk, coffee and cooking oil, and prime commodities such as flour, dried, processed and canned pork, beef and poultry meat, other dairy products and swine and poultry feeds. The Price Act is primarily enforced and implemented by the DA and the DTI in relation to such products.

Under the Price Act, the prices of basic commodities may be automatically frozen or placed under price control in areas declared as disaster areas, under emergency or martial law or in a state of rebellion or war. Unless such price freeze is lifted by the President of the Philippines at an earlier time, prices shall remain frozen for a maximum of sixty days. The President of the Philippines may likewise impose a price ceiling on basic necessities and prime commodities in cases of calamities, emergencies, illegal price manipulation or when the prevailing prices have risen to unreasonable levels. The implementing government agencies of the Price Act are given the authority to issue suggested retail prices, whenever necessary, for certain basic necessities and/or prime commodities for the information and guidance of concerned trade, industry and consumer sectors. The Price Act prohibits and penalizes illegal price manipulation through cartels, hoarding or profiteering. Any person found in violation of the provisions of the Price Act shall be subject to administrative penalties or imprisonment or both.

The Philippine Food Fortification Act

The Philippine Food Fortification Act of 2000 (the “PFF Act”) provides for the mandatory fortification of wheat flour, cooking oil and other staple foods and the voluntary fortification of processed food products. The fortification of food products is required to be undertaken by the manufacturers, importers and processors thereof. The FDA is the government agency responsible for the implementation the PFF Act with the assistance of the different local government units tasked to monitor foods mandated to be fortified which are available in public markets, retail stores and food service establishments and to check if the labels of fortified products contain nutrition. Any person in violation of the PFF Act shall be subject to administrative penalties.

Furthermore, the FDA may refuse or cancel the registration or order the recall of food products in violation of the law.

SMC'S FUEL AND OIL BUSINESS

Downstream Oil Industry Deregulation Act

The Oil Deregulation Act, provides the regulatory framework for the Philippines' downstream oil industry.

Under the Oil Deregulation Act, any person may import or purchase any quantity of crude oil and petroleum products from foreign and domestic sources, lease or own and operate refineries and other downstream oil facilities, and market such crude oil and petroleum products either in a generic name or in its own trade name, or use the same for its own requirement after prior notice to the DOE. The same law declared the liberalization and deregulation of the downstream oil industry as a policy of the state in order to ensure a truly competitive market under a regime of fair prices, adequate and continuous supply of environmentally clean and high quality petroleum products.

To ensure the attainment of these objectives, the DOE, in consultation with relevant government agencies, promulgated the implementing rules and regulations of the Oil Deregulation Act in March 1998 through DOE Department Circular No. 98-03-004.

The DOE is the lead Philippine government agency overseeing the oil industry. With the enactment of the Oil Deregulation Act, however, the regulatory functions of the DOE were significantly reduced. Deregulating the downstream oil industry effectively removed the rate-setting function of the then Energy Regulatory Board, leaving price-setting to market forces. The DOE's current function is primarily to monitor prices and violations under the law, which includes prohibited acts such as cartelization and predatory pricing.

Other functions of the DOE under the Oil Deregulation Act include the following:

- monitoring and publishing the daily international crude oil prices, following the movements of domestic oil prices, monitoring the quality of petroleum and stopping the operation of businesses involved in the sale of petroleum products which do not comply with national standards of quality;
- monitoring the refining and manufacturing processes of local petroleum products to ensure clean and safe technologies are applied;
- maintaining a periodic schedule of present and future total industry inventory of petroleum products to determine the level of supply;
- immediately acting upon any report from any person of an unreasonable rise in prices of petroleum products; and
- in times of national emergency, when the public interest so requires, during the emergency and under reasonable terms, temporarily taking over or directing the operations of any person or entity engaged in the industry.

The implementing rules of the Oil Deregulation Act also require establishments engaged in downstream oil operations to submit periodic reports to the DOE in respect of the following activities or projects relating to petroleum products: (a) refining, processing, including recycling and blending; (b) storing or transshipment; (c) distribution or operation of petroleum carriers; (d) gasoline stations; (e) LPG refilling plant; (f) bunkering from freeports and special economic zones; and (g) importations of petroleum products and additives. In addition, such establishments are required to register with the DOE any fuel additive prior to its use in a product.

Other Regulations Applicable to Petroleum Operations

Philippine government approval of petroleum products and services is generally not required. However, petroleum products refined at Petron's refinery are subject to Philippine National Standards specifications. The

DTI, through the Bureau of Products Standards, ensures that all products comply with the specifications of the Philippine National Standards.

Marine Pollution and Oil Spillage

Philippine maritime laws and regulations are enforced by two Philippine government agencies: the Maritime Industry Authority (“MARINA”) and the Philippine coast guard. Both are agencies under the DOTC.

The MARINA is responsible for integrating the development, promotion, and regulation of the maritime industry in the Philippines. It exercises jurisdiction over the development, promotion, and regulation of all enterprises engaged in the business of designing, constructing, manufacturing, acquiring, operating, supplying, repairing, and/or maintaining vessels, or their component parts, of managing and/or operating shipping lines, shipyards, dry docks, marine railways, marine repair ships, shipping and freight forwarding agencies, and similar enterprises.

To address issues on marine pollution and oil spillage, the MARINA mandated the use of double-hull vessels for transporting black products beginning at the end of 2008 and by year 2011 for white products.

The Philippine Coast Guard, in a 2005 Memorandum Circular, provided implementing guidelines based on the International Convention for the Prevention of Pollution from Ships, (“MARPOL 73/78”). The guidelines provide that oil companies in major ports or terminals/depots are required to inform the Philippine Coast Guard through its nearest station of all transfer operations of oil cargoes in their respective areas. Furthermore, oil companies and tanker owners are required to conduct regular team trainings on managing oil spill operations including the handling and operations of marine pollution combating equipment. A dedicated oil spill response team is required to be organized to react to land and ship-originated oil spills.

Moreover, both the Clean Water Act of 2004 (the “Clean Water Act”, which is discussed more fully below) and the Oil Pollution Compensation Act of 2007 provide that the spiller or the person who causes the pollution has the primary responsibility of conducting clean-up operations at its own expense.

Reduction of Air Emissions

The Clean Air Act of 1999 (the “Clean Air Act”) provides for air quality standards and regulations against air pollution. It provides that the Philippine Department of Environment and Natural Resources (“DENR”) shall have authority to issue permits as it may determine necessary for the prevention and abatement of air pollution. The permits shall cover emission limitations for regulated air pollutants to help attain and maintain the ambient air quality standards. Under the implementing rules and regulations of the Clean Air Act, all sources of air pollution are required to obtain a valid permit to operate while new or modified sources must first obtain valid authority to construct. The DENR, together with other government agencies and the different local government units, is tasked to implement the Clean Air Act.

In relation to petroleum operations, the Clean Air Act imposes more stringent fuel specifications over a period of time to reduce emission that pollutes the air. The Clean Air Act mandates the sulfur and benzene content for gasoline and automotive diesel. Under the law, oil firms are mandated to lower the sulfur content of automotive diesel oils to 0.05% by January 1, 2004 nationwide. The law also regulates the use of any fuel or fuel additives. Furthermore, the Clean Air Act prohibits a manufacturer, processor or trader of any fuel or additive to import, sell, offer for sale, or introduce into commerce such fuel or additive unless these have been registered with the DOE. All the requirements of the law have been implemented, starting with the phase-out of leaded gasoline in Metro Manila in April 2000 and all over the country in December 2000.

The Biofuels Act

The Biofuels Act aims to reduce the dependence of the transport sector on imported fuel and mandates that, starting February 2009, at least 5% bioethanol shall comprise the total annual volume of gasoline fuel sold by every oil company. Oil companies are allowed to blend the different premium gasoline grades with 10% ethanol to be sold in selected areas to achieve the 5% of total gasoline volume requirement. The

requirement to sell ethanol blended gasoline commenced on February 9, 2009. For diesel engines, the mandated biodiesel blend in the country was increased from 1% to 2% starting February 2009.

In 2008, guidelines governing the biofuel feedstock production and biofuel blends production, distribution and sale were issued by various Philippine government agencies. The guidelines provide for responsibilities of oil companies in the sourcing and blending of biodiesel and bioethanol with diesel and gasoline. The guidelines mandate that oil companies should source biofuels only from biofuel producers accredited by the DOE or from biofuel distributors registered with the DOE. Moreover, unless authorized by DOE to import in case of shortage of supply of locally-produced bioethanol as provided for under the Biofuels Act, an oil company's failure to source its biofuels from accredited biofuels producers and/or registered biofuel distributors would constitute a prohibited act.

Relevant Tax-related Regulations

Taxes and duties applicable to the oil industry have had periodic and unpredictable changes over the last several years. The import duty on crude oil was increased on January 1, 2005 from 3% to 5%, but was later reduced to 3% effective as of November 1, 2005.

Under Executive Order No. 527 dated May 12, 2006, upon certification by the DOE that the trigger price levels provided therein have been reached, the 3% import duty on crude oil shall be adjusted to 2%, 1% or 0%. Subsequently, Executive Order No. 850, which took effect on January 1, 2010, modified the rates of duty on certain imported articles in order to implement the Philippines' commitment to eliminate tariffs on certain products under the common effective preferential tariff scheme for the ASEAN free trade area. Under the ASEAN Trade in Goods Agreement, crude oil and refined petroleum products imported from ASEAN Member States are levied zero rates. To address the tariff distortion between ASEAN and non-ASEAN Member States brought about by the implementation of the zero duty under Executive Order No. 850 and to provide a level playing field for local refiners to compete with importers, the President of the Philippines issued Executive Order No. 890, which also imposed zero duty effective as of July 4, 2010 for imported crude oil and refined petroleum products, except certain types of aviation gas, from non-ASEAN member states.

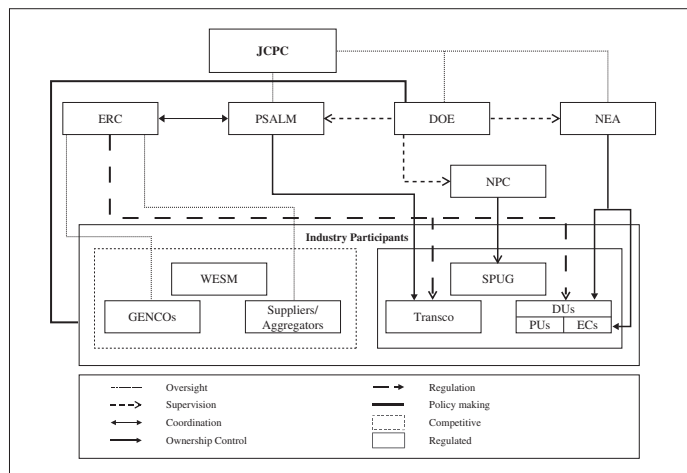
The Expanded VAT Law (the "Expanded VAT Law") imposed a VAT of 10% on certain goods and services, including petroleum products and its raw materials, particularly the sale and importation thereof. The rate was further increased to 12% effective February 1, 2006. The Expanded VAT Law also limited the input VAT tax credit to only 70% of the output VAT. Subsequently, however, Republic Act No. 9361, which was approved on November 21, 2006, removed the 70% ceiling on the credit of input VAT to output VAT. As of November 1, 2005, the implementation date of the Expanded VAT Law, excise taxes on diesel, bunker fuel and kerosene were lifted and excise taxes for regular gasoline were lowered to ₱4.35 per liter of volume capacity.

SMC'S POWER BUSINESS

Organization and Operation of the Power Industry

The EPIRA established a framework for the organization and operation of the electric power industry in connection with its restructuring, with the industry divided into four sectors: generation, transmission, distribution and supply. The following diagram shows the current structure of the electric power industry under the EPIRA.

Power Industry Structure under the EPIRA



Note:

DUs: Distribution Utilities

ECs: Electric Cooperatives

GENCOS: Any entity authorized by the ERC to operate electricity generation facilities

JCPC: Joint Congressional Power Commission

PUs: Production Utilities

Since the enactment of the EPIRA in 2001, the Philippine power industry has undergone and continues to undergo significant restructuring. Through the EPIRA, the Philippine government began to institute major reforms with the goal of fully privatizing all aspects of the power industry. The principal objectives of the EPIRA are:

- to ensure and accelerate the total electrification of the country;
- to ensure the quality, reliability, security and affordability of the supply of electric power;
- to ensure transparent and reasonable prices of electricity in a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency and enhance the competitiveness of Philippine products in the global market;
- to enhance the inflow of private capital and to broaden the ownership base of the power generation, transmission and distribution sectors;
- to ensure fair and non-discriminatory treatment of public and private sector entities in the process of restructuring the electric power industry;
- to protect the public interest as it is affected by the rates and services of electric utilities and other providers of electric power;
- to ensure socially and environmentally compatible energy sources and infrastructure;
- to promote the utilization of indigenous and new and renewable energy resources in power generation in order to reduce dependence on imported energy;
- to provide for an orderly and transparent privatization of the assets and liabilities of NPC;
- to establish a strong and purely independent regulatory body and system to ensure consumer protection and enhance the competitive operation of the electricity market; and
- to encourage the efficient use of energy and other modalities of demand side management.

With a view to implementing these objectives, the DOE, in consultation with the relevant government agencies, electric power industry participants, non-government organizations and electricity consumers, promulgated the EPIRA's Implementing Rules and Regulations (the "IRR") on February 27, 2002.

The IRR governs the relations between, and respective responsibilities of, the different electric power industry participants as well as the particular governmental authorities involved in implementing the structural reforms in the industry, namely the DOE, NPC, National Electrification Administration (“NEA”), ERC and PSALM.

Reorganization of the Electric Power Industry

Of the many changes initiated by the EPIRA, of primary importance is the reorganization of the electric power industry by segregating the industry into four sectors: (1) the generation sector; (2) the transmission sector; (3) the distribution sector; and (4) the supply sector. The goal is for the generation and supply sectors to be fully competitive and open, while the transmission and distribution sectors will remain regulated. Prior to the EPIRA, the industry was regulated as a whole, with no clear distinctions between and among the various sectors and/or services.

The Generation Sector

The EPIRA provides that power generation is not a public utility operation. Thus, generation companies are not required to secure franchises, and there are no restrictions on the ability of non-Filipinos to own and operate generation facilities. However, generation companies must obtain a certificate of compliance from the ERC, as well as health, safety and environmental clearances from appropriate government agencies under existing laws.

Generation companies are also subject to the ERC’s rules and regulations on abuse of market power and anticompetitive behavior. The ERC may impose fines and penalties for violation of the EPIRA and the IRR policy on market power abuse, cross-ownership and anti-competitive behavior.

The goal of the EPIRA is for the generation sector to be open and competitive, while the private sector is expected to take the lead in introducing additional generation capacity. Generation companies will compete either for contracts with various suppliers and private distribution utilities, or through spot sale transactions in the WESM. Competition will be based largely on pricing, subject to availability of transmission lines to wheel electricity to the grid and/or buyers. Recovery by distribution utilities of their purchased power cost is subject to review by the ERC to determine reasonableness of the cost and to ensure that the distribution utilities do not earn any revenue therefrom. Upon commencement of retail competition and Open Access, generation rates, except those intended for such end-users who may not choose their supplier of electricity, as determined by the ERC (the “Captive Market”), will cease to be regulated.

The generation sector converts fuel and other forms of energy into electricity. It consists of the following: (i) NPC-owned-and-operated generation facilities; (ii) NPC-owned plants, which consist of plants operated by IPPs, as well as IPP-owned-and-operated plants, all of which supply electricity to NPC; and (iii) IPP-owned-and-operated plants that supply electricity to customers other than NPC.

Under the EPIRA, generation companies are allowed to sell electricity to distribution utilities or to retail electricity suppliers through either bilateral contracts or the WESM as described below. Once the regime of retail competition and Open Access is implemented, generation companies may likewise sell electricity to eligible end-users. The ERC issued a resolution on January 24, 2007 prescribing the timeline for full retail competition and Open Access in Luzon. Pursuant to section 31 of the EPIRA, such implementation is subject to the fulfillment of five conditions. Four of these conditions have been substantially fulfilled, namely: (1) the establishment of WESM; (2) unbundling of transmission and distribution wheeling charges; (3) initial implementation of the cross-subsidy removal scheme; and (4) privatization of at least 70% of the total capacity of NPC’s generating assets in Luzon and Visayas, with the successful asset turnover of the rebidding for the 600 MW Calaca coal-fired power plant in August 2009. To date, the one condition that remains unsatisfied is 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 IPPAs. No generation company is allowed to own more than 30% of the installed generating capacity of the Luzon, Visayas or Mindanao grids and/or 25% of the national installed generating capacity. Also, no generation company associated with a distribution utility may supply more than 50% of the

distribution utility's total demand under bilateral contracts, without prejudice to the bilateral contracts entered into prior to the effectiveness of the EPIRA.

Historically, the generation sector has been dominated by NPC. To introduce and foster competition in the sector, and, more importantly, to lessen the debt of NPC, the EPIRA mandates the total privatization of the generation assets and IPP contracts of NPC, which exclude the assets devoted to missionary electrification through NPC's small power utilities group. NPC is directed to transfer ownership of all the assets for privatization to a separate entity, PSALM, which is specially tasked to manage the privatization. Beginning early 2004, PSALM has been conducting public bidding for the generation facilities owned by NPC.

As of March 31, 2011, PSALM has privatized 25 operating/generating power facilities with an aggregate rated capacity of 3,468.23 MW accounting for 91.8% of the total 3,778.23 MW total rated capacity of NPC generating assets in the Luzon and Visayas grids. Major generation assets include the 748 MW Tiwi-Makban geothermal power plant, the 620 MW Limay combined-cycle power plant, the 600 MW Calaca coal-fired thermal power plant, the 600 MW Masinloc coal-fired thermal power plant, the 360 MW Magat hydroelectric power plant and the 305 MW Palinpinon-Tongonan geothermal power plant. In addition, as of March 31, 2011, IPPA Agreements covering generation assets with an aggregate rated capacity of 4,213.75 MW, or approximately 85.9% of the total energy output of power plants under contract with NPC and IPPAs have been awarded. These include IPPA Agreements for the 1,000 MW Sual coal-fired power plant, the 700 MW Pagbilao coal-fired power plant, the San Roque Power Plant, the 70 MW Bakun hydroelectric power plant, the 40 MW Benguet hydroelectric power plant and the 1,200 MW Ilijan combined-cycle gas-fired power plant.

Section 47(j) of the EPIRA prohibits NPC from incurring any new obligations to purchase power through bilateral contracts with generation companies or other suppliers. Also, NPC is only allowed to generate and sell electricity from generating assets and IPP contracts that have not been disposed of by PSALM.

The Transmission Sector

Pursuant to the EPIRA, NPC has transferred its transmission and sub-transmission assets to TransCo, which was created pursuant to the EPIRA to assume, among other functions, the electrical transmission function of the NPC. TransCo's principal function is to ensure and maintain the reliability, adequacy, security, stability and integrity of the nationwide electrical grid in accordance with the Philippine Grid Code ("Grid Code"). TransCo is also mandated to provide open and non-discriminatory access to its transmission system to all electricity users.

The transmission of electricity through the transmission grid is subject to transmission wheeling charges. As the transmission of electric power is a regulated common carrier business, TransCo's transmission wheeling charges are subject to regulation and approval by the ERC.

The EPIRA also requires the privatization of TransCo through an outright sale of, or the grant of a concession over, the transmission assets while TransCo's subtransmission assets are to be offered for sale to qualified distribution utilities. In December 2007, NGCP, comprising a consortium of Monte Oro Grid Resources, Calaca High Power Corporation and State Grid Corporation of China, won the concession contract to operate, maintain and expand the TransCo assets with a bid of US\$3.95 billion. NGCP was officially granted the authority to operate the country's sole transmission system on January 15, 2009.

The Grid Code establishes the basic rules, requirements, procedures and standards that govern the operation, maintenance and development of the Philippine grid, or the high-voltage backbone transmission system and its related facilities. The Grid Code identifies and provides for the responsibilities and obligations of three key independent functional groups, namely: (a) the grid owner, or TransCo; (b) the system operator, or NGCP as the current concessionaire of TransCo; and (c) the market operator, or Philippine Electricity Market Corporation ("PEMC"). These functional groups, as well as all users of the grid, including generation companies and distribution utilities, must comply with the provisions of the Grid Code as promulgated and enforced by the ERC.

In order to ensure the safe, reliable and efficient operation of the Philippine grid, the Grid Code provides for, among others, the following regulations:

- the establishment of a grid management committee, which is tasked with the monitoring of the day-to-day operation of the grid;
- performance standards for the transmission of electricity through the grid, as well as the operation and maintenance thereof, which standards shall apply to TransCo, NGCP, distribution utilities and suppliers of electricity;
- technical and financial standards and criteria applicable to users of the grid, including generation companies and distribution utilities connected or seeking to connect thereto; and
- other matters relating to the planning, management, operation and maintenance of the grid.

The Distribution Sector

The distribution of electric power to end-users may be undertaken by private distribution utilities, cooperatives, local government units presently undertaking this function, and other duly authorized entities, subject to regulation by the ERC. The distribution business is a regulated public utility business requiring a franchise from the Philippine congress, although franchises relating to electric cooperatives remained under the jurisdiction of the NEA until the end of 2006. All distribution utilities are also required to obtain a certificate of public convenience and necessity from the ERC to operate as public utilities.

All distribution utilities are also required to submit to the ERC a statement of their compliance with the technical specifications prescribed in the Philippine Distribution Code (“Distribution Code”) (which provides the rules and regulations for the operation and maintenance of distribution systems), the Distribution Services and Open Access Rules and the performance standards set out in the IRR of the EPIRA.

The distribution sector is and will continue to be regulated by the ERC, with distribution and wheeling charges, as well as connection fees from its consumers, subject to ERC approval. Likewise, the retail rate imposed by distribution utilities for the supply of electricity to its captive consumers is subject to ERC approval. In addition, as a result of the Philippine government’s policy of promoting free competition and Open Access, distribution utilities are required to provide universal and non-discriminatory access to their systems within their respective franchise areas following commencement of retail Open Access.

The Distribution Code establishes the basic rules and procedures that govern the operation, maintenance, development, connection and use of the electric distribution systems in the Philippines. The Distribution Code defines the technical aspects of the working relationship between the distributors and all the users of the distribution system, including distribution utilities, embedded generators and large customers. All such electric power industry participants in distribution system operations are required to comply with the provisions of the Distribution Code as promulgated and enforced by the ERC.

To ensure the safe, reliable and efficient operation of distribution systems in the Philippines, the Distribution Code provides for, among others, the following regulations:

- technical, design and operational criteria and procedures to be complied with by any user who is connected or seeking connected to a distribution system;
- performance and safety standards for the operation of distribution systems applicable to distributors and suppliers; and
- other matters relating to the planning, development, management, operation and maintenance of distribution systems.

The Supply Sector

The supply of electricity refers to the sale of electricity directly to end-users. The supply function is currently being undertaken solely by franchised distribution utilities. However, upon commencement of retail

Open Access, the supply function will become competitive. The business is not considered a public utility operation and suppliers are not required to obtain franchises. However, the supply of electricity to a market of end-users who have a choice on their supplier of electricity (“Contestable Market”) is considered a business with a public interest dimension. As such, the EPIRA requires all suppliers of electricity to the Contestable Market to obtain a license from the ERC and they are subject to ERC’s rules and regulations on the abuse of market power and other anti-competitive or discriminatory behavior.

Once retail competition and Open Access are implemented as mandated by the EPIRA, it is expected that the Contestable Markets may choose where to source their electric power requirements and can negotiate with suppliers for their electricity. The EPIRA also contemplates that certain end-users will directly source power through the WESM or by entering into contracts with generation companies. This will encourage competition at the retail level and it is planned that retail competition will gradually increase over time, provided that supply companies are sufficiently creditworthy to be suitable offtakers for generation companies.

Role of the ERC

The ERC is the independent, quasi-judicial regulatory body created under the EPIRA that replaced the Energy Regulatory Board. The ERC plays a significant role in the restructured industry environment, consisting of, among others, promoting competition, encouraging market development, ensuring consumer choice and penalizing abuse of market power by industry participants.

Among the primary powers and functions of the ERC are:

- to determine, fix and approve, after conducting public hearings, transmission and distribution and wheeling charges and retail rates and to fix and regulate the rates and charges to be imposed by distribution utilities and their captive end-users, including self-generating entities;
- to grant, revoke, review or modify the certificates of compliance required of generation companies and the licenses required of suppliers of electricity in the Contestable Market;
- to enforce the Grid Code and Distribution Code, which shall include performance standards, the minimum financial capability standards, and other terms and conditions for access to and use of transmission and distribution facilities;
- to enforce the rules and regulations governing the operations of the WESM and the activities of the WESM operator to ensure a greater supply and rational pricing of electricity;
- to ensure that the electric power industry participants and NPC functionally and structurally unbundled their respective business activities and rates and to determine the levels of cross-subsidies in the existing and retail rates until the same is removed in accordance with the different sectors;
- to set a lifeline rate for marginalized end-users;
- to promulgate rules and regulations prescribing the qualifications of suppliers which shall include, among others, their technical and financial capability and creditworthiness;
- to determine the electricity end-users comprising the Contestable and Captive Markets;
- to fix user fees to be charged by TransCo/NGCP for ancillary services to all electric power industry participants or self-generating entities connected to the grid;
- to review all power purchase contracts executed between NPC and IPPs, including the distribution utilities;
- to monitor and adopt measures to discourage or penalize abuse of market power, cartelization and any anticompetitive or discriminatory behavior by any electric power industry participant;
- to review and approve the terms and conditions of service of TransCo/NGCP and any distribution utility or any changes therein;

- to perform such other regulatory functions as are appropriate and necessary in order to ensure the successful restructuring and modernization of the electric power industry; and
- to have original and exclusive jurisdiction over all cases that involve the contesting of rates, fees, fines and penalties imposed in the exercise of its powers, functions and responsibilities and over all cases involving disputes between and among participants or players in the energy industry relating to the foregoing powers, functions and responsibilities.

Role of the DOE

In accordance with its mandate to supervise the restructuring of the electric power industry, the DOE exercises, among others, the following functions:

- preparation and annual updating of the Philippine Energy Plan and the Philippine Power Development Program, and thereafter integrate the latter into the former;
- ensuring the reliability, quality and security of the supply of electric power;
- exercise of supervision and control over all government activities pertaining to energy projects;
- encouragement of private investment in the power industry and promotion of the development of indigenous and renewable energy sources for power generation;
- facilitation of reforms in the structure and operation of distribution utilities for greater efficiency and lower costs;
- promotion of incentives to encourage industry participants, including new generating companies and end-users, to provide adequate and reliable electric supply;
- education of the public (in coordination with NPC, ERC, NEA and the Philippine Information Agency) on the restructuring of the industry and the privatization of NPC assets; and
- establishment of the WESM in cooperation with electric power industry participants, and formulating rules governing its operations.

Role of the Joint Congressional Power Commission

The Joint Congressional Power Commission created pursuant to the EPIRA consists of 14 members selected from the members of the Philippine senate and house of representatives. Its responsibilities and functions include, among others, the following:

- monitoring and ensuring the proper implementation of the EPIRA;
- endorsement of PSALM's initial privatization plan for approval by the President of the Philippines;
- ensuring transparency in the public bidding procedures adopted for the privatization of NPC's generation and transmission assets;
- evaluation of the adherence of industry participants to the objectives and timelines under the EPIRA; and
- recommendation of necessary remedial legislation or executive measures to correct the inherent weaknesses in the EPIRA.

Competitive Market Devices

Wholesale Electricity Spot Market

The EPIRA mandates the establishment of the WESM, which is a pre-condition for the implementation of retail competition and Open Access, within one year from its effectiveness. The WESM provides a venue whereby generators may sell power, and at the same time suppliers and wholesale consumers can purchase electricity where no bilateral contract exists between the two.

On June 28, 2002, the DOE, in cooperation with electric power industry participants, promulgated detailed rules for the WESM. These rules set the guidelines and standards for participation in the market, reflecting accepted economic principles and providing a level playing field for all electric power industry participants, and procedures for establishing the merit order dispatch for each time (hourly) trading period. These rules also provide for a mechanism for setting electricity prices that are not covered by bilateral contracts between electricity buyers and sellers.

On November 18, 2003, upon the initiative of the DOE, the PEMC was incorporated as a non-stock, non-profit corporation with membership comprising an equitable representation of electricity industry participants and chaired by the DOE. The PEMC acts as the autonomous market group operator and the governing arm of the WESM. The PEMC was tasked to undertake the preparatory work for the establishment of the WESM, pursuant to Section 30 of the EPIRA and in accordance with the WESM Rules. Its primary purpose is to establish, maintain, operate and govern an efficient, competitive, transparent and reliable market for the wholesale purchase of electricity and ancillary services in the Philippines in accordance with relevant laws, rules and regulations. Although the long-term goal is to have an interconnected WESM in Luzon and Visayas, WESM in the Visayas grid is still under trial operation status. Moreover, while WESM intends to operate both energy and reserve markets, only the former has already been launched. Having completed its application for the reserve market's pricing methodology, PEMC has indicated that the Visayas grid commenced operations on December 26, 2010.

The WESM became operational in the Luzon grid on June 26, 2006. Prior to the commencement of the Luzon WESM commercial operations, the ERC issued the enforcement of 90% cap on the bilateral supply contracts of distribution utilities to address other issues that may arise during the commercial operations of the WESM. The ERC is responsible for monitoring the 90% cap on power sourced from bilateral PSCs of distribution utilities' total monthly demand. Any distribution utility that violates the 90% cap will not be allowed to recover the costs pertaining to the volume in excess of the cap from its customers.

As of September 26, 2010, there were 77 entities registered as WESM members.

Retail Competition and Open Access

The EPIRA likewise provides for a system of Open Access on transmission and distribution wires, whereby TransCo/NGCP and distribution utilities may not refuse the use of their wires by qualified persons, subject to the payment of distribution and wheeling charges. Conditions for the commencement of such Open Access system are as follows:

- establishment of the WESM;
- approval of unbundled transmission and distribution wheeling charges;
- initial implementation of the cross-subsidy removal scheme;
- privatization of at least 70% of the total capacity of generating assets of NPC in Luzon and Visayas; and
- transfer of the management and control of at least 70% of the total energy output of power plants under contract with NPC to the IPPAs.

The Philippine government expects retail competition and Open Access to be implemented in phases. As far as Luzon is concerned, the WESM began operations in June 2006 and retail competition has already been introduced, with end-users who comprise the Contestable Market for this purpose already identified.

Open Access in Luzon is expected to commence soon. As of March 31, 2011, PSALM has privatized 25 operating/generating power facilities with an aggregate rated capacity of 3,468.23 MW, accounting for 91.8% of the 3,778.23 MW total rated capacity of NPC's generating assets in the Luzon and Visayas grids. In addition, as of March 31, 2011, IPPA Agreements covering generation assets with an aggregate rated capacity of 4,213.75 MW or approximately 85.92% of the total energy output of power plants under contract with NPC and IPPAs have been awarded.

Upon implementation of Open Access, the various contracts entered into by utilities and suppliers may potentially be stranded. Stranded contract cost refers to the excess of the contracted cost of electricity under eligible contracts of NPC over the actual selling price of the contracted energy output of such contracts in the market. Under the EPIRA, recovery of stranded contract cost may be allowed provided that such contracts were approved by the Energy Regulatory Board (now the ERC) as of December 31, 2000.

Unbundling of Rates and Removal of Cross Subsidies

The EPIRA mandates that distribution and wheeling charges be unbundled from retail rates and that rates reflect the respective costs of providing each service. The EPIRA also states that cross-subsidies shall be phased out within a period not exceeding three years from the establishment by the ERC of a universal charge, which shall be collected from all electricity end-users. However, the ERC may extend the period for the removal of the cross-subsidies for a maximum of one year if it determines that there will be a material adverse effect upon the public interest or an immediate, irreparable and adverse financial effect on a distribution utility.

These arrangements are now in place, in satisfaction of the conditions for retail competition and Open Access.

The EPIRA likewise provides for a socialized pricing mechanism called a lifeline rate to be set by the ERC for marginalized or low-income captive electricity consumers who cannot afford to pay the full cost of electricity. These end-users are exempt from the cross-subsidy removal for a period of ten years, unless extended by law.

Implementation of the PBR

On December 8, 2008, the ERC issued the Rules for Setting Distribution Wheeling Rates that apply to privately owned distribution utilities entering performance-based regulation (“PBR”) for the third entry points, which set out the manner in which the new PBR rate-setting mechanism for distribution-related charges will be implemented. PBR is intended to replace the return-on-rate-base regulation (“RORB”) that has historically determined the distribution charges paid by the distribution companies’ customers. Under the PBR, the distribution-related charges that distribution utilities can collect from customers over a four-year regulatory period will be set by reference to projected revenues which are reviewed and approved by the ERC and used by the ERC to determine a distribution utility’s efficiency factor. For each year during the regulatory period, a distribution utility’s distribution charge is adjusted upwards or downwards taking into consideration the utility’s efficiency factor set against changes in overall consumer prices in the Philippines. The ERC has also implemented a performance incentive scheme whereby annual rate adjustments under PBR will also take into consideration the ability of a distribution utility to meet or exceed service performance targets set by the ERC, such as the average duration of power outages, the average time to provide connections to customers and the average time to respond to customer calls, with utilities being rewarded or penalized depending on their ability to meet these performance targets.

Reduction of Taxes and Royalties on Indigenous Energy Resources

To equalize prices between imported and indigenous fuels, the EPIRA mandates the President of the Philippines to reduce the royalties, returns and taxes collected for the exploitation of all indigenous sources of energy, including but not limited to, natural gas and geothermal steam, so as to effect parity of tax treatment with the existing rates for imported coal, crude oil, bunker fuel and other imported fuels. Following the promulgation of the IRR, then President Arroyo enacted Executive Order No. 100 to equalize the taxes among fuels used for power generation. This mechanism, however, is yet to be implemented.

Government Approval Process

As set forth in the EPIRA, power generation is not considered a public utility operation. Thus, an entity engaged or intending to engage in the generation of electricity is not required to secure a franchise. However, no person or entity may engage in the generation of electricity unless such person or entity has complied with

the standards, requirements and other terms and conditions set by the ERC and has received a certificate of compliance from the ERC to operate facilities used in the generation of electricity. A certificate of compliance is valid for a period of five years from the date of issuance.

In addition to the certificate of compliance requirement, a generation company must comply with technical, financial and environmental standards. A generation company must ensure that all its facilities connected to the grid meet the technical design and operational criteria of the Grid Code and Distribution Code promulgated by the ERC. In this connection, the ERC has issued guidelines setting the minimum financial capability standards for generation companies. Under the guidelines, a generation company is required to meet a minimum annual interest cover ratio or debt service capability ratio of 1.5x throughout the period covered by its certificate of compliance. For certificate of compliance applications and renewals, the guidelines require the submission to the ERC of, among other things, comparative audited financial statements, a schedule of liabilities, and a five-year financial plan. For the duration of the certificate of compliance, the guidelines also require a generation company to submit audited financial statements and forecast financial statements to the ERC for the next two financial years, as well as other documents. The failure by a generation company to submit the requirements prescribed by the guidelines may be grounds for the imposition of fines and penalties.

Upon the introduction of retail competition and Open Access, the rates charged by a generation company will no longer be regulated by the ERC, except rates for Captive Markets (which are determined by the ERC). In addition, since the establishment of the WESM, generation companies are now required to comply with the membership criteria and appropriate dispatch scheduling as prescribed under the WESM Rules.

In the course of developing a power plant, other permits, approvals and consents must also be obtained from relevant national, provincial and local government authorities, relating to, among others, site acquisition, construction and operation, including environmental licenses and permits.

SMC'S PACKAGING BUSINESS

Safety and Quality Regulations under the Consumer Act

The DTI is tasked to implement the Consumer Act with respect to labels and packaging of consumer products other than food products, and regulates product labeling, proper and correct description of goods, product labels with foreign characters/languages, data/information on product contents and origins and other similar matters.

Manufacturers, distributors, importers or repackers of consumer products are required to indicate in their labels or packaging, a parallel translation in the English or Filipino language of the nature, quality and quantity and other relevant prescribed information or instructions of such consumer products in a manner that cannot be easily removed, detached or erased. In addition to the information required to be displayed in the principal and secondary panels, DTI Administrative Order No. 01-08 mandates that all consumer products sold in the Philippines, whether manufactured locally or imported shall indicate and specify the (i) country of manufacture; (ii) required information of consumption duration safety; (iii) warranty of the manufacturer; (iv) weight content prior to packaging; (v) consumer complaint desk address; and (vi) all other information necessary for giving effect to a consumer's right to information.

The packaging of consumer products must not cause the purchaser to be deceived as to the contents, size, quantity, measurement or fill of the product. For consumer products which are packaged in such a way that the contents cannot be seen or inspected upon purchase, samples or labeling describing the product inside the package, in words, in pictorial or graphical representation or by similar means, shall be provided for the inspection of the purchaser. Such sample or description should accurately represent the product in the package.

With respect to the packaging and repackaging of food products, such activities are regulated by the DOH and the FDA as discussed above. Establishments engaged in these activities are required to comply with, among others, the current guidelines on good manufacturing practice in manufacturing, packing, repacking, or holding food promulgated by the DOH.

SMC'S OTHER BUSINESSES

SMC's Banking Business

Bangko Sentral ng Pilipinas

The BSP is the central bank of the Republic of the Philippines. It was rechartered on July 3, 1993, pursuant to the provisions of the 1987 Philippine constitution and the New Central Bank Act of 1993 (the "New Central Bank Act"). The BSP was established on January 3, 1949, as the country's central monetary authority. Among its functions is the management of foreign currency reserves, by maintaining sufficient international reserves to meet any foreseeable net demands for foreign currencies in order to preserve the international stability and convertibility of the Peso.

Pursuant to the New Central Bank Act and the General Banking Law of 2000 (the "General Banking Law"), the Monetary Board of the BSP (the "Monetary Board") was vested with the power to regulate and supervise financial intermediaries in the Philippines.

The BSP Manual of Regulations for Banks (2009) (the "Manual") is the principal source of rules and regulations to be complied with and observed by banks in the Philippines. The Manual contains regulations that include those relating to the organization, management and administration, deposit and borrowing operations, loans, investments and special financing program, and trust and other fiduciary functions, of the relevant bank. Supplementing the Manual are rules and regulations promulgated in various circulars, memoranda, letters and other directives issued by the Monetary Board.

The Manual and other BSP rules and regulations are principally implemented by the Supervision and Examination Sector (the "SES") of the BSP. The SES is responsible for ensuring the observance of applicable laws and rules and regulations by banking institutions operating in the Philippines (including Philippine government credit institutions, their subsidiaries and affiliates, non-bank financial intermediaries, and subsidiaries and affiliates of non-bank financial intermediaries performing quasi-banking functions).

Minimum capitalization

Under the Manual, commercial banks are required to have capital accounts of at least ₱2,800 million. This minimum level of capitalization may be changed by the Monetary Board from time to time. Currently, the BSP requires only minimum capital accounts of ₱2,400 million for commercial banks.

Capital Adequacy Requirements

The Manual provides that the risk-based capital ratio of a bank, expressed as a percentage of qualifying capital to risk-weighted assets, must not be less than 10%. The ratio is required to be maintained daily on both a solo basis (head office plus branches) and a consolidated basis (parent bank plus subsidiary financial allied undertakings, but excluding insurance companies). The qualifying capital refers to the sum of tier 1 and tier 2 or supplementary capital of the bank, less deductions of the value of certain assets. The risk-weighted assets, on the other hand, are determined by assigning risk weights to amounts of on-balance sheet assets and to credit equivalent amounts of off-balance sheet items (including derivative contracts), subject to certain deductions.

The BSP issued a memorandum to all banks on December 13, 2004, mandating commercial and universal banks to comply with the Basel Committee on Banking Supervision's revised International Convergence of Capital Measurement and Capital Standards, ("Basel II"), by July 2007. Basel III which was adopted by the Basel Committee on Banking Supervision in September 2010 and is expected to be implemented by the BSP, will require a more stringent capital adequacy structure to be adopted in stages prior to 2019.

Reserve Requirements

Under the New Central Bank Act, the BSP requires banks to maintain cash reserves and liquid assets in proportion to deposits in prescribed ratios. If a bank fails to meet this reserve during a particular week on an average basis, it must pay a penalty to the BSP on the amount of any deficiency.

Commercial banks are required to maintain regular reserves of 8% against peso demand, savings and time deposits, negotiable order of withdrawal accounts, deposit substitutes, and Unit Investment Trust Funds and other similarly managed funds.

In addition to the foregoing regular reserve requirements, commercial banks are required to set up liquidity reserves against peso demand, savings and time deposits and deposit substitute liabilities, Unit Investment Trust Funds and trust and other fiduciary activities equivalent to 11%.

Loan Limit to a Single Borrower

Under the General Banking Law and its implementing regulations, the total amount of loans, credit accommodations and guarantees that may be extended by a bank to any borrower shall at no time exceed 25% of the net worth of such bank (or 35% of the net worth of the bank in the event that certain types and levels of security are provided). This ceiling may be adjusted by the Monetary Board from time to time.

Loans to Directors, Officers, Stockholders and Related Interests of a Bank

The amount of individual outstanding loans, other credit accommodations and guarantees to the directors, officers, stockholders and related interests of a bank (“DOSRI”) should not exceed an amount equivalent to their unencumbered deposits and book value of DOSRI’s paid-in capital investment. In the aggregate, outstanding loans, other credit accommodations and guarantees to DOSRI generally should not exceed 100% of net worth or 15% of the total loan portfolio, whichever is lower. In no case shall the total unsecured loans, other credit accommodations and guarantees to DOSRI exceed 30% of the aggregate ceiling or of the outstanding loans, other credit accommodations and guarantees, whichever is lower. For the purpose of determining compliance with the ceiling on unsecured loans, other credit accommodations and guarantees, banks shall be allowed to average their ceiling on unsecured loans, other credit guarantees and guarantees every week.

On January 31, 2007, the BSP issued Circular No. 560, which provides that total outstanding loans, other credit accommodations and guarantees to each of the bank’s subsidiaries and affiliates shall not exceed 10% of the net worth of the bank and the unsecured loans, other credit accommodations and guarantees to each of said subsidiaries and affiliates shall not exceed 5.0% of the bank’s net worth. In the aggregate, outstanding loans, other credit accommodations and guarantees to all subsidiaries and affiliates shall not exceed 20% of the net worth of the bank. BSP Circular No. 560 further provides that these subsidiaries and affiliates should not be a related interest of any of the directors, officers and/or stockholders of the lending institution, except where such director, officer, or stockholder sits on the board of directors or is appointed as an officer of such corporation as representative of the bank. However, loans, other credit accommodations and guarantees secured by assets considered as non-risk under existing BSP regulations as well as interbank call loans shall be excluded in determining compliance with these prescribed ceilings.

SMC’s Telecommunications Business

Telecommunications services in the Philippines are considered as a public service and are governed by specific regulations and laws. The principal laws governing the telecommunications industry are the 1936 Commonwealth Act No. 146, as amended, commonly referred to as the “Public Service Act”, and the Public Philippine Telecommunications Policy Act (the “Public Telecommunications Policy Act”).

The Public Service Act seeks to protect the public against unreasonable charges and poor, inefficient service by public utilities and prevent ruinous competition. The Public Telecommunications Policy Act sets forth the current telecommunications policy objectives of the Philippine government. It also seeks to develop and maintain a viable, efficient, reliable and universal telecommunications infrastructure which ensures that telecommunications services are available in unserved or under-served areas, and sets out the functions, powers and responsibilities of the National Telecommunications Commission (“NTC”) of the Philippine department of transportation and communications.

The NTC regulates the telecommunications industry under the provisions of the Public Service Act, Executive Order No. 59 ("E.O. 59"), Executive Order No. 109 ("E.O. 109") and Republic Act No. 7925 ("R.A. 7925"). Under these laws, a telecommunications service provider is required to, among others: (i) secure a certificate of public convenience and necessity ("CPCN") or provisional authority from the NTC for those services it intends to offer which are deemed regulated services under relevant laws, as well as rates sought to be charged, insofar as deemed regulated; (ii) observe the provisions of E.O. 109 and R.A. 7925 which impose an obligation to rollout 700,000 fixed lines as a condition to the grant of by the NTC of provisional authorities for cellular and international gateway services; and (iii) observe the regulations of the NTC on interconnection of public telecommunications networks, and the payment to the NTC of annual supervision and permit fees.

Among the specific functions of the NTC is the granting of permits for the use of radio frequencies for cellular telephone and telegraph systems and radio communications systems, as well as the sub-allocation of frequencies of bands allocated by the international telecommunications union to the specific services. The NTC is required to exercise these functions consistent with the national policy that radio frequency spectrum is a scarce public resource that must be administered in the public interest and in accordance with international agreements and conventions to which the Philippines is a party. It is the policy of the government to allocate frequencies to service providers that will use them efficiently and effectively to meet public demand for telecommunications service and that seek out and utilize new and cost-effective technologies.

All telecommunications service providers are required to obtain a legislative franchise from the Philippine congress. Under the Philippine constitution, only citizens of the Philippines or corporations or associations organized under the laws of the Philippines at least 60% of whose capital is owned by such citizens may be granted a franchise to operate a public utility, which includes telecommunications service providers. The Philippine constitution provides that no franchise to operate a public utility may be exclusive in character or have a term longer than 50 years. The Philippine constitution also requires that any franchise must be granted subject to amendment, alteration or repeal by the Philippine congress when required to serve the common good. Under the Public Telecommunications Policy Act, legislative franchises are also subject to an equality clause by which any advantage, favor, privilege, exemption or immunity granted under franchises issued on or after the date of enactment of the Public Telecommunications Policy Act automatically becomes part of all previously granted franchises. The equality clause, however, does not apply to the territory covered by the franchise, the life span of the franchise or the type of service authorized by the franchise.

In addition to a legislative franchise, those seeking to operate a telecommunication service are required by law to obtain a CPCN from the NTC. This certificate is a grant of final authority to own, operate and maintain a public telecommunications facility or service. Its term cannot be shorter than five years nor longer than the life of the legislative franchise.

Pending the grant of a CPCN, an applicant may request in its application or petition, the issuance of a provisional authority, or file a motion, in the same proceedings for the CPCN, for the grant of a provisional authority to operate a telecommunications service. The provisional authority may be granted if the NTC is satisfied, based on the application for the CPCN and the attached supporting documents, that the applicant is prima facie entitled to a CPCN. The grant of provisional authority, however, is without prejudice to the final decision of the NTC on the application for a CPCN. A provisional authority is usually granted for a period of 18 months. If a CPCN is not issued prior to the expiration of the provisional authority, the applicant may request the renewal or extension of the provisional authority by filing a motion in the same proceedings for its CPCN application. As a matter of practice, the NTC grants requests for renewal or extension of a provisional authority once it is satisfied that the applicant has substantially complied with the conditions of the provisional authority and appears to be capable of fulfilling its commitments.

Compulsory Interconnection and Cross-Subsidization

The Public Telecommunications Policy Act requires carriers to interconnect their networks with other networks with the objective of creating a seamless nationwide network. The Government first adopted compulsory interconnection with the issuance of E.O. 59 on February 24, 1993 by then President Fidel V.

Ramos. Pursuant to this legislation, the NTC issued Memorandum Circular No. 14-7-2000, dated July 14, 2000, implementing the rules and regulations for the interconnection of networks of authorized public telecommunication of networks of authorized public telecommunications entities. This memorandum circular provides a general framework for interconnection of public telecommunications networks and public telecommunications services, regardless of the supporting technologies employed.

Interconnection costs and access charges are determined through bilateral negotiation among telecommunication carriers. The NTC may on its own initiative intervene in any of these negotiations and mediate between the parties at any time. Additionally, if the parties do not come to an agreement after 90 days from commencement of negotiation, the NTC may, upon application of one of the parties, commence mediation proceedings. If the parties fail to come to an agreement in the course of mediation, the NTC is authorized to intervene and impose interconnection terms and conditions. The NTC has promoted a policy allowing international and domestic toll and cellular interconnect services to subsidize local exchange operators to allow them to earn a rate of return comparable with other segments of the telecommunications industry. This reflects the policy under the Public Telecommunications Policy Act of providing cross-subsidies to local exchange operators when they interconnect with local exchanges of other carriers. This cross-subsidy is required to be imputed in the interconnection fee negotiated by the operators and the carriers and is payable under the interconnection arrangement. Carriers that are required to operate local exchanges as a result of being previously granted licenses to provide international and/or cellular services are also required to cross-subsidize the operations of other local exchange operators that are linked with them.

Local Exchange Service Roll-out Requirements

On July 12, 1993, then President Fidel V. Ramos issued E.O. 109 to implement the Philippine government's objective of improving the provision of local exchange carrier services. To implement E.O. 109, the NTC issued regulations which required all authorized operators of international gateway facilities to install at least 300,000 local exchange lines within three years from the date of the grant of a provisional authority for local exchange carrier service. In providing local exchange carrier services, operators of international gateway facilities are required to maintain a ratio of at least one rural exchange line for every 10 urban exchange lines installed. These regulations also required all authorized cellular operators to install at least 400,000 local exchange lines within five years from the date when the regulations took effect. Operators that provide both international gateway facility and cellular services are required to install a minimum of 700,000 lines. In implementing E.O. 109, the NTC divided the country into 11 service areas. The NTC assigned to each international gateway facility and cellular operator a designated area in which the operator is required to provide local exchange services. Failure to meet the minimum lines obligation may be grounds for cancellation of an operator's CPCN or provisional authority after due notice and hearing. Since 1997, the NTC has permitted additional telecommunications companies to provide local exchange lines in the designated service areas.

The local exchange service roll-out requirements under E.O. 109 were adopted by the Philippine congress in the Public Telecommunications Policy Act. However, under the said law, the period of time within which cellular operators are required to comply with their roll-out requirements was changed from five years from the date of issuance of the implementing regulations to three years from the date of issuance of the provisional authority to operate a local exchange service.

3G Radio Frequency Allocation

On October 31, 2000 then President Joseph Estrada signed Executive Order No. 307 which provides that 3G radio frequency spectrum and other parts of the radio frequency spectrum not yet allocated be allocated by auction, subject to the terms and conditions as approved by a 3-member joint committee.

The NTC issued Memorandum Circular 06-08-2005 on August 23, 2005 to reallocate certain frequency bands to support the development and deployment of telecommunications networks and services for broadband wireless access for fixed, nomadic and mobile networks.

In January 2006, the NTC, through a public bidding, sold four of the five frequencies available for the cellular telephone 3G radio frequency under the standards provided by NTC Memorandum Circular 07-08-2005, which outlined the procedure for the allocation and assignment of 3G radio frequency bands. An entity intending to operate a 3G mobile telecommunications system is required to file its application for authority or CPCN and must possess the following minimum qualifications, including (i) a congressional franchise, (ii) minimum paid-up capital stock of ₱100.0 million for new public telecommunications entities, (iii) a debt to equity ratio of 70:30 with total investment in the cellular mobile telecommunications system or 3G networks of at least ₱400.0 million and (iv) proof of technical capability to install, operate and maintain the proposed cellular mobile telecommunications system or 3G networks.

The last remaining frequency remains unsold because of legal action resorted to by some of the losing bidders.

In July 19, 2007, the NTC reallocated the band 410-430 MHz for broadband wireless access in addition to the frequency bands in MC 06-08-2005. On March 13, 2010, the NTC published MC 01-03-2010 which introduced a stricter standard for the allocation of radio frequency bands to discourage frequency hoarding by existing telecommunications companies.

Public Ownership

In order to diversify the ownership base of public utilities, the Public Telecommunications Policy Act requires a telecommunications entity with regulated types of services to make a public offering through the stock exchanges of at least 30% of its aggregate common stock by the later of the following (i) the fifth anniversary of the date the law became effective; and (ii) the fifth anniversary of the date of the entity's commencement of commercial operations.

Tariffs

The Public Service Act and the Public Telecommunications Policy Act give the NTC the authority to regulate telecommunications tariffs and approve all rates charged by operators of telecommunication services, other than paging, public repeater network services and value-added services. The NTC is also authorized to establish rates for telecommunications services that are fair and reasonable. In making its determination, the NTC is required to consider socio-economic factors and financial, technical and commercial criteria, including the cost of property and equipment, depreciation, working capital and the operator's rate of return on its investment. Telecommunications companies are free to set rates, within a range established by the NTC, for services in which the NTC deems there to be sufficient competition, such as international long distance and cellular communications. Pursuant to NTC circulars, the rates for special features on telephone networks, cellular mobile telephone service and national and international leased line services have been deregulated.

The NTC may approve an application to increase tariffs after due notice and hearing upon the petition of an operator. The NTC may, however, grant provisional authority to increase rate upon filing and compliance with requirements of publications and notice to affected parties, provided all documents required to justify the increase are submitted and a formal hearing is held within 30 days from the grant of the provisional authority. An operator may apply to the NTC to have rates reduced through an administrative process involving the submission of only supporting documentation without the necessity of a hearing.

The NTC also permits some operators to use a currency exchange rate mechanism which allows, but does not oblige, operators to increase and requires operators to decrease, monthly charges depending on the Peso-to-U.S. dollar exchange rate. Under the currency exchange rate mechanism, a telecommunications operator, which at the time of application to the NTC had U.S. dollar or other foreign currency denominated debt, is allowed to adjust telephone tariffs to reflect Peso-U.S. dollar exchange rate fluctuations. Following a grant of authorizations by the NTC to an operator, currency exchange tariff adjustments are not required to be approved by the NTC. The permitted rate adjustment may be different for every operator.

Acts Requiring NTC Approval

Under the Public Service Act, certain acts of telecommunications entities require prior approval from the NTC, including: (i) increase in capital stock; (ii) the sale, transfer, alienation, mortgage, encumbrance or lease of all or substantially all of their assets or of authorizations to operate telecommunications service; and (iii) issuance of bonds or evidence of indebtedness payable more than one year following their dates of issuance.

Nationality Restrictions on Telecommunications Operators

The Philippine constitution prohibits non-Philippine persons from owning more than 40% of the capital of any public utility, which includes telecommunications service providers. It also provides that representation of non-Philippine citizens on the board of directors of any public utility is limited to their proportionate share of the utility's capital stock.

SMC's Infrastructure Business

Government Procurement Reform Act

Under the Government Procurement Reform Act, which was approved on January 10, 2003 ("Government Procurement Reform Act"), all procurement activities of the Philippine government, its departments, bureaus, offices and agencies, including state universities and colleges, government-owned and/or controlled corporations, government financial institutions and local government units shall be done through public, open and competitive bidding. The said law covers all procurement activities by all branches and instrumentalities of the Philippine government, including infrastructure projects, regardless of source of funds, whether local or foreign,

Each procuring entity (i.e., the relevant Philippine government agency or instrumentality) is required to establish a bids and awards committee, composed of at least five but not more than seven members. The committee shall advertise and/or post the invitation to bid, conduct pre-procurement and pre-bid conferences, determine the eligibility of prospective bidders, receive bids, conduct the evaluation of bids, undertake post-qualification proceedings, recommend award of contracts to the head of the procuring entity or his duly authorized representative.

The Government Procurement Reform Act requires a winning bidder, as a measure of guarantee for the faithful performance of and compliance of its obligations under the contracts, to post a performance security prior to the signing of any awarded contract. The failure to do the same within the period stipulated in the bidding documents may disqualify the bidder.

Build-Operate-Transfer Law

Under Republic Act No. 6957 (the "BOT Law"), which took effect on October 9, 1990, all government infrastructure agencies, including government-owned and controlled corporations and local government units, were authorized to enter into contract with any duly prequalified private contractor for the financing, construction, operation and maintenance of any financially viable infrastructure facilities through private initiative and investment: the Build-Operate-Transfer ("BOT") or Build-Transfer ("BT").

Republic Act No. 7718 ("RA 7718") amended the original BOT Law and authorized variations of the contractual schemes that may be entered into by the Government with qualified private parties. RA 7718 also introduced the concept of unsolicited proposals, by virtue of which national and local government agencies are allowed to accept unsolicited proposals for projects which (i) involve a new concept or technology, (ii) are not part of the list of priority projects identified by the agency, including any projects which may have been identified in the Comprehensive and Integrated Infrastructure Program ("CIIP"), and (iii) do not involve direct government guarantees, subsidies or equity. The CIIP is a list of priority infrastructure projects, including the proposed timeline and scope of work, which is prepared by the NEDA and the Office of the President for projects appropriate for purely private investment, public-private partnership and purely public investment.

The BOT Law embodies the basic principle of PPP in infrastructure development and has been cited as instrumental in increasing private investment in infrastructure, especially in the areas of power, telecommunications, airports and water utilities.

Guidelines and Procedures for Entering into Joint Venture Agreements

The Philippine government issued a set of guidelines on joint ventures between the Philippine government and private entities which covers all government-owned and/or controlled corporations, government corporate entities, government instrumentalities with corporate powers, government financial institutions, state universities and colleges. Excluded from the application of the guidelines are local government units and transactions of government financial institutions in the ordinary course of business. The guidelines provide for the parameters for entering into joint venture agreements, which should involve investments made only in activities directly and immediately related to and in furtherance of the primary corporate purpose of the investing government entity. Further, the joint venture should be clear in its intent to undertake a specific activity and should not crowd out the private sector.

Under the guidelines, the preferred mode of implementing a joint venture agreement is through a special purpose joint venture company to be formed by the government and the private sector which shall be registered as a stock corporation in compliance with the ownership and nationality requirements under Philippine law (if applicable). The Philippine government must have proportionate representation to the board of such joint venture company. The joint venture company shall be permitted to derive income from the authorized activities under the agreement and is further encouraged to stipulate a fixed period for the participation of the participating agency or instrumentality of the Philippine government. The selection of a partner may be made through competitive selection or negotiated agreements.

Regulation of Toll Operations

The Toll Regulatory Board (the “TRB”), created by virtue of Presidential Decree No. 1112, is the government agency authorized to regulate toll operations in the Philippines and exercises close supervision, monitoring and regulation of the construction, operation and maintenance of toll facilities, such as but not limited to national highways, roads, bridges and public thoroughfares, including collection of toll fees and rates that may be charged for the use of said facilities.

The TRB currently has the power to (i) issue, modify and proclaim the rates of the toll that will be charged the direct users of toll facilities and upon notice and hearing, to approve or disapprove petitions for the increases and (ii) grant authority to operate a toll facility and to issue the necessary toll operation certificate.

Civil Aviation

Pursuant to the Civil Aviation Authority Act of 2008 (the “Civil Aviation Authority Act”), the Civil Aviation Authority of the Philippines (the “CAAP”) was created as an attached agency of the department of transportation and communications, with jurisdiction over the restructuring of the civil aviation system of the Philippines and the promotion, development and regulation of the technical, operational, safety and aviation security function. The creation of the CAAP was intended to update and strengthen the international framework of the country’s civil aviation industry and meet the standards set by the international civil aviation organization.

In the exercise and performance of its powers and duties, the CAAP shall consider the following, as being in the public interest and in accordance with public convenience and necessity: (i) the development and utilization of the air potential of the Philippines; (ii) the encouragement and development of an air transportation system properly adapted to the present and future of foreign and domestic commerce of the Philippines; (iii) the regulation of air transportation in such manner as to support sound economic condition in such transportation and to improve the relations between air carriers; (iv) ensuring the safety, quality, reliability and affordability of air transport service for the riding public; and (v) the encouragement and

development of a viable and competitive Philippine aviation industry. Further, the CAAP board of directors is responsible for the planning, development, construction, operation, maintenance or expansion of airports.

OTHER REGULATORY MATTERS

Registration under the Board of Investments

Under the Omnibus Investments Code, a Board of Investments-registered enterprise may enjoy certain incentives provided such enterprise invests in preferred areas of investment enumerated in the Investment Priorities Plan annually prepared by the Government. However, prior to registration with the BOI, the enterprise must first satisfy the minimum equity required to finance the project applied equivalent to 25% of the estimated project cost, or as may be prescribed by the Board of Investments.

Such incentives may include: (i) income tax holiday; (ii) additional deduction for labor expenses; (iii) tax exemption on imported capital equipment; (iv) tax credit on domestic capital equipment; (v) exemption from contractor's tax; (vi) simplification of customs procedure; (vii) unrestricted use of consigned equipment; (viii) employment of foreign nationals; (ix) tax exemption on imported spare parts; and (x) exemption from wharfage dues and export duties and fees.

Intellectual Property

Under the Intellectual Property Code of the Philippines (the "Intellectual Property Code"), the rights to a trademark are acquired through registration with the Bureau of Trademarks of the Intellectual Property Office of the Philippines, which is the principal government agency involved in the registration of brand names, trademarks, patents and other registrable intellectual property materials. Once the mark has been duly registered, the Intellectual Property Office issues a certificate of registration to the owner of the mark, which shall serve as prima facie evidence of (i) the validity of registration, (ii) the registrant's ownership of the mark, and (iii) the registrant's exclusive right to use the mark in connection with the goods or services and those that are related thereto as specified in the certificate.

Registration of a trademark is valid for an initial period of ten years; thereafter, it may be renewed for ten-year periods by the registrant upon payment of the prescribed fee and upon the filing of a request with the Intellectual Property Office for such purpose within six months prior to the date of expiration of registration.

Advertising Regulations

The Consumer Act protects consumers from misleading advertisement and fraudulent sales and promotion practices. Any false, deceptive or misleading advertisement for the purpose of inducing or which is likely to induce, directly or indirectly, the purchase of consumer products or services is prohibited.

In addition, any advertisement involving signs or signboard structures is covered by the national building code of the Philippines and requires securing prior permit for the installation or attachment of any sign to the structure.

The Advertising Board of the Philippines (the "AdBoard"), a non-stock, non-profit corporation, is an umbrella of organizations involved in the advertising industry which has the power to impose sanctions on its members who broadcast advertisements without prior clearance of the AdBoard. Further, it has adopted a code of ethics and is guided by the Advertising Content Regulation Manual of Procedures and the Standards of Trade Practices and Conduct Manual.

Labor and Employment

The Philippine Department of Labor and Employment ("DOLE") is the Philippine government agency mandated to formulate policies, implement programs and services, and serve as the policy-coordinating arm of the Executive Branch in the field of labor and employment. The DOLE has exclusive authority in the administration and enforcement of labor and employment laws such as the Labor Code of the Philippines and

the Occupational Safety and Health Standards, as amended, and such other laws as specifically assigned to it or to the Secretary of the Department of Labor and Employment.

Social Security System, PhilHealth and the Pag-IBIG Fund

An employer, or any person who uses the services of another person in business, trade, industry or any undertaking is required under the Social Security Act of 1997 to ensure coverage of employees following procedures set out by the law and the Social Security System (“SSS”). Under the said law, an employer must deduct from its employees their monthly contributions based on a given schedule, pay its share of contribution and remit these to the SSS within a period set by law and/ or SSS regulations.

Employers are likewise required to ensure enrollment of its employees in a National Health Program administered by the Philippine Health Insurance Corporation (“PhilHealth”) a government corporation attached to the DOH tasked with ensuring sustainable, affordable and progressive social health insurance pursuant to the provisions of the National Health Insurance Act of 1995. Under the Home Development Mutual Fund Law of 2009, all employees who are covered by the Social Security Act of 1997 must also be registered with and covered by the Home Development Mutual Fund, more commonly referred to as the Pag-IBIG Fund.

ENVIRONMENTAL MATTERS

The operations of SMC's businesses are subject to various laws, rules and regulations that have been promulgated for the protection of the environment.

EISS Law

The Philippine Environmental Impact Statement System (the "EISS Law"), which is implemented by the DENR, is the general regulatory framework for any project or undertaking that is either (a) classified as environmentally critical or (b) is situated in an environmentally critical area. It requires an entity that will undertake any such declared environmentally critical project or operate in any such declared environmentally critical area to submit an Environmental Impact Statement ("EIS") which is a comprehensive study of the significant impacts of a project on the environment. The EIS serves as an application for the issuance of an Environmental Compliance Certificate ("ECC"), if the proposed project is environmentally critical or situated in an environmentally critical area, otherwise, for the issuance of a Certificate of Non-Coverage ("CNC"). An ECC is a Philippine government certification that, among others, (i) the proposed project or undertaking will not cause significant negative environmental impact; (ii) the proponent has complied with all the requirements of the EISS in connection with the project; and (iii) the proponent is committed to implement its approved Environmental Management Plan in the EIS. In general, only projects that pose potential significant impact on the environment shall be required to secure an ECC. The proponent of a project for which an ECC is issued and determined by the DENR to pose a significant public risk or necessitate rehabilitation or restoration shall be required to establish an environmental guarantee fund. Such fund is intended to meet any damage caused by, as well as any rehabilitation and restoration measures in connection with, the said project.

The Clean Water Act

The Clean Water Act and its implementing rules and regulations provide for water quality standards and regulations for the prevention, control, and abatement of pollution of the country's water resources. The Clean Water Act requires owners or operators of facilities that discharge regulated effluents (such as wastewater from manufacturing plants or other commercial facilities) to secure a discharge permit from the DENR which authorizes the owners and operators to discharge waste and/or pollutants of specified concentration and volumes from their facilities into a body of water or land resource for a specified period of time. The DENR, together with other government agencies and the different local government units, is tasked to implement the Clean Water Act and to identify existing sources of water pollutants, as well as strictly monitor pollution sources which are not in compliance with the effluent standards provided in the law.

The Clean Air Act

As previously discussed in this Offering Circular, enterprises that operate or utilize air pollution sources are required to obtain an Authority to Construct or a Permit to Operate from the DENR with respect to the construction or the use of air pollutants. The issuance of the said permits seek to ensure that regulations of the DENR with respect to air quality standards and the prevention of air pollution are achieved and complied with by such enterprises.

The Renewable Energy Act

Republic Act No. 9513, also known as the Renewable Energy Act of 2008 aims to promote development and commercialization of renewable and environment-friendly energy resources such as biomass, solar, and wind through various tax incentives. Some of the tax incentives granted to renewable energy developers under the said law include (i) a seven-year income tax holiday; (ii) duty free importation of renewable energy machinery, equipment, and materials; (iii) special realty tax rates on equipment and machinery; (iv) zero percent VAT rate for power generated from these energy sources; and (v) the imposition of a reduced corporate tax of 10% on its net taxable income after the income tax holiday.

Other Environmental Laws

Other regulatory environmental laws and regulations applicable to SMC's businesses include the following:

- The Toxic Substances and Hazardous and Nuclear Waste Control Act of 1990, which regulates, restricts or prohibits the (i) importation, manufacture, processing, handling, storage, transportation, sale, distribution, use and disposal of chemical substance and mixtures that present unreasonable risk or injury to health or the environment, and (ii) entry into the Philippines or the keeping in storage of hazardous wastes which include by-products, process residue, contaminated plant or equipment or other substances from manufacturing operations. The said law is implemented by the DENR.
- The Ecological Solid Waste Management Act of 2000, which provides for the proper management of solid waste which includes discarded commercial waste and non-hazardous institutional and industrial waste. The said law prohibits, among others, the transporting and dumping of collected solid wastes in areas other than prescribed centers and facilities. The National Solid Waste Management Commission, together with other government agencies and the different local government units, are responsible for the implementation and enforcement of the said law.
- The Code on Sanitation of the Philippines (the "Sanitation Code"), which provides for sanitary and structural requirements in connection with the operation of certain establishments such as food establishments which include such places where food or drinks are manufactured, processed, stored, sold or served. Under the Sanitation Code, which is implemented by the DOH, food establishments are required to secure sanitary permits prior to operation which shall be renewable on a yearly basis.

BSP FOREIGN EXCHANGE REGULATIONS

Under current BSP regulations, an investment in listed Philippine securities (such as the Shares) must be registered with the BSP if the foreign exchange needed to service the repatriation of capital and the remittance of dividends, profits and earnings derived from such Shares is to be sourced from the Philippine banking system. The application for registration is made with the BSP through an investor's designated custodian bank on behalf of the BSP. A custodian bank may be any authorised agent bank of the BSP or an offshore banking unit registered with the BSP to act as such and appointed by the investor to register the investment, hold shares for the investor, and represent the investor in all necessary actions in connection with such investor's investments in the Philippines. Applications for registration must be accompanied by: (i) a purchase invoice, subscription agreement and proof of listing on the PSE (either or both) and (ii) the original Certificate of Inward Remittance of foreign exchange and its conversion to Pesos through an authorised agent bank of the BSP in the format prescribed by the BSP.

Upon registration of the investment, proceeds of divestments, or dividends of registered investments are repatriable or remittable immediately and in full through the Philippine banking system, net of applicable tax, without need of BSP approval. Capital repatriation of investments in listed securities is permitted upon presentation of the BSP registration document from the registering custodian bank and the broker's sales invoice, at the exchange rate prevailing at the time of purchase of the foreign exchange from the banking system. Remittance of dividends is permitted upon presentation of: (i) the BSP registration document from the registering custodian bank; (ii) the cash dividends notice from the PSE and the Philippine Central Depository printout of cash dividend payment or computation of interest earned; (iii) copy of secretary's sworn statement on the board resolution covering the dividend declaration and (iv) detailed computation of the amount applied for in the format prescribed by the BSP. Pending reinvestment or repatriation, divestment proceeds, as well as dividends of registered investments, may be lodged temporarily in interest-bearing deposit accounts. Interest earned thereon, net of taxes, may also be remitted in full. Divestment proceeds or dividends of registered investments may be reinvested in the Philippines if the investments are registered with the BSP or the investor's custodian bank.

The foregoing is subject to the power of the BSP, through the Monetary Board, with the approval of the President of the Philippines, to suspend temporarily or restrict the availability of foreign exchange, require licensing of foreign exchange transactions or require delivering of foreign exchange to the BSP or its designee during an exchange crisis, when an exchange crisis is imminent, or in times of national emergency.

BOARD AND SENIOR MANAGEMENT

BOARD

The table below sets forth each member of the Board as of the date of this Offering Circular.

<u>Name⁽¹⁾</u>	<u>Year of Birth</u>	<u>Position</u>
Eduardo M. Cojuangco, Jr.	1935	Chairman
Ramon S. Ang	1954	Vice Chairman
Estelito P. Mendoza	1930	Director
Iñigo Zobel	1956	Director
Winston F. Garcia	1958	Independent Director
Menardo R. Jimenez.	1932	Director
Leo S. Alvez	1943	Director
Hector L. Hofileña	1929	Director
Carmelo L. Santiago.	1943	Independent Director
Joselito D. Campos, Jr.	1951	Director
Roberto V. Ongpin	1937	Director
Eric O. Recto	1963	Director
Alexander J. Poblador	1953	Director
Ferdinand K. Constantino	1951	Director, Senior Vice President, CFO and Treasurer
Reynato S. Puno.	1943	Independent Director

⁽¹⁾ Each member of the Board is a Filipino citizen.

Eduardo M. Cojuangco, Jr. is the CEO and Chairman of SMC and has over 40 years of senior managerial experience in the Philippines. He is also the Chairman of the Executive Committee and concurrently holds the following positions: Chairman and Chief Executive Officer, Ginebra; and Chairman of SMPFC. He is also the Chairman of ECJ & Sons Agricultural Enterprises, Inc. and the Eduardo Cojuangco, Jr. Foundation, Inc., and a Director of Cainaman Farms, Inc. and Petron. He is a former Director of Meralco. Previously, the positions he held include: President and Chief Executive Officer of United Coconut Planters Bank; President and Director of United Coconut Life Assurance Corporation and Governor of the Development Bank of the Philippines. Mr. Cojuangco was formerly a member of the House of Representatives (1970 to 1972), Governor of Tarlac (1967 to 1979) and Philippine Ambassador Plenipotentiary. He attended the University of the Philippines — Los Baños College of Agriculture and the California Polytechnic College in San Luis Obispo, USA and was conferred a post graduate degree in Economics, *honoris causa*, from the University of Mindanao.

Ramon S. Ang is the Vice Chairman since 1999, President and Chief Operating Officer since 2002 and has over 30 years of senior managerial experience in the Philippines. He is also a Member of the Executive Committee and Nomination and Hearing Committee. He also holds, among others, the following positions: Chairman of SMB, SMPI, SMYPC, Anchor Insurance Brokerage Corporation and San Miguel Brewery Hong Kong Ltd. (Hong Kong); a Director of Ginebra, SMPFC and the Selling Shareholder. He is also the Chairman and Chief Executive Officer of Petron and SMCGP; Chairman of Liberty, Philippine Diamond Hotel & Resort, Inc., Philippine Oriental Realty Development, Inc., Atea Tierra Corporation and Cyber Bay Corporation; Vice Chairman of Meralco; and an Independent Director of Philweb Corporation. Mr Ang has held directorships in various subsidiaries of SMC in the last five years. Previously, Mr. Ang was the Chief Executive Officer of the Paper Industries Corporation of the Philippines and Executive Managing Director of Northern Cement Corporation, Aquacor Food Marketing, Inc., Marketing Investors Inc., PCY Oil Mills, Metroplex Commodities, Southern Island Oil Mills and Indophil Oil Corporation. He has a Bachelor of Science degree in Mechanical Engineering from the Far Eastern University.

Estelito P. Mendoza has been a Director since 1998. He is a Member of SMC's Executive Committee, Audit Committee, and Nomination and Hearing Committee. He is also a Director of Petron, Meralco and Philippine Airlines, Inc., and Chairman of Prestige Travel, Inc. Atty. Mendoza, a former Solicitor General, Minister of Justice, Member of the Batasang Pambansa and Governor of the Province of Pampanga, heads the E.P. Mendoza Law Office. He is also a former Chairman of Dutch Boy Philippines, Inc. and Alcorn Petroleum and Minerals Corporation, and Director of East-West Bank. His professional affiliations include membership with the Integrated Bar of the Philippines, the Philippine Bar Association, International Academy of Trial Lawyers (USA), and the American Society of International Law. Mr Mendoza took his pre-law course and Bachelor of Laws degree, *cum laude*, at the University of the Philippines. He also holds a Master of Laws degree from Harvard Law School.

Iñigo Zobel has been a Director since 1999. He also holds the following positions: President and Chief Executive Officer of E. Zobel, Inc., President of Ayala España S.A., Calatagan Golf Club, Inc. and Hacienda Bigaa, Inc.; Chairman of the board of directors of the Selling Shareholder, Vice Chairman of SMCGP, and a Director of Calatagan Resort, Inc., Calatagan Gulf Realty, Inc., and Mermac, Inc. He was previously the President of Diamond Star Agro Products, Inc. (1985-2007) and an Independent Director of San Miguel Pure Foods Company Inc. (2006-2009).

Winston F. Garcia has been a Director since 2001. He is a Member of SMC's Audit Committee, Executive Compensation Committee and Nomination and Hearing Committee. Garcia was the President and General Manager of the Government Service Insurance System and Vice Chairman of its Board of Trustees. He has also held the following positions: Chairman of the National Reinsurance Corporation of the Philippines, GSIS Mutual Fund, Inc., ASEAN Forum, Incorporated and Philippine Social Security Association; Director of Philippine National Construction Corporation, and PhilHealth; Board Member of ASEAN Social Security Association; and a Member of the International Insurance Society, Inc., International Social Security Association, and Federation of Afro Insurers and Reinsurers. Mr. Garcia has been a practicing lawyer since 1983.

Menardo R. Jimenez has been a Director since 2002. He is also the Chairman of SMC's Executive Compensation Committee and a Member of the Executive Committee. He is also a Director of San Miguel Pure Foods Company Inc., and Magnolia Inc. ("Magnolia"). He is currently the chairman of the board of directors of United Coconut Planters Bank. His other positions include: President and Chief Executive Officer of Albay-Agro Industrial Development Corporation; Chairman and President of Majent Management and Development Corporation, Majent Agro Industrial Corporation, M. A. Jimenez Enterprises, Inc., Pac Rim Realty Development Corporation, Television International Corporation, Alta Tierra Resources, Inc. and Fibers Trading, Inc.; Chairman of Cable Entertainment Corporation, Majent Foundation, Inc., Marathon Building Technologies, Inc. and Meedson Properties Corporation; and a Director of First Metro Investment Corporation, Cunickel Mining Corporation, Electronic Realty Associates, Inc., Mabuhay Philippines Satellite Corporation, Franchise One Corporation, CBTL Holdings, Inc., CCC Insurance Corporation and Pan-Phil Aqua Culture Corporation.

Leo S. Alvez has been Director since 2002. He is also a Member of SMC's Nomination and Hearing Committee. He is also a Director of Ginebra and San Miguel Pure Foods Company Inc. Ret. Major General Alvez is a former Security Consultant to the Prosecution Panel of the Senate Impeachment Trial of President Joseph Estrada (2000-2001), Vice Commander of the Philippine Army (1998), and Division Commander of the 7th Infantry Division (1996-1998).

Hector L. Hofileña has been a Director since 2008. He is also a Member of SMC's Executive Committee and Audit Committee. He is a former Associate Justice of the Court of Appeals (1994-1999) and currently Director of SMPI. Justice Hofileña is a professor at the Ateneo De Manila University School of Law.

Carmelo L. Santiago has been an Independent Director of SMC since 2008 and the Chairman of SMC's Audit Committee, and Member of the Executive Committee, Executive Compensation Committee and Nomination and Hearing Committee. He is an Independent Director of SMB, Ginebra, SMPI, Anchor Insurance Brokerage Corporation, San Miguel Brewery Hong Kong Limited (Hong Kong) and Liberty; and

Director of Terbo Concept. Mr. Santiago is the founder and owner of several branches of Melo's Restaurant and founder of Wagyu Restaurant.

Joselito D. Campos, Jr. has been a Director since 2010. He is the Managing Director and Chief Executive Officer and a Director of Del Monte Pacific Ltd, and President and Chief Executive Officer of Del Monte Philippines. He is also the Chairman and Chief Executive Officer of the NutriAsia Group of Companies, a major food conglomerate in the Philippines, Chairman of Fort Bonifacio Development Corp. and Vice-Chairman of Ayala-Greenfield Development Corp., two major Philippine property developers. He is also a Director of FieldFresh Foods (P) Ltd., a joint venture of DMPL with the Bharti Group of India, one of India's largest companies. He was the former Chairman and Chief Executive Officer of United Laboratories, Inc. and its regional subsidiaries and affiliates. He is also the Honorary Consul in the Philippines for the Republic of Seychelles. He is Chairman of the Metropolitan Museum of Manila and a Trustee of the Asia Society in the Philippines, the Philippines-China Business Council, the Philippine Center for Entrepreneurship and the World Wildlife Fund for Nature-Philippines. Mr. Campos holds a Master of Business Administration degree from the Johnson School, Cornell University.

Roberto V. Ongpin has been a Director since 2009. He also holds the following positions: Director of Petron, the Selling Shareholder, Araneta Properties, Inc. and Shangri-La Asia (Hong Kong); Chairman of PhilWeb Corporation, ISM Communications Corporation, Developing Countries Investment Corporation, Alphaland Corporation, Atok-Big Wedge Co., Inc., and Acentic GmbH; Nonexecutive Director, Forum Energy PLC (UK) and Deputy Chairman, South China Morning Post (Hong Kong). He served as Minister of Trade and Industry of the Republic of the Philippines from 1979 to 1986. Mr. Ongpin holds a Bachelor of Science in Business Administration, major in Accountancy, *cum laude*, from the Ateneo de Manila University. He is a Certified Public Accountant and has a Master of Business Administration degree from Harvard Business School.

Eric O. Recto has been a Director since 2010. He is the President/Executive Director of Petron since 2008 and a member of the Executive Compensation Committee and the Nomination and Hearing Committee. He is currently the Vice Chairman and President of ISM Communications Corporation and Director and President of the Selling Shareholder. He is also Vice Chairman of Philweb Corporation and Alphaland Corporation. He was previously Undersecretary of the Department of Finance, in charge of both the International Finance Group and the Privatization Office from 2002 to 2005. Before joining the Philippine government, Mr. Recto was CFO of Alaska Milk Corporation from 2000 to 2002 and Belle Corporation from 1994 to 2000. Mr. Recto has a degree in Industrial Engineering from the University of the Philippines and has a Master of Business Administration degree from the Johnson School, Cornell University.

Alexander J. Poblador has been a Director since 2009. He is the Founding Partner and Chairman of the Executive Committee of Poblador Bautista & Reyes Law Office. Atty. Poblador is a practicing lawyer, specializing in the fields of commercial litigation, international arbitration, real estate finance and project development, bankruptcy and corporate reorganization. He is a graduate of the University of the Philippines, Bachelor of Arts (1974), *cum laude*, and Bachelor of Laws (1978), *cum laude* and class valedictorian. He completed his Master of Laws degree at the University of Michigan at Ann Arbor (1982).

Ferdinand K. Constantino has been a Director since 2010. He is SMC's Chief Finance Officer and Treasurer. He also holds, among others, the following positions: President of Anchor Insurance Brokerage Corporation, and a Director of SMB, SMYPC, SMCGP, and the Selling Shareholder. Mr. Constantino previously served as Chief Finance Officer of the San Miguel Beer Division (1999-2005) and as Chief Finance Officer and Treasurer of SMB (2007-2009); Director of San Miguel Pure Foods Company Inc. (2008-2009) and SMPI (2001-2009); and Chief Finance Officer of Meralco (2009). He has held directorships in various subsidiaries of SMC during the last five years.

Reynato S. Puno was elected to the Board as an independent director on January 20, 2011. Former Chief Justice Reynato S. Puno served as the Chief Justice of the Supreme Court from December 6, 2006 until his retirement on May 17, 2010. He joined the Court as an Associate Justice on June 1993 and was previously Associate Justice of the Court of Appeals (1986 to 1993), Appellate Justice of the Intermediate Appellate Court (1983), Assistant Solicitor General (1974-1982) and City Judge of Quezon City (1972-1974). He has

also served as Deputy Minister of Justice from 1984-1986. He completed his Bachelor of Laws from the University of the Philippines in 1962, and has a Master of Laws degree from the University of California in Berkeley (1968) and a Master in Comparative Law degree from the Southern Methodist University, Dallas, Texas (1967).

SENIOR MANAGEMENT

The table below sets forth senior executive officers of SMC and its key subsidiaries as of the date of this Offering Circular.

<u>Name⁽¹⁾</u>	<u>Year of Birth</u>	<u>Position</u>
Eduardo M. Cojuangco, Jr.	1935	Chairman and Chief Executive Officer
Ramon S. Ang	1954	Vice Chairman, President and Chief Operating Officer
Ferdinand K. Constantino	1951	Director, Senior Vice President, Chief Finance Officer and Treasurer
Virgilio S. Jacinto	1956	Corporate Secretary, Senior Vice President, General Counsel and Compliance Officer
Joseph N. Pineda	1963	Senior Vice President, Deputy Chief Finance Officer
Aurora T. Calderon.	1954	Senior Vice President, Senior Executive Assistant to the President and Chief Operating Officer
Sergio G. Edeza	1957	Senior Vice President, Head of Treasury
Francisco S. Alejo III	1948	President and Director of SMPFC
Ferdinand A. Tumpalan	1960	President of SMYPC
Roberto N. Huang	1948	President of SMB
Gerardo C. Payumo	1958	President of Ginebra
Carlos Antonio M. Berba	1965	Managing Director of SMBIL

⁽¹⁾ Each of the senior executive officers is a Filipino citizen.

Virgilio S. Jacinto is the Corporate Secretary, Senior Vice President and General Counsel and Compliance Officer of SMC (since October 8, 2010). He is a Director of SMB and Petron. He was formerly the Vice President and First Deputy General Counsel from 2006 to 2010 and appointed as SMC General Counsel in 2010. He was Director and Corporate Secretary of United Coconut Planters Bank, Partner at Villareal Law Offices and Associate at SyCip, Salazar, Feliciano & Hernandez Law Office. Mr. Jacinto is an associate professor at the University of the Philippines. He obtained his law degree from the University of the Philippines where he was the class salutatorian and placed sixth in the 1981 Bar Examinations. He holds a Master of Laws degree from Harvard University. In addition, Mr. Jacinto holds various directorships in various local and offshore subsidiaries of SMC.

Joseph N. Pineda is the Senior Vice President and Deputy Chief Finance Officer of SMC. He was formerly Vice-President of SMC prior to his promotion on July 27, 2010, and has been the Deputy Chief Financial Officer since December 2005. He was previously Special Projects Head of SMC since January 2005. Mr. Pineda has a degree of Bachelor of Arts in Economics from San Beda College and obtained units towards a Master in Business Administration degree from De La Salle University. In addition, Mr. Pineda holds directorships in various SMC subsidiaries.

Aurora T. Calderon is the Senior Vice President-Senior Executive Assistant to the President and Chief Operating Officer of SMC since January 20, 2011. Previous to her appointment, she was a consultant of SMC reporting to the Chief Operating Officer since 1998. She is also a member of the board of directors of Petron, Petron Marketing Corporation, Petron Freeport Corporation, SMCGP, SRC, Thai San Miguel Liquor Co., Ltd., NVRC, Las Lucas Construction and Development Corp., and Kankiyo Corporation. She is the President and a

Director of Total Managers, Inc. and was a Director of Meralco (2008-2009). She is also the Treasurer of the Selling Shareholder. A certified public accountant, Ms. Calderon graduated from the University of the East with a degree in Bachelor of Science in Business Administration, major in Accountancy, *magna cum laude*. In addition, Ms. Calderon holds directorships in various SMC subsidiaries.

Sergio G. Edeza is the Senior Vice President and Head of Treasury of SMC. Prior to joining SMC, Mr. Edeza was a Director of Merchant's Bank (2008), President (2007) and Director (2008) of Money Market Association of the Philippines, Executive Vice President and Treasurer of Rizal Commercial Banking Corporation, Treasury Consultant of YGC Corporate Services, and President and CEO of PhilEXIM Guarantee Corporation. He was also Treasurer of the Republic of the Philippines from February 16, 2001 to February 16, 2004. Mr. Edeza is a Certified Public Accountant and a Career Service Professional. He obtained his Bachelor of Science in Commerce degree and Master of Business Administration degree from the De La Salle University, and was accepted at the John F. Kennedy School of Government at Harvard University. In addition, Mr. Edeza holds various directorships in various SMC subsidiaries.

Francisco S. Alejo III is the President (since 2005) and a Director (since 2001) of San Miguel Pure Foods Company Inc. He also holds the following positions: Vice Chairman of San Miguel Foods, Inc.; President of The Purefoods-Hormel Company, Inc., Magnolia and San Miguel Super Coffeemix Co., Inc.; and Chairman and President of Sugarland Corporation and Star Dari, Inc.

Ferdinand A. Tumpalan has been President of SMYPC since 2005. He is also President of SMYAC, San Miguel Paper Packaging Corporation, Mincorr and SMC Yamamura Fuso Molds Corporation. He is a former President of SMC's Packaging Products Division in 2005.

Roberto N. Huang is the President of SMB. He also served as General Manager of SMB (2007-2009); Director of Ginebra (2004-2008), SMPFC (2004-2008); President of SMB (2007-2008); and President of Coca-Cola Bottlers Philippines, Inc., Cosmos Bottling Corporation and Philippine Beverage Partners, Inc. (2003-2007).

Gerardo C. Payumo has been President of Ginebra since 2006. He was a former Senior Vice President and Director of the Corporate Procurement Unit of SMC (1998-2006).

Carlos Antonio M. Berba has been Managing Director of SMBIL since 2008. He is also currently Director of San Miguel Brewery Hong Kong Limited (Hong Kong) and a Commissioner of PT Delta Djakarta Tbk (Indonesia). He previously served SMC as President of the San Miguel Beer Division (2006); and Vice President, CFO for International Beer Operations and Director for Business Planning and Information Management, San Miguel Beer Division (2002-2006).

Board Committees

Executive Committee

The Executive Committee is currently composed of six directors, which includes the Chairman of the Board and Chief Executive Officer, Vice-Chairman of the Board, President and Chief Operating Officer and an independent director in the person of Mr. Carmelo Santiago. Mr. Eduardo M. Cojuangco, Jr. sits as Chairman of the Committee.

The Committee acts within the power and authority granted upon it by the Board and is called upon when the Board is not in session to exercise the powers of the latter in the management of the Company, with the exception of the power to appoint any entity as general managers or management or technical consultants, to guarantee obligations of other corporations in which the company has lawful interest, to appoint trustees who, for the benefit of the Company, may receive and retain such properties of the Company or entities in which it has interests and to perform such acts as may be necessary to transfer ownership of such properties to trustees of the Company, and such other powers as may be specifically limited by the Board or by law.

Audit Committee

The Audit Committee is currently composed of five members with two independent directors as members, Mr. Carmelo L. Santiago, who also sits as Committee Chairman, and Mr. Winston Garcia.

The Audit Committee reviews and monitors, among others, the integrity of all financial reports and ensures their compliance with both the internal financial management manual and pertinent accounting standards, including regulatory requirements. It also performs oversight financial management functions and risk management, approves audit plans, directly interfaces with internal and external auditors, and elevates to international standards the accounting and auditing processes, practices, and methodologies of the Company.

Nomination and Hearing Committee

The Nomination and Hearing Committee is currently composed of six voting directors— two of whom are independent, Mr. Carmelo Santiago and Mr. Winston F. Garcia — and one non-voting member, the head of SMC's Corporate Human Resources' department. Atty. Estelito P. Mendoza is the Chairman of the Committee.

The primary function of the Nomination and Hearing Committee is to screen and shortlist candidates for members of the Board nominated by the shareholders in accordance with the qualifications and disqualifications for directors set out in the company's Manual on Corporate Governance, the amended articles of incorporation and amended by-laws of the Company and applicable laws, rules and regulations.

Executive Compensation Committee

The Executive Compensation Committee of SMC is composed of five directors, two of whom are independent in the persons of Mr. Winston F. Garcia and Mr. Carmelo L. Santiago. Mr. Menardo R. Jimenez is Chairman of the Committee.

The Executive Compensation Committee advises the Board in the establishment of formal and transparent policies and practices on directors and executive remuneration and provides oversight over remuneration of senior management and other key personnel — ensuring consistency with the company's culture, strategy and control environment. In meetings during 2010, the Committee, among others, designated the amount of remuneration for directors and reviewed promotions of certain executive officers.

Compliance and Monitoring System

The Compliance Officer of SMC is Virgilio S. Jacinto.

The Compliance Officer is appointed by the Board. He or she is responsible for monitoring compliance by SMC with the provisions and requirements of the Manual and the rules and regulations of the relevant regulatory agencies, and ensures adherence to corporate principles and best practices. The Compliance Officer holds the position of a Vice President or its equivalent and has direct reporting responsibilities to the Chairman of the Board.

RELATED PARTY TRANSACTIONS

SMC and its subsidiaries, in their ordinary course of business, have entered into transactions with affiliates and other related parties, principally consisting of advances and sale and purchase of services and/or products. Transactions with related parties are entered into on an arm's length basis. See note 34 to SMC's consolidated financial statements included elsewhere in this Offering Circular for more detailed information.

TOP FRONTIER SHAREHOLDING IN SMC

On November 27, 2009, the Selling Shareholder acquired 857,115,914 Common Shares from San Miguel Corporation Retirement Plan for ₱64,284 million, at ₱75.00 per share.

On January 7, 2010, the Selling Shareholder entered into a share purchase agreement with Q-Tech to acquire 327,000,000 Common Shares for ₱66.00 per share. As a consequence of entering into such agreement, the Selling Shareholder was required under the Securities Regulation Code of the Philippines (the "Securities Regulation Code") to make a tender offer for all SMC shares held by other parties as the acquisition would result in the Selling Shareholder acquiring 35.0% or more of the issued and outstanding shares of SMC in one or more transactions within a 12-month period. On April 8, 2010 such tender offer closed and a total of 79,460,178 Common Shares were tendered for ₱75.00 per share, for a total consideration of ₱5,959.5 million. Such tendered shares were crossed in the PSE on April 13, 2010 together with the 327,000,000 Common Shares acquired from Q-Tech under the share purchase agreement.

Following the tender offer, Top Frontier acquired in the open market a total of 1,942,906 Common Shares for ₱75 per share.

On March 16, 2011, the Selling Shareholder acquired an additional 301,666,675 Common Shares for ₱21,117 million, at ₱70.00 per share pursuant to an option it acquired in the share purchase agreement, dated as of January 7, 2010, with Q-Tech.

As of March 31, 2011, the Selling Shareholder held 1,567,185,673 Common Shares, representing approximately 67.2% of the issued and outstanding Common Shares.

Pursuant to an agreement entered into on November 20, 2009, the Selling Shareholder acquired an option from the group of 44 companies associated with Eduardo M. Cojuangco, Jr., the Chairman of SMC, to acquire 476,722,639 Class A and 16,652,544 Class B Common Shares held by such companies for ₱37,003 million, at an option strike price of ₱75.00 per share. This option may be exercised by the Selling Shareholder at any time until November 19, 2012.

SMC SHAREHOLDING IN TOP FRONTIER

SMC acquired 2,401,960 common shares of the Selling Shareholder, having a par value of ₱100.00 per share, representing an approximately 49% equity interest in the issued and outstanding common shares of the Selling Shareholder, on January 7, 2010. Such shares were purchased from the Selling Shareholder's unissued capital stock for ₱44,676 million.

SMC also holds 2,598,040 preferred shares of the Selling Shareholder, representing 100% of the issued and outstanding preferred shares of the Selling Shareholder. On January 7, 2010, SMC paid the total consideration for such shares of ₱48,324 million as a deposit for future subscription for these preferred shares. The preferred shares were issued to SMC on October 22, 2010 after the Philippine SEC approved the Selling Shareholder's application for an increase in its authorized capital stock on August 6, 2010.

The preferred shares are entitled to receive dividends at a fixed annual rate of 3% of the issue price on a cumulative basis having a par value of ₱100.00 per share. The preferred shares are non-voting and participating and are redeemable in whole or in part, at the sole option of the Selling Shareholder, at their issue price of ₱18,600 per share, plus any accrued and unpaid dividends.

LOANS AND ADVANCES TO TOP FRONTIER

The total advances to Top Frontier from its shareholders as of December 31, 2010 were ₱14,691.5 million (approximately US\$335 million) of which ₱2,543 million was advanced by SMC. Such advances were used to partially pay for the purchase by Top Frontier of Common Shares from Q-Tech and complete the related tender offer discussed above.

With the exercise of the option on Common Shares held by Q-Tech on March 16, 2011, Top Frontier shareholders other than SMC advanced an additional amount to Top Frontier of approximately US\$487 million to fund the exercise price. Such advance increased the total advances to Top Frontier by its shareholders to approximately US\$822 million as of March 31, 2011.

SMC's RETIREMENT PLAN

SMC's total advances to the SMC Retirement Fund were ₱3,997 million and ₱2,785 million as of December 31, 2010 and 2009, respectively, which accrue interest at 6.5% per annum.

SMPI received advances from the SMC Retirement Fund totaling ₱1,800 million as of December 31, 2010. Such advances were used mainly for the acquisition of additional shares in BOC. In addition, SMPI had advances to the SMC Retirement Fund totalling ₱2 million as of December 31, 2010.

MERALCO

SMC had sales of electricity to Meralco of ₱17,103 million in 2010. SMC purchased electric utility services from Meralco totalling ₱692 million in 2009 and ₱490 million in 2010.

SMC held a 33.2% equity interest in Meralco as of December 31, 2010.

VEGA

Vega had advances to LTHI totalling ₱145 million as of December 31, 2010.

BOC

SMC has outstanding receivables from BOC totalling ₱4 million as of December 31, 2010.

PETRON

As of December 31, 2010, Petron had noncurrent receivables of ₱22,435 million from the Petron Corporation Employee Retirement Plan, which receivables are subject to interest at the rate of 4.0% per annum.

SMEC

As of December 31, 2009, SMC had advances to SMEC totalling ₱315 million.

DESCRIPTION OF THE SHARES

The following is general information relating to SMC's capital stock. It does not purport to be complete or to give full effect to the applicable provisions of law and is in all respects qualified by reference to the applicable provisions of SMC's Amended Articles of Incorporation and Amended By-laws.

SHARE CAPITAL

As of the date of this Offering Circular, SMC has an authorized capital stock of ₱22.5 billion, composed of 3.390 billion common shares and 1.110 billion Series "1" preferred shares, all with a par value of ₱5.00 per share.

All shares rank equally with regard to SMC's residual assets, except that holders of preferred shares participate only to the extent of the issue price of such shares plus any accumulated and unpaid cash dividends.

Common Shares

As of December 31, 2010, there were 3,268,594,254 issued Common Shares, of which 938,648,724 were treasury shares, and 2,329,945,530 were issued and outstanding Common Shares.

Preferred Shares

The Series "1" preferred shares are peso-denominated, perpetual, cumulative and non-voting with a par value of ₱5.00 per share, an issue price of ₱75.00 per share and a dividend rate of 8% per annum computed with reference to the issue price. The Series "1" preferred shares are redeemable in whole or in part, at the sole option of SMC, after the end of three years from issue date, or on any dividend payment date thereafter, at ₱75.00 plus any accumulated and unpaid cash dividends. Unless the Series "1" preferred shares are redeemed by SMC, the dividend rate will be adjusted at the end of the fifth year after their issue date. As of December 31, 2010, there were issued and outstanding 970,506,353 Series "1" preferred shares, 873,173,353 of which were issued on October 5, 2009, and 97,333,000 on December 22, 2009.

VOTING RIGHTS OF COMMON SHARES

Each Common Share entitles the holder to one vote.

At each meeting of the shareholders, every shareholder entitled to vote on a particular resolution or matter involved is entitled to one vote for each share of stock standing in such shareholders' name in the books of SMC at the time of the closing of the transfer books for such meeting.

In accordance with Section 24 of the Corporation Code, at each election of directors, every shareholder entitled to vote at such election shall have the right to vote, in person or by proxy, the number of shares owned by such shareholder as of the relevant record date for as many persons as there are directors to be elected and for whose election such shareholder has a right to vote, or to cumulate such shareholder's votes by giving one candidate the number of votes equal to the number of directors to be elected multiplied by the number of shares shall equal or by distributing such votes on the same principle among any number of candidates as the shareholder shall see fit.

DIVIDEND RIGHTS OF COMMON SHARES

SMC is allowed to declare dividends on its Common Shares out of its unrestricted retained earnings at such times and in such amounts as may be determined by the Board. Such determination may take into consideration factors such as the implementation of business plans, budgets, funding for new investments, operating expenses, working capital, debt service requirements, and appropriate reserves among other things.

The Board is authorized to declare dividends. A cash dividend declaration does not require any further approval from the shareholders. A stock dividend declaration requires the further approval of shareholders holding or representing not less than two-thirds of SMC's outstanding capital stock. The Corporation Code defines "outstanding capital stock" to mean the "total shares of stock issued to subscribers or shareholders, whether or not fully or partially paid (as long as there is a binding subscription agreement), except treasury shares." Such shareholders' approval may be given at a general or special meeting duly called for such purpose. Holders of the Series "1" preferred shares do not vote on stock dividend declaration. See "Dividend Policy."

RESTRICTIONS ON TRANSFER OF SHARES

SMC may not allow the issuance or the transfer of shares to persons other than Philippine Nationals and cannot record transfers in its books if such issuance or transfer would result in SMC ceasing to be a Philippine National. See “Description of Shares — Restriction on Foreign Ownership” below.

PRE-EMPTIVE RIGHTS

The Corporation Code confers pre-emptive rights on shareholders of a Philippine corporation, which entitle them to subscribe to all issues or other disposition of shares of any class by the corporation in proportion to their respective shareholdings, subject to certain exceptions. A Philippine corporation may provide for the denial of these pre-emptive rights in its articles of incorporation.

SMC’s Amended Articles of Incorporation provide that shareholders shall have no pre-emptive rights to any issuance of any class of shares.

APPRAISAL RIGHTS

Under Philippine law, shareholders dissenting from the following corporate actions may demand payment of the fair value of their shares in certain circumstances:

- in case any amendment to the corporation’s articles of incorporation has the effect of changing and restricting the rights of any shareholder or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class;
- in case of any sale, lease, exchange, transfer, mortgage or other disposition of all or substantially all of the corporate property or assets;
- in case of merger or consolidation;
- in case the corporation decides to invest its funds in another corporation or business or for any purpose other than the primary purpose; and
- in case of extension or shortening of the term of corporate existence.

RESTRICTION ON FOREIGN OWNERSHIP

SMC and certain of its subsidiaries are engaged in activities reserved to Filipino citizens or to corporations or associations at least 60% of the capital of which are owned by such citizens.

Since the aggregate foreign ownership in SMC is limited to a maximum of 40% of its issued and outstanding capital stock, SMC cannot allow the issuance or the transfer of its shares to persons other than Philippine Nationals and cannot record transfers in its books if such issuance or transfer would result in SMC ceasing to be a Philippine National. This restriction may adversely affect the liquidity and market price of the Offer Shares to the extent that international investors are not permitted to purchase SMC’s Common Shares in normal secondary transactions.

STOCK TRANSFER AGENT

SMC’s share register is maintained by its stock transfer agent, SMC Stock Transfer Service Corporation, a corporation organized under the laws of the Republic of the Philippines, which holds office at 40 San Miguel Avenue, Mandaluyong City, Philippines.

Depository Receipts

In addition to the listing and trading of the Common Shares on the PSE, there are depository receipts in the over-the-counter, or OTC, market trading under the symbol “SMGBY”. Each of these depository receipts represents ten Common Shares.

SHAREHOLDING STRUCTURE

Common Shares

As of March 31, 2011, SMC had 2,331,973,215 Common Shares issued and outstanding. Top Frontier, a Philippines-based holding company, held approximately 67.2% of SMC's common shares. A group of 44 companies associated with Eduardo M. Cojuangco, Jr., the Chairman of SMC, owned approximately 21.2% of SMC's Common Shares as of March 31, 2011.

Top Frontier has an option to acquire all of the shares of SMC held by the group of 44 companies associated with Mr. Cojuangco by November 19, 2012 at an option strike price of ₱75.00 per share. Top Frontier currently holds the voting rights for 88.4% of SMC's common shares, which include both its direct stake and the voting rights for all of the shares subject to such option. SMC has been advised that it is the intention of Top Frontier to exercise such option on or before its expiration date.

Preferred Shares

As of March 31, 2011, SMC had 970,506,353 preferred shares issued and outstanding. As of the same date, CIIF and SMC's Retirement Plan held 77.7% and 8.8% of SMC's preferred shares, respectively, with the remaining 13.5% held by the public.

SMC's preferred shares are non-voting, with an annual cumulative fixed cash dividend of 8% payable at the discretion of the Board. The preferred shares have a par value of ₱5.00 per share with no fixed maturity date. They are redeemable in whole or in part at the option of SMC at the end of three years from issue date or on any dividend payment date thereafter at the price equal to the issue price of ₱75 plus any accumulated and unpaid cash dividends. There is a step up in dividend at the end of the fifth year after the date of issue to the higher of (a) 8% and (b) the 10-year "PDST-F Rate" plus a spread of 3.00%. It is the intention of SMC to redeem these preferred shares as and when it becomes redeemable and if it has sufficient liquidity.

Shareholdings

The following table shows the shareholding structure for SMC's common and preferred shares as of March 31, 2011.

	Percentage Ownership of Common Shares	Number of Common Shares	Percentage Ownership of Preferred Shares	Number of Preferred Shares
Top Frontier	67.2% ⁽¹⁾	1,567,185,673	—	—
44 companies associated with Mr. Cojuangco, Jr.	21.2 ⁽¹⁾	493,375,183	—	—
CIIF	—	—	77.7	753,848,312
SMC Retirement Fund	—	—	8.8	85,751,165
Others	11.6	271,412,359	13.5	130,906,876
Total	<u>100.0%</u>	<u>2,331,973,215</u>	<u>100.0%</u>	<u>970,506,353</u>

⁽¹⁾ Top Frontier holds an option to purchase the Common Shares owned by the 44 companies. Top Frontier presently controls the voting rights of those shares, giving Top Frontier an effective 88.4% voting stake in SMC prior to the Offer.

Top Frontier

Top Frontier is a holding company registered with the Philippine SEC on March 11, 2008. On November 27, 2009, Top Frontier acquired 857,115,914 common shares of SMC from the SMC Retirement Fund. On April 13, 2010, Top Frontier acquired an additional 327,000,000 class "B" shares from Q-Tech. In connection with the transaction with Q-Tech, Top Frontier made a tender offer for all SMC shares held by other parties as the acquisition would result in Top Frontier acquiring 35% or more of the issued and

outstanding shares of SMC in one or more transactions within a 12-month period. Top Frontier acquired 49,629,119 class “A” shares and 31,773,965 class “B” shares of SMC. All class “A” shares and class “B” shares of SMC were declassified on August 26, 2010. On March 16, 2011, Top Frontier acquired an additional 301,666,675 Common Shares from Q-Tech. As of March 31, 2011, Top Frontier held approximately 1,567,185,673 Common Shares.

SMC’s Cross Ownership of Top Frontier

In January 2010, SMC acquired approximately 49% of the common shares and 100% of the non-voting, redeemable, participating preferred shares of Top Frontier, resulting in cross shareholdings between SMC and Top Frontier. The investment consists of subscription for: (i) 2,401,960 common shares of Top Frontier having a par value of ₱100.00 per share from its unissued stock; and (ii) 2,598,040 non-voting, redeemable, cumulative, participating preferred shares having a par value of ₱100.00 per share.

As of the date of this Offering Circular, all of Top Frontier’s directors, Iñigo Zobel, Eric O. Recto, Roberto V. Ongpin, Ramon S. Ang and Fredinand K. Constantino, are also on the Board and Mr. Ang and Mr. Constantino are also executive officers of SMC. In addition, approximately 40.7% of the common shares of Top Frontier are held by Mr. Zobel, who is also a member of the Board. The substantial portion of the remaining issued and outstanding shares are owned by Master Year Limited. Roberto V. Ongpin is a director of Master Year Limited.

As of December 31, 2010, SMC’s total investment in Top Frontier has a carrying value of ₱92.480 billion.

PHILIPPINE TAXATION

The following is a discussion of the material Philippine tax consequences of the acquisition, ownership and disposition of the Shares. This general description does not purport to be a comprehensive description of the Philippine tax aspects of the Shares and no information is provided regarding the tax aspects of acquiring, owning, holding or disposing of the Shares under applicable tax laws of other applicable jurisdictions and the specific Philippine tax consequence in light of particular situations of acquiring, owning, holding and disposing of the Shares in such other jurisdictions. This discussion is based upon laws, regulations, rulings, and income tax conventions (treaties) in effect at the date of this Offering Circular. The tax treatment applicable to a holder of the Shares may vary depending upon such holder's particular situation, and certain holders may be subject to special rules not discussed below. This summary does not purport to address all tax aspects that may be important to a holder of the Shares. Prospective investors of the Shares are urged to consult their own tax advisors as to the particular tax consequences of the ownership and disposition of the Shares, including the applicability and effect of any local or foreign tax laws.

As used in this section, the term "resident alien" refers to an individual whose residence is within the Philippines and who is not a citizen of the Philippines; a "non-resident alien" is an individual whose residence is not within the Philippines and who is not a citizen of the Philippines. A non-resident alien who is actually within the Philippines for an aggregate period of more than 180 days during any calendar year is considered a "non-resident alien doing business in the Philippines." A non-resident alien who is actually within the Philippines for an aggregate period of 180 days or less during any calendar year is considered a "non-resident alien not doing business in the Philippines." A "resident foreign corporation" is a non-Philippine corporation engaged in trade or business within the Philippines; and a "non-resident foreign corporation" is a non-Philippine corporation not engaged in trade or business within the Philippines. The term "dividends" under this section refers to cash or property dividends. "Tax Code" means the Philippine National Internal Revenue of 1997, as amended.

Taxes on Dividends on the Shares

Individual Philippine citizens and resident aliens are subject to a final tax on dividends derived from the Shares at the rate of 10%, which tax shall be withheld by SMC.

Non-resident alien individuals engaged in a trade or business in the Philippines are subject to a final withholding tax on dividends derived from the Shares at the rate of 20%, subject to applicable preferential tax rates under tax treaties in force between the Philippines and the country of domicile or residence of such non-resident alien individual. A non-resident alien individual not doing business in the Philippines is subject to a final withholding tax on dividends derived from the Shares at the rate of 25% subject to applicable preferential tax rates under tax treaties in force between the Philippines and the country of domicile or residence of such non-resident alien individuals.

The term "non-resident holder" means a holder of the Shares:

- who is an individual who is neither a citizen nor a resident of the Philippines or an entity which is a foreign corporation not engaged in trade or business in the Philippines; and
- should a tax treaty be applicable, whose ownership of the Shares is not effectively connected with a fixed base or a permanent establishment in the Philippines.

Dividends derived by domestic corporations (i.e. corporations created or organized in the Philippines or under its laws) and resident foreign corporations from the Shares shall not be subject to tax.

Dividends received from a domestic corporation by a non-resident foreign corporation are generally subject to final withholding tax at the rate of 30%, subject to applicable preferential tax rates under tax treaties in force between the Philippines and the country of domicile of such non-resident foreign corporation.

The 30% rate for dividends paid to non-resident foreign corporations with countries of domicile having no tax treaty with the Philippines may be reduced to a special 15% rate if:

- the country in which the non-resident foreign corporation is domiciled imposes no taxes on foreign sourced dividends; or
- the country in which the non-resident foreign corporation is domiciled allows a credit against the tax due from the non-resident corporation for taxes deemed to have been paid in the Philippines equivalent to 15%.

The BIR has prescribed, through an administrative issuance, procedures for the availment of tax treaty relief. The application for tax treaty relief has to be filed with the BIR by the non-resident holder of the Shares prior to the deadline for the filing by the investee domestic corporation of the withholding tax return on such dividends and its payment of the withholding tax, to allow the investee domestic corporation the option to withhold taxes at the reduced rate, but subject always to the BIR's ruling on the application. The investee domestic corporation may withhold taxes at a reduced rate on dividends paid to a non-resident holder of the Shares if such non-resident holder submits to the domestic corporation proof of the filing of the tax treaty relief application prior to the deadline for the filing of the withholding tax return.

The requirements for a tax treaty relief application in respect of dividends are set out in the applicable tax treaty and BIR Form No. 0901-D. These include proof of residence in the country that is a party to the tax treaty. Proof of residence consists of a consularized certification from the tax authority of the country of residence of the non-resident holder of Shares which states that the non-resident holder is a resident of such country under the applicable tax treaty. If the non-resident holder of Shares is a juridical entity, authenticated certified true copies of its articles of incorporation or association issued by the proper government authority should also be submitted to the BIR in addition to the certification of its residence from the tax authority of its country of residence.

If tax at the regular rate is withheld by the corporation instead of the reduced rates applicable under a treaty, the non-resident holder of the Shares may file a claim for refund from the BIR. However, because the refund process in the Philippines requires the filing of an administrative claim and the submission of supporting information, and may also involve the filing of a judicial appeal, it may be impractical to pursue obtaining such a refund. Moreover, in view of the requirement of the BIR that an application for tax treaty relief be filed prior to the deadline for the filing by the investee domestic corporation of the final withholding tax return on dividend income, the non-resident holder of Shares may not be able to successfully pursue a claim for refund if such an application is not filed before the deadline for the filing of the withholding tax return.

Taxes on the Sale or Other Disposition of the Shares

Sales, exchanges or other dispositions of the Shares which are effected through the PSE by persons other than a dealer in securities are subject to a stock transaction tax at the rate of 0.5% based on the gross selling price or gross value in money of the Shares. This tax is required to be collected by and paid to the Philippine government by the selling stockbroker on behalf of his client.

Under the terms of some tax treaties, an exemption may be specifically available for stock transaction tax; under other treaties, an exemption may be available for taxes substantially similar to and in place of taxes covered by the treaty when it took effect. The stock transaction tax is classified as a percentage tax and not as an income tax under the Tax Code. Notwithstanding its classification as a percentage tax, an exemption from the stock transaction tax may be available under the terms of some tax treaties. However, the BIR's current position on this matter is that the stock transaction tax is not identical or substantially similar to the income tax/capital gains tax on a sale of shares in a domestic corporation, and, hence, not covered by the treaty exemption, for capital gains tax. Thus, the treaty must specifically provide for an exemption from stock transaction tax, for such an exemption to apply. If such an exemption were available, an application for tax treaty relief would also have to be filed.

Subject to applicable exemptions under various tax treaties, a capital gains tax of 5% on the net capital gains realized during the taxable year, not in excess of ₱100,000, and 10% on the net capital gains realized

during the taxable year, in excess of ₱100,000, is imposed on sales, exchanges or other dispositions of shares of stock not traded through a local stock exchange. The BIR requires that an application for tax treaty relief for capital gains tax on the sale of shares be filed before the deadline for the filing of the documentary stamp tax return — otherwise the tax treaty exemption cannot be availed of.

The BIR appears to intend to expand the application of the 5%/10% capital gains tax by extending it even to trades through the stock exchange of shares of listed companies which will not maintain their public ownership requirement.

The BIR, in a letter dated December 28, 2010 addressed to the Philippine SEC, stated that it intended to “strictly impose the 5%/10% capital gains tax” for trades in listed companies “who will not maintain their public ownership requirement”, said public ownership requirement being the 10% to 33% public ownership levels (based on the listed company’s market capitalization) required for an initial public offering. This BIR letter was referred to the PSE by the Philippine SEC on January 3, 2011.

The PSE subsequently issued a memorandum dated January 20, 2011 in response to the Philippine SEC on the BIR’s statements. The PSE noted that the Tax Code imposes a stock transaction tax of ½ of 1% of the gross selling price or gross value in money of shares of stock listed and traded on the PSE, without qualification and that the powers of the Secretary of Finance to promulgate rules and regulations implementing the Tax Code should be confined to the details for implementing the law as it has been enacted and such powers cannot be extended to amend or expand the statutory requirement of the Tax Code. Discussions are still ongoing between the PSE and the BIR and there is as yet no formal BIR issuance on the matter.

Tax Treaties

The following table lists some of the countries with which the Philippines has tax treaties and the tax rates currently applicable to non-resident holders who are residents of those countries:

<u>Country</u>	<u>Dividends</u>	<u>Capital Gains Tax</u>
	<u>(In Percentage (%))</u>	<u>Due on Disposition</u> <u>of Shares Outside</u> <u>the PSE</u> <u>(In Percentage (%))</u>
Canada	25 ⁽¹⁾	Exempt ⁽⁸⁾
France	15 ⁽²⁾	Exempt ⁽⁸⁾
Germany	15 ⁽³⁾	5/10 ⁽⁹⁾
Japan	15 ⁽⁴⁾	Exempt ⁽⁸⁾
Singapore	25 ⁽⁵⁾	Exempt ⁽⁸⁾
United Kingdom	25 ⁽⁶⁾	Exempt ⁽¹⁰⁾
United States	25 ⁽⁷⁾	Exempt ⁽⁸⁾

Notes:

- (1) 15% if the recipient company controls at least 10% of the voting power of the company paying the dividends.
- (2) 10% if the recipient company (excluding a partnership) holds directly at least 10% of the voting shares of the company paying the dividends.
- (3) 10% if the recipient company (excluding a partnership) owns directly at least 25% of the capital of the company paying the dividends.
- (4) 10% if the recipient company holds directly at least 10% of either the voting shares of the company paying the dividends or of the total shares issued by that company during the period of six months immediately preceding the date of payment of the dividends.
- (5) 15% if during the part of the paying company’s taxable year which precedes the date of payment of dividends and during the whole of its prior taxable year at least 15% of the outstanding shares of the voting stock of the paying company were owned by the recipient company.
- (6) 15% if the recipient company is a company which controls directly or indirectly at least 10% of the voting power of the company paying the dividends.
- (7) 20% if during the part of the paying corporation’s taxable year which precedes the date of payment of dividends and during the whole of its prior taxable year, at least 10% of the outstanding shares of the voting stock of the paying corporation were owned by the recipient corporation. Notwithstanding the rates provided under the Republic of the Philippines-United States Treaty, residents of the United States may avail of the 15% withholding tax rate under the tax-sparing clause of the Tax Code provided certain conditions are met.

- (8) Capital gains are taxable only in the country where the seller is a resident, provided the shares are not those of a corporation, the assets of which consist principally of real property situated in the Philippines, in which case the sale is subject to Philippine taxes.
- (9) Under the tax treaty between the Philippines and Germany, capital gains from the alienation of shares of a Philippine corporation may be taxed in the Philippines irrespective of the nature of the assets of the Philippine corporation. Tax rates are 5% on the net capital gains realized during the taxable year not in excess of ₱100,000 and 10% on the net capital gains realized during the taxable year in excess of ₱100,000.
- (10) Under the tax treaty between the Philippines and the United Kingdom, capital gains on the sale of the stock of Philippine corporations are subject to tax only in the country where the seller is a resident, irrespective of the nature of the assets of the Philippine corporation.

In order for an exemption under a tax treaty to be recognized, an application for tax treaty relief on capital gains tax on the sale of shares must be filed by the income recipient before the deadline for the filing of the documentary stamp tax return and approved by the BIR.

The requirements for a tax treaty relief application in respect of capital gains tax on the sale of shares are set out in the applicable tax treaty and BIR Form No. 0901-C. These include proof of residence in the country that is a party to the tax treaty. Proof of residence consists of a consularized certification from the tax authority of the country of residence of the seller of shares which provides that the seller is a resident of such country under the applicable tax treaty. If the seller is a juridical entity, authenticated certified true copies of its articles of incorporation or association issued by the proper government authority should also be submitted to the BIR in addition to the certification of its residence from the tax authority of its country of residence.

Documentary Stamp Taxes on Shares

The Philippines imposes a documentary stamp tax upon transfers of the Shares at a rate of ₱0.75 on each ₱200, or fractional part thereof, of the par value of the Shares. The documentary stamp tax is imposed on the person making, signing, issuing, accepting or transferring the document and is thus payable either by the vendor or the purchaser of the Shares.

However, the sale, barter or exchange of Shares should they be listed and traded through the PSE are exempt from documentary stamp tax.

Estate and Gift Taxes

The transfer of the Shares upon the death of a registered holder to his heirs by way of succession, whether such an individual was a citizen of the Philippines or an alien, regardless of residence, will be subject to Philippine estate tax at progressive rates ranging from 5% to 20% if the net estate is over ₱200,000.

Individual registered holders, whether or not citizens or residents of the Philippines, who transfer shares by way of gift or donation will be liable for Philippine donor's tax on such transfers at progressive rates ranging from 2% to 15% if the total net gifts made during the calendar year exceed ₱100,000. The rate of tax with respect to net gifts made to a stranger (one who is not a brother, sister, spouse, ancestor, lineal descendant or relative by consanguinity within the fourth degree of relationship) is a flat rate of 30%. Corporate registered holders are also liable for Philippine donor's tax on such transfers, but the rate of tax with respect to net gifts made by corporate registered holders is always at a flat rate of 30%.

Estate and gift taxes will not be collected in respect of intangible personal property, such as shares of stock, (a) if the deceased at the time of death, or the donor at the time of donation, was a citizen and resident of a foreign country which at the time of his death or donation did not impose a transfer tax of any character in respect of intangible personal property of citizens of the Philippines not residing in that foreign country, or (b) if the laws of the foreign country of which the deceased or the donor was a citizen and resident at the time of his death or donation allow a similar exemption from transfer or death taxes of every character or description in respect of intangible personal property owned by citizens of the Philippines not residing in that foreign country.

Corporate Income Tax

In general, a tax of 30% is imposed upon the taxable net income of a domestic corporation from all sources (within and outside the Philippines) pursuant to Philippine Republic Act 9337.

PLAN OF DISTRIBUTION

General

SMC and the Selling Shareholder, through the International Joint Bookrunners, are offering 78,800,000 Offer Shares in the International Offer (excluding the Over-Allotment Option described below) only outside the United States to non-U.S. persons in compliance with Regulation S under the Securities Act.

The number of International Offer Shares each International Joint Bookrunner and the International Co-Bookrunner agrees to procure purchasers for or purchase is set forth below:

<u>International Joint Bookrunners and International Co-Bookrunner</u>	<u>Number of International Offer Shares</u>
Credit Suisse (Singapore) Limited	18,912,000
Standard Chartered Securities (Singapore) Pte. Limited	18,912,000
Goldman Sachs (Singapore) Pte.	18,912,000
UBS AG	18,912,000
Daiwa Capital Markets Singapore Limited	3,152,000
Total	<u>78,800,000</u>

SMC and the Selling Shareholder, through the Domestic Joint Bookrunners, are offering 31,520,000 Offer Shares in the Domestic Offer (excluding the Domestic Option described below) at the Offer Price within the Philippines to holders of PSE trading rights (the “PSE Trading Participants”), clients of the Domestic Joint Bookrunners and the syndicate of participating domestic underwriters to be formed by the Domestic Joint Bookrunners (the “Domestic Underwriting Syndicate Members”), and the general public following the pricing of the International Offer. 7,370,000 Domestic Offer Shares shall initially be offered to PSE Trading Participants (the “PSE Offer Shares”). Prior to the closing of the Domestic Offer on April 29, 2011, the PSE Offer Shares not taken up by the PSE Trading Participants shall be distributed by the Domestic Joint Bookrunners and the Domestic Underwriting Syndicate Members to their clients or the general public in the Philippines. All Domestic Offer Shares not taken up by the PSE Trading Participants, the clients of the Joint Domestic Bookrunners and the Domestic Underwriting Syndicate Members or the general public or not reallocated to the International Offer as described below shall be purchased by the Joint Domestic Bookrunners and the Domestic Underwriting Syndicate Members.

The number of Domestic Offer Shares each Domestic Joint Bookrunner agrees to procure purchasers for or purchase is set forth below:

<u>Domestic Joint Bookrunners</u>	<u>Number of Domestic Offer Shares</u>
ATR KimEng Capital Partners, Inc.	13,338,200
BDO Capital & Investment Corporation	9,090,900
SB Capital Investment Corporation	9,090,900
Total	<u>31,520,000</u>

In addition, the Selling Shareholder has granted the Domestic Joint Bookrunners an option (the “Domestic Option”) to sell up to 27,580,000 Additional Domestic Offer Shares, in the event that demand in the Domestic Offer exceeds the number of Domestic Offer Shares.

SMC is giving applicants who are both (i) holders of Common Shares as of the date of this Offering Circular and (ii) resident in the Philippines (as reflected on the share register of SMC) priority in the distribution and sale of the Domestic Offer Shares so that applications from such applicants will be allocated in full in preference to other applicants.

The Offer Shares are subject to reallocation between the International Offer and the Domestic Offer. In the event of an under-application in the International Offer and an over-application in the Domestic Offer, International Offer Shares may (upon the agreement of the Domestic Joint Bookrunners and International Joint Bookrunners) be reallocated from the International Offer to the Domestic Offer. In the event of an under-

application in the Domestic Offer and an over-application in the International Offer, Domestic Offer Shares may (upon the agreement of the International Joint Bookrunners and Domestic Joint Bookrunners) be reallocated from the Domestic Offer to the International Offer. There will not be a reallocation in the event of an over-application in both the International Offer and the Domestic Offer.

Each Bookrunner has agreed, pursuant to an international underwriting agreement, dated as of April 20, 2011, among SMC, the Selling Shareholder and the International Joint Bookrunners (the “International Underwriting Agreement”) and pursuant to a domestic underwriting agreement, dated as of April 20, 2011, among SMC, the Selling Shareholder and the Domestic Joint Bookrunners (the “Domestic Underwriting Agreement” and together with the International Underwriting Agreement, the “Underwriting Agreements”), and subject to the satisfaction of certain conditions, to procure purchasers for or, failing which, to purchase, the number of Offer Shares set forth opposite the name of such Bookrunner in the tables above. In addition, SMC and the Selling Shareholder have agreed to reimburse the Bookrunners for certain of their expenses in connection with the issue of the Offer Shares. The underwriting fees, discounts and commissions, applicable taxes and other expenses payable by SMC and the Selling Shareholder in respect of the Offer are approximately ₱54 million and ₱162 million, respectively. None of the International Joint Bookrunners and the International Co-Bookrunner will sell Offer Shares to investors in the Philippines.

The Offer Price does not include any brokerage fees, transaction fees, taxes or other expenses that investors must pay to their brokers, Philippine or other relevant tax authorities or any other persons.

Indemnity

The International Underwriting Agreement provides that SMC and the Selling Shareholder will indemnify the International Joint Bookrunners against certain liabilities. The International Underwriting Agreement entitles the International Joint Bookrunners to terminate the International Underwriting Agreement in certain circumstances prior to payment being made to SMC and the Selling Shareholder.

The Domestic Underwriting Agreement provides that SMC and the Selling Shareholder will indemnify the Domestic Joint Bookrunners against certain liabilities. The Domestic Underwriting Agreement entitles the Domestic Joint Bookrunners to terminate the Domestic Underwriting Agreement in certain circumstances prior to payment being made to SMC and the Selling Shareholder.

Over-Allotment and Stabilization

In connection with the Offer, SMC has granted the International Joint Bookrunners an Over-Allotment Option, which is exercisable in whole or in part within 30 days from the date of allotment of the Offer Shares in the International Offer, to purchase up to 7,880,000 additional Common Shares (being 10.0% of the total number of International Offer Shares) on the same terms and conditions as the sale of the Offer Shares in the International Offer, solely to cover over-allotments, if any. In connection therewith, the International Joint Bookrunners have entered into an over-allotment option agreement (the “Over-Allotment Option Agreement”) with SMC. Equivalent securities to any Common Shares that may be delivered by SMC to the International Joint Bookrunners pursuant to the Over-Allotment Option Agreement will be delivered back to SMC either through the purchase of Common Shares in the open market by the Stabilizing Agent in the conduct of stabilization activities or through the exercise of the Over-Allotment Option by the International Joint Bookrunners.

In connection with the Offer, the Stabilizing Agent or any person acting on its behalf may over-allot Offer Shares or effect transactions with a view to supporting the market price of the Offer Shares at a level higher than that which might otherwise prevail for a limited period after the Closing Date. However, there is no assurance that the Stabilizing Agent (or any person acting on behalf of the Stabilizing Agent) will undertake stabilization activities. Any stabilization activities may begin on or after the date on which adequate public disclosure of the final price of the Offer Shares is made and, if begun, may be ended at any time, but must end no later than 30 calendar days after the date of allotment of the Offer Shares. Any stabilization activities shall be done in compliance with all applicable laws, regulations and rules. The total number of Offer Shares which the Stabilizing Agent or any agent of it may buy to undertake any stabilizing activities

shall not exceed 15.0% of the aggregate number of the Offer Shares. The stabilization arrangements were approved by the Philippine SEC on April 19, 2011.

Lock-up

SMC has agreed with the International Joint Bookrunners that, except in connection with: (i) the sale of the Offer Shares as contemplated by this Offering Circular; (ii) the sale of up to US\$600 million aggregate principal amount of exchangeable bonds in the Concurrent Offer and the delivery of Common Shares upon exchange of the exchangeable bonds; and (iii) any issuance, offer, sale, contract to sell, pledge or other disposal pursuant to existing management incentive programs, neither SMC nor any of its affiliates over which SMC exercises management or voting control will, for a period of 180 days from the Closing Date, without the prior written consent of the International Joint Bookrunners, issue, offer, sell, contract to sell, pledge or otherwise dispose of (or publicly announce any such issuance, offer, sale or disposal of) any Common Shares or any shares of SMC or securities convertible or exchangeable into or exercisable for shares of SMC or warrants or other rights to purchase shares of SMC or any security or financial product whose value is determined directly or indirectly by reference to the price of the Common Shares, including equity swaps, forward sales and options.

The Selling Shareholder has agreed with the International Joint Bookrunners that, except in connection with the sale of the Offer Shares as contemplated by this Offering Circular, neither the Selling Shareholder nor any of its affiliates over which the Selling Shareholder exercises management or voting control will, for a period of 180 days from the Closing Date, without the prior written consent of the International Joint Bookrunners, issue, offer, sell, contract to sell, pledge or otherwise dispose of (or publicly announce any such issuance, offer, sale or disposal of) any Common Shares or any shares of SMC or securities convertible or exchangeable into or exercisable for shares of SMC or warrants or other rights to purchase shares of SMC or any security or financial product whose value is determined directly or indirectly by reference to the price of the Common Shares, including equity swaps, forward sales and options.

Concurrent Offer

Concurrently with the pricing of the Offer, SMC has priced a separate offer of US\$600,000,000 2.0% Exchangeable Bonds due 2014. The exchangeable bonds will be exchangeable for Common Shares from the treasury stock of SMC. The initial exchange price for the exchange of the exchangeable bonds into Common Shares is ₱137.50.

Other Relationships

The Bookrunners and their affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. Certain of the Bookrunners and their respective affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for SMC or the Selling Shareholder or their affiliates, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Bookrunners and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities or instruments of SMC. The Bookrunners and their affiliates may also make investment recommendations or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire or sell such securities or instruments. The Bookrunners or certain of their affiliates may purchase the Offer Shares for its or their own account at the same time as the Offer or in secondary market transactions. Such transactions would be carried out as bilateral trades with selected counterparties and separately from any existing sale or resale of the Offer Shares to which this Offering Circular relates (notwithstanding that such selected counterparties may also be purchasers of the Offer Shares).

The Bookrunners or certain of their affiliates may purchase the Offer Shares and be allocated Offer Shares for asset management or proprietary purposes and not with a view to distribution.

The Bookrunners and their respective affiliates have engaged in transactions with and provided various investment banking, commercial banking and other services to SMC, the Selling Shareholder and their respective subsidiaries and affiliates in the past and may provide such services in the future.

The Selling Shareholder intends to use the net proceeds of the Offer that it will receive to repay advances from its shareholders (not including SMC) which the Selling Shareholder used to fund purchases of Common Shares. The shareholders receiving repayment from the Selling Shareholder will in turn use such repayment to repay their respective loans from an affiliate of Standard Chartered Securities (Singapore) Pte. Limited, one of the International Joint Bookrunners.

Selling Restrictions

The distribution of this Offering Circular or any offering material and the offer, sale or delivery of the Offer Shares is restricted by law in certain jurisdictions. Persons who may come into possession of this Offering Circular or any offering material are advised to consult with their own legal advisers as to what restrictions may be applicable to them and to observe such restrictions. This Offering Circular may not be used as an offer or invitation to purchase Offer Shares in any circumstances in which such offer or invitation is not authorized.

Investors who acquire beneficial ownership of 5% or more of the outstanding capital stock of SMC must disclose such acquisition to the Philippine SEC and the PSE (through SMC) on SEC Form 18-A within 5 business days from such acquisition. Investors who acquire beneficial ownership of 10% or more of the outstanding capital stock of SMC must disclose such acquisition to the Philippine SEC and the PSE (through SMC) on SEC Form 23-A within 10 days from such acquisition.

United States of America

The Offer Shares have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to U.S. persons. The Offer Shares are being offered and sold only outside of the United States to non-U.S. persons in compliance with Regulation S. In addition, until 40 days after the commencement of the Offer, an offer or sale of the Offer Shares within the United States by a dealer (whether or not participating in the Offer) may violate the registration requirements of the Securities Act.

Philippines

The Offer Shares have been registered with the Philippine SEC and are listed on the PSE under the symbol “SMC”. The Offer Shares may be offered and sold to the general public in the Philippines.

Australia

This Offering Circular is not a formal disclosure document and has not been, nor will it be, lodged with the Australian Securities and Investments Commission. It does not purport to contain all information that an investor or their professional advisers would expect to find in a prospectus or other disclosure document (as defined in the Corporations Act 2001 (Australia)) for the purposes of Part 6D.2 of the Corporations Act 2001 (Australia) or in a product disclosure statement for the purposes of Part 7.9 of the Corporations Act 2001 (Australia), in either case, in relation to the Offer Shares.

The Offer Shares are not being offered in Australia to “retail clients” as defined in sections 761G and 761GA of the Corporations Act 2001 (Australia). This Offer is being made in Australia solely to “wholesale clients” for the purposes of section 761G of the Corporations Act 2001 (Australia) and, as such, no prospectus, product disclosure statement or other disclosure document in relation to the Offer Shares has been, or will be, prepared.

This Offering Circular does not constitute an offer in Australia other than to wholesale clients. By submitting an application for the Offer Shares, you represent and warrant that you are a wholesale client for the purposes of section 761G of the Corporations Act 2001 (Australia). If any recipient of this Offering Circular is not a wholesale client, no offer of, or invitation to apply for, the Offer Shares shall be deemed to be made to such recipient and no applications for the Offer Shares will be accepted from such recipient. Any offer to a recipient in Australia, and any agreement arising from acceptance of such offer, is personal and may only be accepted by such recipient. In addition, by applying for the Offer Shares you undertake to SMC and the Selling Shareholder that, for a period of 12 months from the date of settlement of the Offer Shares, you will not transfer any interest in the Offer Shares to any person in Australia other than to a wholesale client.

Dubai International Financial Centre

This Offering Circular relates to an exempt offer (an offering to 50 or less persons in the Dubai International Financial Centre) in accordance with the Offered Securities Rules of the Dubai Financial Services Authority.

This Offering Circular is intended for distribution only to professional investors. It must not be delivered to, or relied on by, any other person.

The Dubai Financial Services Authority has no responsibility for reviewing or verifying any documents in connection with exempt offers. The Dubai Financial Services Authority has not approved this Offering Circular nor taken steps to verify the information set forth in this Offering Circular, and has no responsibility for this Offering Circular.

The Offer Shares to which this Offering Circular relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the Offer Shares should conduct their own due diligence on the Offer Shares.

If you do not understand the contents of this Offering Circular, you should consult an authorized financial adviser.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “Relevant Member State”), each Bookrunner has agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “Relevant Implementation Date”) it has not made and will not make an offer of Offer Shares which are the subject of the Offer contemplated by this Offering Circular to the public in that Relevant Member State other than:

(a) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(b) to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the Bookrunners nominated by the Company for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Offer Shares shall require the Company or any Bookrunner to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this Offering Circular, the expression an offer of Offer Shares to the public in relation to any Offer Shares in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the Offer and the Offer Shares so as to enable an investor to decide to purchase the Offer Shares, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State, the expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression “2010 PD Amending Directive” means Directive 2010/73/EU.

The European Economic Area selling restriction is in addition to any other selling restrictions set forth in this Offering Circular.

Hong Kong

Each of the Bookrunners has agreed that:

(1) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Offer Shares other than (a) to “professional investors” within the meaning of Part I of Schedule 1 to the Securities and Futures Ordinance of Hong Kong (Cap. 571) and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance of Hong Kong (Cap. 32) or which do not constitute an offer or invitation to the public within the meaning of the Companies Ordinance or the Securities and Future Ordinance; and

(2) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Offer Shares, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Offer Shares which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in Part I of Schedule 1 to the Securities and Futures Ordinance and any rules made under that Ordinance.

Japan

The Offer Shares have not been and will not be registered under the Financial Instruments and Exchange Law of Japan and the Offer Shares will not be offered or sold, directly or indirectly, in Japan, or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan, or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Financial Instruments and Exchange Law of Japan and any other applicable laws of Japan, regulations and ministerial guidelines of Japan.

Malaysia

No offering circular or other offering material or document in connection with the offer and sale of the Offer Shares has been or will be registered with the Securities Commission of Malaysia pursuant to the Capital Markets and Services Act 2007 as the offer for purchase of, or invitation to purchase the Offer Shares is meant to qualify as an “excluded offer” or “excluded invitation” as defined in Section 229 of the Capital Markets and Services Act 2007. The Offer Shares will not be offered, sold, transferred or otherwise disposed of, directly or indirectly, nor any document or other material in connection therewith distributed, in Malaysia, other than to persons falling within any one of the categories or person specified in Schedule 6 or Schedule 7 of the Capital Markets and Services Act 2007 who are also persons to whom any offer or invitation to purchase or sell would be an excluded offer or excluded invitation within the meaning of Section 229 of the Capital Markets and Services Act 2007.

Singapore

This Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. In Singapore, the offer and sale of the Offer Shares is made pursuant to exemptions provided in Sections 274 and 275 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”). Accordingly, this Offering Circular and any other document or material in connection with the offer or sale, or invitation for purchase, of the Offer Shares may not be circulated or distributed, nor may the Offer Shares be offered or sold, or be made the subject of an invitation to purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor as defined in Section 4A of the SFA pursuant to Section 274 of the SFA, (ii) to a relevant person as defined in Section 275(2) of the SFA pursuant to Section 275(1) of the SFA, or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA, in each case subject to compliance with the conditions (if any) set forth in the SFA. Moreover, this Offering Circular is not a prospectus as defined in the SFA. Accordingly, statutory liability under the SFA in relation to the content of prospectuses will not apply. Prospective investors in Singapore should consider carefully whether an investment in the Offer Shares is suitable for them.

Where the Offer Shares are purchased under Section 275 of the SFA by a relevant person:

(a) which is a corporation (and which is not an accredited investor as defined in Section 4A of the SFA) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(b) for a trust (where none of the trustees is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor, shares of that corporation or the beneficiaries' rights and interest (howsoever described) in that trust shall not be transferable for six months after that corporation or that trust has acquired the Offer Shares under Section 275 of the SFA, except:

(1) to an institutional investor (for corporations under Section 274 of the SFA) or to a relevant person as defined in Section 275(2) of the SFA, or any person pursuant to an offer that is made on terms that such shares of that corporation or such rights and interest in that trust are acquired at a consideration of not less than 200,000 Singapore dollars (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions, specified in Section 275 of the SFA;

(2) where no consideration is given for the transfer; or

(3) where the transfer is by operation of law.

In addition, investors in Singapore should note that the Offer Shares acquired by them are subject to resale and transfer restrictions specified in Section 276 of the SFA, and they should seek their own legal advice before effecting any resale or transfer of their Offer Shares.

United Arab Emirates

SMC has not been approved or licensed by the UAE Central Bank or any other relevant licensing authorities or governmental agencies in the United Arab Emirates. This Offering Circular is strictly private and confidential and has not been reviewed, deposited or registered with any licensing authority or governmental agency in the United Arab Emirates, and is being issued to a limited number of institutional investors in the United Arab Emirates and must not be provided to any person other than the original recipient and may not be reproduced or used for any other purpose. The Offer Shares may not be offered or sold directly or indirectly to the public in the United Arab Emirates.

United Kingdom

Each of the Bookrunners has agreed that:

(1) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (as defined in section 21 of the Financial Services and Markets Act 2000 ("FSMA") received by it in connection with the sale of any Offer Shares in circumstances in which section 21(1) of the FSMA does not apply to the Company; and

(2) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Offer Shares in, from or otherwise involving the United Kingdom.

This Offering Circular is only being distributed to and is only directed at (i) persons who are outside the United Kingdom or (ii) investment professionals falling within Article 19(5) of the FSMA (Financial Promotion) Order 2005 or (iii) high net worth companies, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) to (d) of the FSMA (Financial Promotion) Order 2005 Order (all such persons together being referred to as "relevant persons"). The Offer Shares are only available to, and any invitation, offer or agreement to purchase or otherwise acquire such Offer Shares will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this Offering Circular or any of its contents.

General

Purchasers of the Offer Shares may be required to pay stamp taxes and or other charges in accordance with the laws and practices of the country of purchase.

TRANSFER RESTRICTIONS

Due to the following restrictions, purchasers of the Offer Shares are urged to consult their own legal counsel prior to making any offer, resale, pledge or other transfer of the Offer Shares.

Terms used herein that are defined in Regulation S are used herein as defined therein.

The Offer Shares have not been registered under the Securities Act and are not being offered or sold within the United States or to U.S. Persons. The Offer Shares are being offered and sold only outside the United States to non-U.S. persons in accordance with Regulation S.

The Offer Shares may be resold, pledged or otherwise transferred only in compliance with the U.S. securities laws and are subject to the following restrictions:

Restrictions upon the transfer of Offer Shares

If you purchase Offer Shares pursuant to the Offer, you shall not, for a period of one year from the date of the Offer, sell the Offer Shares so acquired except on the PSE.

During the “distribution compliance period” (the period ending forty days after the later of the commencement of the Offer and the related closing date), the Offer Shares may be resold, pledged or otherwise transferred only:

- (i) outside the United States to a person other than a U.S. person (as defined in Regulation S) in accordance with Regulation S; or
- (ii) pursuant to an effective registration statement under the Securities Act.

Each person purchasing Offer Shares pursuant to this Offer will be deemed to have acknowledged, represented to and agreed with SMC and the Bookrunners that:

- The Offer Shares have not been, and will not be, registered under the Securities Act or with any securities regulatory authority of any state of the United States, and the Offer Shares are being offered and sold only outside the United States to non-U.S. persons in accordance with Regulation S;
- Such purchaser is not a U.S. person and is acquiring the Offer Shares outside the United States pursuant to, and in accordance with, Regulation S;
- Such purchaser will not resell, pledge or otherwise transfer any Offer Shares in the United States or for the account or benefit of a U.S. person, except in accordance with Regulation S, pursuant to another exemption from the registration requirements of the Securities Act, if available, or pursuant to an effective registration statement under the Securities Act;
- SMC, the Bookrunners and their respective affiliates will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements; and
- Any resale or other transfer, or attempted resale or other transfer, of any Offer Shares, or any interest therein, made other than in compliance with the transfer restrictions above will not be recognized by SMC.

THE PHILIPPINE STOCK MARKET

The information presented in this section has been extracted from publicly available documents which have not been prepared or independently verified by SMC, the Bookrunners or any of their respective subsidiaries, affiliates or advisors in connection with sale of the Offer Shares.

Brief History

The Philippines initially had two stock exchanges, the Manila Stock Exchange, which was organized in 1927, and the Makati Stock Exchange, which began operations in 1963. Each exchange was self-regulating, governed by its respective Board of Governors elected annually by its members.

Several steps initiated by the Philippine government have resulted in the unification of the two bourses into the PSE. The PSE was incorporated in 1992 by officers of both the Makati and the Manila Stock Exchanges. In March 1994, the licenses of the two exchanges were revoked. While the PSE maintains two trading floors, one in Makati City and the other in Pasig City, these floors are linked by an automated trading system which integrates all bid and ask quotations from the bourses.

In June 1998, the Philippine SEC granted the Self-Regulatory Organization status to the PSE, allowing it to impose rules as well as implement penalties on erring trading participants and listed companies. On August 8, 2001, the PSE completed its demutualization, converting from a non-stock member-governed institution into a stock corporation in compliance with the requirements of the Philippine Securities Regulation Code. The PSE has an authorized capital stock of 97.8 million shares of which 30.7 million shares are subscribed and fully paid-up. Each of the 184 member-brokers was granted 50,000 common shares of the new PSE at a par value of ₱1 per share. In addition, a trading right evidenced by a “Trading Participant Certificate” was immediately conferred on each member broker allowing the use of the PSE’s trading facilities. As a result of the demutualization, the composition of the PSE Board of Governors was changed, requiring the inclusion of seven brokers and eight non-brokers, one of whom is the President.

On December 15, 2003, the PSE listed its shares by way of introduction at its own bourse as part of a series of reforms aimed at strengthening the Philippine securities industry.

Classified into financial, industrial, holding firms, property, services, and mining and oil sectors, companies are listed either on the PSE’s First Board, Second Board or the Small and Medium Enterprises Board. Each index represents the numerical average of the prices of component stocks. The PSE has an index, referred to as the PHISIX, which as at the date thereof reflects the price movements of selected stocks listed on the PSE, based on traded prices of stocks from the various sectors. The PSE shifted from full market capitalization to free float market capitalization effective April 3, 2006 simultaneous with the migration to the free float index and the renaming of the PHISIX to PSEi. The PSEi is composed of stocks of 30 selected companies listed on the PSE.

With the increasing calls for good corporate governance, PSE has adopted an online daily disclosure system to improve the transparency of listed companies and to protect the investing public.

The table below sets out movements in the composite index from 1995 up to December 1, 2010 and shows the number of listed companies, market capitalization, and value of shares traded for the same period:

<u>Year</u>	<u>Composite Index at Closing</u>	<u>Number of Listed Companies</u>	<u>Aggregate Market Capitalization (in billions)</u>	<u>Combined Value of Turnover (in billions)</u>
1995	2,594.2	205	₱1,545.7	₱ 379.0
1996	3,170.6	216	2,121.1	668.9
1997	1,869.2	221	1,261.3	588.0
1998	1,968.8	221	1,373.7	408.7
1999	2,142.9	226	1,938.6	713.9
2000	1,494.5	230	2,577.6	357.6
2001	1,168.1	232	2,142.6	159.5
2002	1,018.4	234	2,083.2	159.7
2003	1,442.2	236	2,973.8	145.4
2004	1,822.8	236	4,766.2	206.6
2005	2,096.0	237	5,948.4	383.5
2006	2,982.5	240	7,172.8	572.6
2007	3,621.6	244	7,980.0	1,340.0
2008	1,872.9	248	4,070.0	763.9
2009	3,052.7	248	6,029.1	994.2
2010	4,002.9	252	8,235.1	658.9

Source: PSE

Trading

The PSE is a double auction market. Buyers and sellers are each represented by stockbrokers. To trade, bids or ask prices are posted on the PSE's electronic trading system. A buy (or sell) order that matches the lowest asked (or highest bid) price is automatically executed. Buy and sell orders received by one broker at the same price are crossed at the PSE at the indicated price. Payment of purchases of listed securities must be made by the buyer on or before the third trading day (the settlement date) after the trade.

Trading on the PSE starts at 9:30 a.m. and ends at 12:00 p.m. with a 10-minute extension during which transactions may be conducted, provided that they are executed at the last traded price and are only for the purpose of completing unfinished orders. Trading days are Monday to Friday, except legal holidays and days when the BSP clearing house is closed.

Minimum trading lots range from 10 to 5,000,000 shares depending on the price range and nature of the security traded. Odd-sized lots are traded by brokers on a board specifically designed for odd-lot trading.

To maintain stability in the stock market, daily price swings are monitored and regulated. Under current PSE regulations, when the price of a listed security moves up by 50% or down by 40% in one day (based on the previous closing price or last posted bid price, whichever is higher), the price of that security is automatically frozen by the PSE, unless there is an official statement from the company or a government agency justifying such price fluctuation, in which case the affected security can still be traded but only at the frozen price. If a company fails to submit such explanation, a trading halt is imposed by the PSE on the listed security the following day. Resumption of trading shall be allowed only when the disclosure of the company is disseminated, subject again to the trading ban.

Non-Resident Transactions

When the purchase/sale of Philippine shares of stock involves a non-resident, whether the transaction is effected in the domestic or foreign market, it will be the responsibility of the securities dealer/broker to

register the transaction with the BSP. The local securities dealer/broker shall file with the BSP, within three business days from the transaction date, an application in the prescribed registration form. After compliance with other required undertakings, the BSP shall issue a Certificate of Registration. Under BSP rules, all registered foreign investments in Philippine securities including profits and dividends, net of taxes and charges, may be repatriated.

Settlement

The Securities Clearing Corporation of the Philippines (“SCCP”) is a private institution organized primarily as a clearance and settlement agency for depository eligible trades executed in the PSE. The PSE holds 100% ownership of SCCP. SCCP received its permanent license to operate on January 17, 2002. It is responsible for:

- synchronizing the settlement of funds and the transfer of securities through Delivery versus Payment clearing and settlement of transactions of Clearing Members, who are also Trading Participants of the PSE;
- guaranteeing the settlement of trades in the event of a Trading Participant’s default through the implementation of its Fails Management System and administration of the Clearing and Trade Guaranty Fund, and;
- performance of Risk Management and Monitoring to ensure final and irrevocable settlement.

SCCP settles PSE trades on a three-day rolling settlement environment, which means that settlement of trades takes place three trading days after transaction date (“T+3”). The deadline for settlement of trades is 12:00 n.n. on T+3. Securities sold should be in scripless form and lodged under the book-entry system of the Philippine Depository & Trust Corporation’s (“PDTC”, formerly the Philippine Central Depository, Inc). Each Trading Participant maintains a Cash Settlement Account with one of the two existing Settlement Banks of SCCP which are Banco de Oro Unibank, Inc. and Rizal Commercial Banking Corporation. Payment for securities bought should be in good, cleared funds and should be final and irrevocable. Settlement is presently on a broker level.

SCCP implemented its Central Clearing and Central Settlement system on May 29, 2006, which employs multilateral netting whereby the system automatically offsets “buy” and “sell” transactions on a per issue and a per flag basis to arrive at a net receipt or a net delivery security position for each Clearing Member. All cash debits and credits are also netted into a single net cash position for each Clearing Member. Novation of the original PSE trade contracts occurs, and SCCP stands between the original trading parties and becomes the Central Counterparty to each PSE-Eligible trade cleared through it.

Scripless Trading

In 1995, the PDTC, was organized to establish a central depository in the Philippines and introduce scripless or book-entry trading in the Philippines. On December 16, 1996, the PDTC was granted a provisional license by the Philippine SEC to act as a central securities depository.

All listed securities at the PSE have been converted into book-entry settlement in the PDTC. The depository service of the PDTC provides the infrastructure for lodgment (deposit) and upliftment (withdrawal) of securities, pledge of securities, securities lending and borrowing and corporate actions including shareholders’ meetings, dividend declarations and rights offerings. The PDTC also provides depository and settlement services for non-PSE trades of listed equity securities. For transactions on the PSE, the security element of the trade will be settled through the book-entry system, while the cash element will be settled through the current settlement banks, Rizal Commercial Banking Corporation and Banco de Oro Unibank, Inc.

In order to benefit from the book-entry system, securities must be immobilized into the PDTC system through a process called lodgment. Lodgment is the process by which shareholders transfer legal title (but not beneficial title) over their shares of stock in favor of PCD Nominee Corporation (“PCD Nominee”), a corporation wholly-owned by the PDTC whose sole purpose is to act as nominee and legal title holder of all

shares of stock lodged into the PDTC. “Immobilization” is the process by which the warrant or share certificates of lodging holders are canceled by the transfer agent and the corresponding transfer of legal ownership of the immobilized shares to PCD Nominee will be recorded in SMC’s registry. This trust arrangement between the participants and PDTC through PCD Nominee is established by and explained in the PDTC Rules and Operating Procedures approved by the Philippine SEC. No consideration is paid for the transfer of legal title to PCD Nominee. Once lodged, transfers of beneficial title of the securities are accomplished via book-entry settlement.

Under the current PDTC system, only participants (e.g. brokers and custodians) will be recognized by the PDTC as the beneficial owners of the lodged equity securities. Thus, each beneficial owner of shares, through his participant, will be the beneficial owner to the extent of the number of shares held by such participant in the records of the PCD Nominee. All lodgments, trades and uplifts on these shares will have to be coursed through a participant. Ownership and transfers of beneficial interests in the shares will be reflected, with respect to the participant’s aggregate holdings, in the PDTC system, and with respect to each beneficial owner’s holdings, in the records of the participants. Beneficial owners are thus advised that in order to exercise their rights as beneficial owners of the lodged shares, they must rely on their participant-brokers and/or participant-custodians.

Any beneficial owner of shares who wishes to trade his interests in the shares must course the trade through a participant. The participant can execute PSE trades and non-PSE trades of lodged equity securities through the PDTC system. All matched transactions in the PSE trading system will be fed through the SCCP, and into the PDTC system. Once it is determined on the settlement date (T+3) that there are adequate securities in the securities settlement account of the participant-seller and adequate cleared funds in the settlement bank account of the participant-buyer, the PSE trades are automatically settled in the SCCP Central Clearing and Central Settlement system, in accordance with the SCCP and PDTC Rules and Operating Procedures. Once settled, the beneficial ownership of the securities is transferred from the participant-seller to the participant-buyer without the physical transfer of stock certificates covering the traded securities.

If a shareholder wishes to withdraw his stockholdings from the PDTC system, the PDTC has a procedure of upliftment under which PCD Nominee will transfer back to the shareholder the legal title to the shares lodged. The uplifting shareholder shall follow the Rules and Operating Procedures of the PDTC for the upliftment of the shares lodged under the name of the PCD Nominee. The transfer agent shall prepare and send a Registry Confirmation Advice to the PDTC covering the new number of shares lodged under the PCD Nominee. The expenses for upliftment are for the account of the uplifting shareholder.

The difference between the depository and the registry would be on the recording of ownership of the shares in the issuing corporations’ books. In the depository set-up, shares are simply immobilized, wherein customers’ certificates are canceled and a new certificate is issued in the name of PCD Nominee to confirm new balances of the shares lodged with the PDTC. Transfers among/between broker and/or custodian accounts, as the case may be, will only be made within the book-entry system of PDTC. However, as far as the issuing corporation is concerned, the underlying certificates are in the nominee’s name. In the registry set-up, settlement and recording of ownership of traded securities will already be directly made in the corresponding issuing company’s transfer agents’ books or system. Likewise, recording will already be at the beneficiary level (whether it be a client or a registered custodian holding securities for its clients), thereby removing from the broker its current “de facto” custodianship role.

Amended Rule on Lodgment of Securities

On April 15, 2009, the PSE apprised all listed companies and market participants through Memorandum No. 2009-218 that commencing on July 1, 2009, as a condition for the listing and trading of the securities of an applicant company, the applicant company shall electronically lodge its registered securities with the PDTC or any other entity duly authorized by the Philippine SEC, without any jumbo or mother certificate in compliance with the requirements of Section 43 of the Philippine Securities Regulation Code. In compliance with the foregoing requirement, actual listing and trading of securities on the scheduled listing date shall take

effect only after submission by the applicant company of the documentary requirements stated in Article III Part A of the Revised Listing Rules.

Further, the PSE apprised all listed companies and market participants on May 21, 2010 through Memorandum No. 2010-0246 that the Amended Rule on Lodgment of Securities under Section 16 of Article III, Part A of the Revised Listing Rules of the PSE shall apply to all securities that are lodged with the PDTC or any other entity duly authorized by the Philippine SEC.

For listing applications, the amended rule on lodgment of securities is applicable to:

- The offer shares/securities of the applicant company in the case of an initial public offering;
- The shares/securities that are lodged with the PDTC, or any other entity duly authorized by the Philippine SEC in the case of a listing by way of introduction;
- New securities to be offered and applied for listing by an existing listed company; and
- Additional listing of securities of an existing listed company.

Pursuant to the said amendment, the PDTC issued an implementing procedure in support thereof to wit:

For a new company to be listed at the PSE as of July 1, 2009, the usual procedure will be observed but the transfer agent of the company shall no longer issue a certificate to PCD Nominee but shall issue a Registry Confirmation Advice, which shall be the basis for the PDTC to credit the holdings of the depository participants on listing date.

On the other hand, for an existing listed company, the PDTC shall wait for the advice of the transfer agent that it is ready to accept surrender of PCD Nominee jumbo certificates and upon such advice the PDTC shall surrender all PCD Nominee jumbo certificates to the transfer agent for cancellation. The transfer agent shall issue a Registry Confirmation Advice to PDTC evidencing the total number of shares registered in the name of PCD Nominee in SMC's registry as of confirmation date.

Issuance of Certificated Shares

On or after the listing of the shares on the PSE, any beneficial owner of the shares may apply to PDTC through his broker or custodian-participant for a withdrawal from the book-entry system and return to the conventional paper-based settlement. If a shareholder wishes to withdraw his stockholdings from the PDTC system, the PDTC has a procedure of upliftment under which PCD Nominee will transfer back to the shareholder the legal title to the shares lodged. The uplifting shareholder shall follow the Rules and Operating Procedures of the PDTC for the uplifting of the shares lodged under the name of the PCD Nominee. The transfer agent shall prepare and send a Registry Confirmation Advice to the PDTC covering the new number of shares lodged under PCD Nominee. The expenses for upliftment are on the account of the uplifting shareholder.

Upon the issuance of certificated shares in the name of the person applying for upliftment, such shares shall be deemed to be withdrawn from the PDTC book-entry settlement system, and trading on such shares will follow the normal process for settlement of certificated securities. The expenses for upliftment of beneficial ownership in the shares to certificated securities will be charged to the person applying for upliftment. Pending completion of the upliftment process, the beneficial interest in the shares covered by the application for upliftment is frozen and no trading and book-entry settlement will be permitted until certificated shares shall have been issued by the relevant company's transfer agent.

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SEC Accreditation No. 0004-FR-2
BSP Accredited

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
San Miguel Corporation
No. 40 San Miguel Avenue
Mandaluyong City

We have audited the accompanying consolidated financial statements of San Miguel Corporation and Subsidiaries which comprise the consolidated statements of financial position as at December 31, 2010 and 2009, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Manabat Sanagustin & Co., CPAs, a Philippine partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of San Miguel Corporation and Subsidiaries as at December 31, 2010 and 2009, and its consolidated financial performance and its consolidated cash flows for each of the three years in the period ended December 31, 2010, in accordance with Philippine Financial Reporting Standards.

MANABAT SANAGUSTIN & CO., CPAs

JORGE MA. S. SANAGUSTIN

Partner

CPA License No. 0030399

SEC Accreditation No. 0026-AR-2

Tax Identification No. 124-282-616

BIR Accreditation No. 08-001987-7-2010

Issued June 30, 2010; Valid until June 29, 2013

PTR No. 2639631MB

Issued January 3, 2011 at Makati City

March 14, 2011

Makati City, Metro Manila

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	December 31		
	Note	2010	2009
		(In millions)	
ASSETS			
Current Assets			
Cash and cash equivalents	9,41,42	P125,188	P209,411
Trade and other receivables — net	4,10,34,41,42	75,904	49,082
Inventories	4,11	57,442	25,458
Current portion of biological assets — net	4,18	3,267	2,525
Prepaid expenses and other current assets	12,36,41,42	16,914	8,891
		<u>278,715</u>	<u>295,367</u>
Assets held for sale	5,8	823	2,746
Total Current Assets		<u>279,538</u>	<u>298,113</u>
Noncurrent Assets			
Investments and advances — net	4,13,41	152,814	39,005
Available-for-sale financial assets	14,41,42	3,597	351
Property, plant and equipment — net	4,16	308,073	65,919
Investment properties — net	4,17	2,133	1,867
Biological assets — net of current portion	4,18	1,479	1,847
Goodwill — net	4,5,19,39	30,251	6,408
Other intangible assets — net	4,5,19	10,980	3,630
Deferred tax assets	4,25	7,134	8,883
Other noncurrent assets — net	4,5,20,36,41,42	33,801	12,468
		<u>550,262</u>	<u>140,378</u>
Total Noncurrent Assets		<u>P829,800</u>	<u>P438,491</u>
LIABILITIES AND EQUITY			
Current Liabilities			
Drafts and loans payable	21,41,42	P 74,128	P 56,789
Accounts payable and accrued expenses	22,35,36,41,42	69,774	31,391
Finance lease liabilities — current portion	35,41,42	10,946	13
Income and other taxes payable		10,001	4,186
Dividends payable	6,37	826	573
Current maturities of long-term debt — net of debt issue costs	23,41,42	12,549	1,077
Total Current Liabilities		<u>178,224</u>	<u>94,029</u>
Noncurrent Liabilities			
Long-term debt — net of current maturities and debt issue costs	23,41,42	P156,378	P 71,885
Deferred tax liabilities	25	13,752	12,037
Finance lease liabilities — net of current portion	35, 41, 42	197,461	17
Other noncurrent liabilities	24, 36, 41, 42	17,160	19,585
Total Noncurrent Liabilities		<u>384,751</u>	<u>103,524</u>
Equity	26,37,38		
Equity Attributable to Equity Holders of the Parent Company			
Capital stock — common		16,343	16,150
Capital stock — preferred		4,852	4,852
Additional paid-in capital		101,406	99,085
Revaluation increment		1,391	18
Cumulative translation adjustments		5,365	5,845
Retained earnings:			
Appropriated		5,671	5,497
Unappropriated		150,544	151,911
Treasury stock		<u>(69,541)</u>	<u>(69,541)</u>
		<u>216,031</u>	<u>213,817</u>
Non-controlling Interests	2	50,794	27,121
Total Equity		<u>266,825</u>	<u>240,938</u>
		<u>P829,800</u>	<u>P438,491</u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(In millions, except per share data)		
SALES	34	₱246,109	₱174,213	₱168,041
COST OF SALES	27	<u>173,906</u>	<u>124,295</u>	<u>124,072</u>
GROSS PROFIT		72,203	49,918	43,969
SELLING AND ADMINISTRATIVE EXPENSES	28	(37,426)	(30,249)	(29,151)
INTEREST EXPENSE AND OTHER FINANCING CHARGES	21,23,31,35	(16,578)	(7,926)	(6,032)
INTEREST INCOME	32	3,023	5,989	6,630
EQUITY IN NET EARNINGS (LOSSES) OF ASSOCIATES	13	6,817	2,816	(1,132)
GAIN ON SALE OF INVESTMENTS AND PROPERTY AND EQUIPMENT	13,16,17	529	50,630	8,746
OTHER INCOME (CHARGES) — Net	33	<u>6,926</u>	<u>(6,843)</u>	<u>(2,262)</u>
INCOME BEFORE INCOME TAX FROM CONTINUING OPERATIONS		35,494	64,335	20,768
INCOME TAX EXPENSE	25	<u>11,438</u>	<u>3,706</u>	<u>6,098</u>
INCOME FROM CONTINUING OPERATIONS		24,056	60,629	14,670
INCOME AFTER INCOME TAX FROM DISCONTINUED OPERATIONS	8	<u>—</u>	<u>—</u>	<u>5,413</u>
NET INCOME		<u><u>₱ 24,056</u></u>	<u><u>₱ 60,629</u></u>	<u><u>₱ 20,083</u></u>
Attributable to:				
Equity holders of the Parent Company		₱ 20,091	₱ 57,799	₱ 19,348
Non-controlling interests		<u>3,965</u>	<u>2,830</u>	<u>735</u>
		<u><u>₱ 24,056</u></u>	<u><u>₱ 60,629</u></u>	<u><u>₱ 20,083</u></u>
Basic Earnings Per Common Share				
Attributable to Equity Holders of the Parent Company	38			
From Continuing Operations		₱ 6.18	₱ 19.21	₱ 4.41
From Discontinued Operations		<u>—</u>	<u>—</u>	<u>1.72</u>
		<u><u>₱ 6.18</u></u>	<u><u>₱ 19.21</u></u>	<u><u>₱ 6.13</u></u>
Diluted Earnings Per Common Share				
Attributable to Equity Holders of the Parent Company	38			
From Continuing Operations		₱ 6.14	₱ 19.10	₱ 4.40
From Discontinued Operations		<u>—</u>	<u>—</u>	<u>1.71</u>
		<u><u>₱ 6.14</u></u>	<u><u>₱ 19.10</u></u>	<u><u>₱ 6.11</u></u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(In millions)		
NET INCOME		<u>₱24,056</u>	<u>₱60,629</u>	<u>₱20,083</u>
GAIN (LOSS) ON EXCHANGE DIFFERENCES ON TRANSLATION OF FOREIGN OPERATIONS		(653)	521	689
SHARE IN COMPREHENSIVE INCOME (LOSS) OF ASSOCIATES	13	(422)	252	(19)
GAIN (LOSS) ON CASH FLOW HEDGES — Net.	42	—	222	(221)
INCOME TAX BENEFIT (EXPENSE)		—	(67)	66
NET GAIN (LOSS) ON AVAILABLE-FOR-SALE FINANCIAL ASSETS		447	(33)	(17)
INCOME TAX BENEFIT (EXPENSE)		<u>(45)</u>	<u>3</u>	<u>2</u>
OTHER COMPREHENSIVE INCOME (LOSS) - NET OF TAX		<u>(673)</u>	<u>898</u>	<u>500</u>
TOTAL COMPREHENSIVE INCOME — NET OF TAX		<u>₱23,383</u>	<u>₱61,527</u>	<u>₱20,583</u>
Comprehensive Income Attributable to:				
Equity holders of the Parent Company		₱19,611	₱58,807	₱19,314
Non-controlling interests		<u>3,772</u>	<u>2,720</u>	<u>1,269</u>
		<u>₱23,383</u>	<u>₱61,527</u>	<u>₱20,583</u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

Equity Attributable to Equity Holders of the Parent Company													
Note	Capital Stock		Additional Paid-in Capital	Cumulative Translation Adjustments			Retained Earnings		Treasury Stock	Total	Non-controlling Interests	Total Equity	
	Common	Preferred		Revaluation Increment	Translation Reserve	Hedging Reserve	Fair Value Reserve	Appropriated					Unappropriated
(In millions)													
As of January 1, 2010.													
Loss on exchange differences on translation of foreign operations	P16,150	P4,852	P 99,085	P 18	P5,737	P —	P 108	P5,497	P151,911	(P69,541)	P213,817	P240,938	
Share in comprehensive loss of associates	—	—	—	—	(496)	—	—	—	—	—	(496)	(653)	
Net gain on available-for-sale financial assets, net of tax	—	—	—	—	—	—	(422)	—	—	—	(422)	(422)	
Other comprehensive income (loss)	—	—	—	—	—	—	438	—	—	—	438	402	
Net income for the year	—	—	—	—	(496)	—	16	—	20,091	—	(480)	(673)	
Total comprehensive income (loss) for the year	—	—	—	—	(496)	—	16	—	20,091	—	20,091	24,056	
Issuance of capital stock	26	193	2,121	—	—	—	—	—	20,091	—	19,611	23,383	
Stock options	40	—	200	—	—	—	—	—	—	—	2,314	2,314	
Addition to non-controlling interests	2, 5, 6, 13	—	—	(23)	—	—	—	—	—	—	200	200	
Appropriations — net	26	—	—	—	—	—	—	—	—	(23)	24,877	24,854	
Cash dividends	37	—	—	—	—	—	—	174	(174)	—	—	—	
Common	—	—	—	—	—	—	—	—	(15,584)	—	(15,584)	(20,560)	
Preferred	—	—	—	—	—	—	—	—	(5,700)	—	(5,700)	(5,700)	
Acquisition of subsidiary and others	5	—	—	1,396	—	—	—	—	—	—	1,396	1,396	
As of December 31, 2010													
As of January 1, 2009	P16,343	P4,852	P101,406	P1,391	P5,241	P —	P 124	P5,671	P150,544	(P69,541)	P216,031	P266,825	
Gain on exchange differences on translation of foreign operations	P16,112	P —	P 31,183	P 18	P4,882	(P123)	P 78	P5,522	P 96,298	(P4,053)	P149,917	P168,224	
Share in comprehensive income of associates	—	—	—	—	662	—	—	—	—	—	662	521	
Gain on cash flow hedges, net of tax	—	—	—	—	193	—	59	—	—	—	252	252	
Net gain on available-for-sale financial assets, net of tax	—	—	—	—	—	123	(29)	—	—	—	123	155	
Other comprehensive income (loss)	—	—	—	—	—	—	—	—	—	—	(29)	(30)	
Net income for the year	—	—	—	—	855	123	30	—	—	—	1,008	898	
Total comprehensive income for the year	—	—	—	—	—	—	—	—	57,799	—	57,799	60,629	
Issuance of capital stock	26	38	6,563	—	855	123	30	—	57,799	—	58,807	61,527	
Exchange of capital stock	26	—	61,122	—	—	—	—	—	—	(65,488)	7,087	7,087	
Stock options	40	—	217	—	—	—	—	—	—	—	217	217	
Addition to non-controlling interests	2, 5, 6, 13	—	—	—	—	—	—	—	—	—	8,392	8,392	
Appropriations — net	26	—	—	—	—	—	—	(25)	25	—	—	—	
Cash dividends	37	—	—	—	—	—	—	—	(2,211)	—	(2,298)	(4,509)	
As of December 31, 2009													
As of January 1, 2008	P16,150	P4,852	P 99,085	P 18	P5,737	P —	P 108	P5,497	P151,911	(P69,541)	P213,817	P240,938	

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY — (Continued)
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

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See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

	Note	2010	2009	2008
		(In millions)		
CASH FLOWS FROM OPERATING ACTIVITIES				
Income before income tax from continuing operations		P 35,494	P 64,335	P 20,768
Loss before income tax from discontinued operations	8	—	—	(19)
Gain from disposal of discontinued operations	8	—	—	5,425
Income before income tax		35,494	64,335	26,174
Adjustments for:				
Depreciation, amortization and others — net	29	9,457	14,724	9,303
Interest expense and other financing charges	31	16,578	7,926	6,032
Interest income		(3,023)	(5,989)	(6,630)
Equity in net losses (earnings) of associates	13	(6,817)	(2,816)	1,132
Gain on sale of investments and property and equipment		(5,020)	(50,630)	(8,746)
Gain from disposal of discontinued operations	8	—	—	(5,425)
Operating income before working capital changes		46,669	27,550	21,840
Changes in noncash current assets, certain current liabilities and others . . .	39	13,112	(1,183)	(1,291)
Cash generated from operations		59,781	26,367	20,549
Interest paid		(5,155)	(6,348)	(5,665)
Income taxes paid		(9,312)	(6,651)	(7,835)
Net cash flows provided by operating activities		45,314	13,368	7,049
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisition of subsidiaries, net of cash and cash equivalents acquired	39	(18,978)	(1,494)	—
Additions to investments and advances		(99,762)	(5,771)	(6,667)
Additions to property, plant and equipment	16	(8,518)	(6,249)	(6,437)
Decrease (increase) in other noncurrent assets and others		1,424	(950)	(16,010)
Payment by (advances to) related parties		(6,070)	3,243	31,708
Proceeds from sale of investments and property and equipment		1,175	55,127	13,663
Interest received		3,798	5,249	6,558
Proceeds from disposal of discontinued operations, net of cash and cash equivalents disposed of	8	—	—	9,083
Net cash flows (used in) provided by investing activities		(126,931)	49,155	31,898
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from:				
Short-term borrowings		P 685,768	P 691,093	P 608,756
Long-term borrowings		72,937	67,786	64
Payments of:				
Short-term borrowings		(703,376)	(683,569)	(605,088)
Long-term borrowings		(29,196)	(44,657)	(13,336)
Payment of finance lease liabilities		(4,798)	(12)	—
Cash dividends paid	37	(21,118)	(3,301)	(4,463)
Proceeds from issuance of capital stock	26	2,314	7,087	3
Dividends paid to non-controlling shareholders		(4,883)	(2,192)	(393)
Increase in non-controlling interests		126	315	592
Net cash flows provided by (used in) financing activities		(2,226)	32,550	(13,865)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS				
		(380)	(2,601)	(1,424)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS				
		(84,223)	92,472	23,658
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR				
		209,411	116,939	93,281
CASH AND CASH EQUIVALENTS AT END OF YEAR				
	9	P 125,188	P 209,411	P 116,939

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions, Except Per Share Data)

1. Reporting Entity

San Miguel Corporation (SMC or Parent Company) was incorporated in the Philippines. The accompanying consolidated financial statements comprise the financial statements of the Parent Company and its Subsidiaries (collectively referred to as the “Group”) and the Group’s interest in associates and jointly controlled entities. The Parent Company is a public company under Section 17.2 of the Securities Regulation Code and its shares are listed on the Philippine Stock Exchange (PSE). The Group is engaged in the production, processing and marketing of beverage, food and packaging products, power generation and distribution, mining, fuel and oil, infrastructure, telecommunications and management and development of real estate properties. The registered office address of the Parent Company is No. 40 San Miguel Avenue, Mandaluyong City.

The accompanying consolidated financial statements were authorized for issue by the Board of Directors (BOD) on March 14, 2011.

2. Basis of Preparation

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis of accounting, except for the following:

- derivative financial instruments are measured at fair value;
- available-for-sale (AFS) financial assets are measured at fair value;
- defined benefit asset is measured as the net total of the fair value of the plan assets, less unrecognized actuarial gains and the present value of the defined benefit obligation; and
- agricultural produce are measured at 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 Parent Company’s functional currency. All values are rounded off to the nearest million (₱000,000), except when otherwise indicated.

Statement of Compliance

The consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards (PAS) and Philippine Interpretations from International Financial Reporting Interpretations Committee (IFRIC), issued by the Financial Reporting Standards Council (FRSC).

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Basis of Consolidation

The consolidated financial statements include the accounts of the Parent Company and its subsidiaries. The major subsidiaries include the following:

	Percentage of Ownership		Country of Incorporation
	2010	2009	
Beverage Business:			
San Miguel Brewery Inc. (SMB) and subsidiaries [including Iconic Beverages, Inc. (IBI), Brewery Properties Inc. (BPI) ^(a) and subsidiary, Brewery Landholdings, Inc. (BLI) and San Miguel Brewing International Ltd. (SMBIL) ^(b) and subsidiaries {including San Miguel Brewery Hong Kong Limited (SMBHK) and subsidiaries, PT Delta Djakarta Tbk (PT-Delta) and subsidiaries, San Miguel (Baoding) Brewery Co. Ltd., San Miguel Brewery Vietnam Ltd. (SMBV), San Miguel Beer (Thailand) Ltd. (SMBTL) and San Miguel Marketing Thailand Ltd.}]	51.00	51.00	Philippines
Ginebra San Miguel, Inc. (GSMI) and subsidiaries [including Distileria Bago, Inc. and Ginebra San Miguel International, Ltd. (GSMIL), Ginebra San Miguel International Holdings Ltd. (GSMIHL), Global Beverage Holdings Ltd. (GBHL) and Siam Holdings Ltd. (SHL)]	78.00	79.53	Philippines
San Miguel Foods and Beverage International Limited (SMFBIL) and subsidiaries [including PT San Miguel Indonesia Foods & Beverages (PTSMIFB), San Miguel (Thailand) Co. Ltd., San Miguel (Guangdong) Foods & Beverages Co. Ltd., San Miguel (Vietnam) Co. Ltd., PT San Miguel Marketing Indonesia, and San Miguel (Malaysia) Sdn. Bhd.]	100.00	100.00	BVI
Food Business:			
San Miguel Pure Foods Company, Inc. (SMPFC) and subsidiaries [including San Miguel Foods, Inc. (SMFI), San Miguel Mills, Inc. (SMMI), The Purefoods-Hormel Company, Inc., Magnolia Inc. (Magnolia), San Miguel Super Coffeemix Co., Inc. (SMSCCI), P.T. San Miguel Pure Foods Indonesia (PTSMPFI) ^(c) and San Miguel Pure Foods International, Limited (SMPFIL) and subsidiary, San Miguel Pure Foods Investment (BVI) Limited (SMPFI) and subsidiary, San Miguel Pure Foods (Vn) Co. Ltd. (SMPFVN)]	99.92	99.92	Philippines
Packaging Business:			
San Miguel Yamamura Packaging Corporation (SMYPC) and subsidiary, San Miguel Yamamura Fuso Molds Corporation	65.00	65.00	Philippines
San Miguel Yamamura Packaging International Limited (SMYPIL) and subsidiaries [including San Miguel Yamamura Phu Tho Packaging Co. Ltd., Zhaoqing San Miguel Yamamura Glass Co., Ltd., Foshan San Miguel Yamamura Packaging Co. Ltd., San Miguel Yamamura Utama Indoplas, San Miguel Yamamura Packaging & Printing Sdn. Bhd., San Miguel Yamamura Woven Products Sdn. Bhd., Packaging Research Centre Sdn. Bhd., San Miguel Plastic Films Sdn. Bhd. and San Miguel Yamamura Knox Pty. Ltd. (SMYK) ^(d) and subsidiaries] . . .	65.00	65.00	BVI
Mindanao Corrugated Fibreboard, Inc. (Mincorr) ^(c)	100.00	100.00	Philippines
San Miguel Paper Packaging Corporation (SMPPC) ^(c)	100.00	100.00	Philippines
San Miguel Yamamura Asia Corporation (SMYAC)	60.00	60.00	Philippines

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	<u>Percentage of Ownership</u>		<u>Country of Incorporation</u>
	<u>2010</u>	<u>2009</u>	
Power Generation and Distribution Business:			
SMC Global Power Holdings Corp. (SMC Global) ^(e) and subsidiaries [including Strategic Power Devt. Corp. (SPDC), San Miguel Energy Corporation (SMEC), Panasia Energy Holdings Inc. (PanAsia) and South Premiere Power Corp. (SPPC)]	100.00	—	Philippines
Fuel and Oil Business:			
Sea Refinery Corporation (SRC) and subsidiary, Petron Corporation (Petron) and subsidiaries [including Petron Marketing Corporation, Petron Freeport Corporation, Petrogen Insurance Corporation (Petrogen), Overseas Ventures Insurance Corporation, Petron Singapore Trading Pte. Ltd., and New Ventures Realty Corporation and subsidiary, Las Lucas Construction & Development Corporation] ^(f)	100.00	—	Philippines
Infrastructure Business:			
San Miguel Holdings Corp. (SMHC) and subsidiaries [including Rapid Thoroughfares Inc. (Rapid), Trans Aire Development Holding Corp. (TADHC) ^(c, g) , Universal LRT Corporation (BVI) Limited (ULC BVI) ^(c, h) and subsidiaries]	100.00	100.00	Philippines
Telecommunications Business:			
Vega Telecom, Inc. (Vega) and subsidiaries [including Two Cassandra- CCI Conglomerates, Inc. (TCCI), Perchpoint Holdings Corp. (PHC), Power Smart Capital Limited (PSCL) and A.G.N. Philippines, Inc. (AGNP)] ⁽ⁱ⁾	100.00	100.00	Philippines
Real Estate Business:			
San Miguel Properties, Inc. (SMPI) and subsidiaries [including SMPI- Government Service Insurance System Joint Venture Corporation (SMPI-GSIS JVC) and Integrated Geosolutions, Inc. (IGI)] ^(c)	99.68	99.68	Philippines
Others:			
SMC Stock Transfer Service Corporation	100.00	100.00	Philippines
ArchEn Technologies, Inc.	100.00	100.00	Philippines
SMITS, Inc. ^(c) and subsidiary	100.00	100.00	Philippines
Anchor Insurance Brokerage Corporation (AIBC)	58.33	58.33	Philippines
SMC Shipping and Lighterage Corporation (SMCSLC) and subsidiary . . .	70.00	70.00	Philippines
Challenger Aero Air Corp.	100.00	100.00	Philippines
Philippine Breweries Corporation (PBC)	99.52	99.52	Philippines
Pacific Central Properties, Inc. (PCPI)	100.00	100.00	Philippines

^(a) Parent Company owned 40% of BPI and SMBRP owned 60% of BPI when the increase in capital stock (including the assignment of the land in exchange for the common shares and assignment of BLI shares in exchange for the preferred shares) was approved by SEC on September 10, 2009. Consolidated to SMB in November 10, 2010 (Note 6).

^(b) Consolidated to SMB effective January 29, 2010.

^(c) The financial statements of these subsidiaries were audited by other auditors.

^(d) Consolidated to SMYPIL effective December 17, 2009. JHK Investments was renamed “San Miguel Yamamura Knox Pty. Ltd.” in February 2010.

^(e) Formerly Global 5000 Investment Inc. Consolidated effective July 31, 2010.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

^(f) Consolidated effective December 15, 2010.

^(g) Formerly Caticlan International Airport Development Corp. (CIADC). Consolidated to SMHC effective April 8, 2010.

^(h) Consolidated to SMHC effective November 8, 2010.

⁽ⁱ⁾ TCCI, PHC, and PSCL were consolidated to Vega effective July 30, 2010. AGNP was consolidated to Vega effective December 30, 2010.

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefit from its activities. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account. The financial statements of the subsidiaries are included in the consolidated financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The consolidated financial statements are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the consolidated financial statements.

Non-controlling interests represent the portion of profit or loss and net assets not held by the Group and are presented in the consolidated statements of income, consolidated statements of comprehensive income and within equity in the consolidated statements of financial position, separately from the Group's equity attributable to equity holders of the Parent Company.

Non-controlling interests include the interests not held by the Group in SMB, SMBHK, PT-Delta, SMBV, SMBTL, GSML, PTSMIFB, SMPFC, PTSMPFI, SMPFI, SMYPC, SMYPIL, SMYAC, SMPI, AIBC, SMCSLC, PBC in 2010 and 2009 and also Petron, TADHC, ULC BVI, SMPI-GSIS JVC and IGI in 2010.

3. Significant Accounting Policies

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

Adoption of New or Revised Standards, Amendments to Standards and Interpretations

The FRSC approved the adoption of a number of new or revised standards, amendments to standards, and interpretations (based on IFRIC Interpretations) as part of PFRS. Accordingly, the Group changed its accounting policies in the following areas:

Adopted Effective 2010

The Group has adopted the following PFRSs starting January 1, 2010:

- Revised PFRS 3, *Business Combinations* (2008), effective for annual periods beginning on or after July 1, 2009, incorporates the following changes that are likely to be relevant to the Group's operations:
 - The definition of a business has been broadened, which is likely to result in more acquisitions being treated as business combinations.
 - Contingent consideration will be measured at fair value, with subsequent changes therein recognized in profit or loss.
 - Transaction costs, other than share and debt issue costs, will be expensed as incurred.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognized in profit or loss.
- Any non-controlling interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

The Group has applied Revised PFRS 3 (2008) in the acquisitions of SMC Global, SRC, TADHC, ULC BVI, TCCI, PHC, PSCL, AGNP and IGI (Notes 5 and 13).

- Revised PAS 27, *Consolidated and Separate Financial Statements* (2008), effective for annual periods beginning on or after July 1, 2009, requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognized as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognized in profit or loss.

The Group has applied the Revised PAS 27 to acquisitions of non-controlling interests in SMC Global (Note 5).

- Amendments to PAS 39, *Financial Instruments: Recognition and Measurement — Eligible Hedged Items*, provide for the following: a) new application guidance to clarify the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedge relationship; and b) additional application guidance on qualifying items, assessing hedge effectiveness, and designation of financial items as hedged items. The amendments are effective for annual periods beginning on or after July 1, 2009. The adoption of these amendments to standards did not have a material effect on the consolidated financial statements.
- Philippine Interpretation IFRIC 17, *Distributions of Non-cash Assets to Owners*, provides guidance on the accounting for non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners. It also applies to distributions in which the owners may elect to receive either the non-cash asset or a cash alternative. The liability for the dividend payable is measured at the fair value of the assets to be distributed. The interpretation is effective for annual periods beginning on or after July 1, 2009. The adoption of this Philippine Interpretation did not have a material effect on the consolidated financial statements.
- *Improvements to PFRSs 2008* — Amendments to PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, specify that if an entity is committed to a plan to sell a subsidiary, then it would classify all of that subsidiary's assets and liabilities as held for sale when the held for sale criteria in paragraphs 6 to 8 of PFRS 5 are met. This applies regardless of the entity retaining an interest (other than control) in the subsidiary. Disclosures for discontinued operations are required by the parent when a subsidiary meets the definition of a discontinued operation. The amendments are effective for annual periods beginning on or after July 1, 2009. The adoption of these improvements to standard did not have a material effect on the consolidated financial statements.
- Amendments to PFRS 2, *Share-based Payment: Group Cash-settled Share-based Payment Transactions*, clarify the scope of PFRS 2, that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, and regardless of whether the transaction is equity-settled or cash-settled; and the interaction of PFRS 2 and other standards, that in PFRS 2, a "group" has the same meaning as in PAS 27, that is, it includes only a parent and its subsidiaries. The amendments are effective for annual periods beginning on or after January 1, 2010. The adoption of these amendments to standards did not have a material effect on the consolidated financial statements.
- *Improvements to PFRSs 2009*, contain 15 amendments to 12 standards. The improvements are generally effective for annual periods beginning on or after January 1, 2010. The following are the

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

said improvements or amendments to PFRSs, none of which has a significant effect on the consolidated financial statements of the Group:

- PFRS 2 and PFRS 3 (2008). The amendments clarify that business combinations as defined in PFRS 3 (2008) are outside the scope of PFRS 2, notwithstanding that they may be outside the scope of PFRS 3 (2008). Therefore business combinations among entities under common control and the contribution of a business upon the formation of a joint venture will not be accounted for under PFRS 2.
- PAS 38, *Intangible Assets*. The amendments clarify that (i) an intangible asset that is separable only together with a related contract, identifiable asset or liability is recognized separately from goodwill together with the related item; and (ii) complementary intangible assets with similar useful lives may be recognized as a single asset. The amendments also describe valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination for which no active market exists.
- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*. The International Accounting Standards Board (IASB) amended the scope of IFRIC 9 so that embedded derivatives in contracts acquired in business combinations as defined in PFRS 3 (2008), joint venture formations and common control transactions remain outside the scope of IFRIC 9.
- Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*. The amendments remove the restriction that prevented a hedging instrument from being held by a foreign operation that itself is being hedged.
- PFRS 5. The amendments clarify that the required disclosures for non-current assets (or disposal groups) classified as held for sale or discontinued operations are specified in PFRS 5.
- PFRS 8, *Operating Segments*. The amendments clarify that segment information with respect to total assets is required only if such information is regularly reported to the chief operating decision maker.
- PAS 1, *Presentation of Financial Statements*. The amendments clarify that the classification of the liability component of a convertible instrument as current or non-current is not affected by terms that could, at the option of the holder of the instrument, result in settlement of the liability by the issue of equity instruments.
- PAS 7, *Statement of Cash Flows*. The amendments clarify that only expenditures that result in the recognition of an asset can be classified as a cash flow from investing activities.
- PAS 17, *Leases*. The IASB deleted guidance stating that a lease of land with an indefinite economic life normally is classified as an operating lease, unless at the end of the lease term title is expected to pass to the lessee. The amendments clarify that when a lease includes both the land and building elements, an entity should determine the classification of each element based on paragraphs 7 — 13 of PAS 17, taking account of the fact that land normally has an indefinite economic life.
- PAS 36, *Impairment of Assets*. The amendments clarify that the largest unit to which goodwill should be allocated is the operating segment level as defined in PFRS 8 before applying the aggregation criteria of PFRS 8.
- PAS 39. The amendments provide: (i) additional guidance on determining whether loan prepayment penalties result in an embedded derivative that needs to be separated; (ii) clarify that the scope exemption in PAS 39 paragraph 2 (g) is restricted to forward contracts, i.e. not options, between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

business combination at a future acquisition date within a reasonable period normally necessary to obtain any required approvals and to complete the transaction; and (iii) clarify that the gains or losses on a cash flow hedge should be reclassified from other comprehensive income to profit or loss during the period that the hedged forecast cash flows impact profit or loss.

Additional disclosures required by the revised standards and improvements were included in the consolidated financial statements, where applicable.

New or Revised Standards, Amendments to Standards and Interpretations Not Yet Adopted

The Group will adopt the following new or revised standards, amendments to standards and interpretations in the respective effective dates:

- Amendment to PAS 32, *Financial Instruments: Presentation — Classification of Rights Issues*, permits rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. The amendment is applicable for annual periods beginning on or after February 1, 2010.
- Philippine Interpretation IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*, addresses issues in respect of the accounting by the debtor in a debt for equity swap transaction. It clarifies that equity instruments issued to a creditor to extinguish all or part of a financial liability in a debt for equity swap are consideration paid in accordance with PAS 39 paragraph 41. The interpretation is applicable for annual periods beginning on or after July 1, 2010.
- Revised PAS 24, *Related Party Disclosures* (2009), amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. The revised standard is effective for annual periods beginning on or after January 1, 2011.
- *Prepayments of a Minimum Funding Requirement (Amendments to Philippine Interpretation IFRIC 14: PAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction)*. These amendments remove unintended consequences arising from the treatment of prepayments where there is a minimum funding requirement and result in prepayments of contributions in certain circumstances being recognized as an asset rather than an expense. The amendments are effective for annual periods beginning on or after January 1, 2011.
- *Improvements to PFRSs 2010* contain 11 amendments to 6 standards and 1 interpretation, of which only the following are applicable to the Group.
 - PFRS 3. The amendments: (i) clarify that contingent consideration arising in a business combination previously accounted for in accordance with PFRS 3 (2004) that remains outstanding at the adoption date of PFRS 3 (2008) continues to be accounted for in accordance with PFRS 3 (2004); (ii) limit the accounting policy choice to measure non-controlling interests upon initial recognition at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets to instruments that give rise to a present ownership interest and that currently entitle the holder to a share of net assets in the event of liquidation; and (iii) expand the current guidance on the attribution of the market-based measure of an acquirer's share-based payment awards issued in exchange for acquiree awards between consideration transferred and post-combination compensation cost when an acquirer is obliged to replace the acquiree's existing awards to encompass voluntarily replaced unexpired acquiree awards. The amendments are effective for annual periods beginning on or after July 1, 2010. Early application is permitted and is required to be disclosed.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- PAS 27. The amendments clarify that the consequential amendments to PAS 21, *The Effects of Changes in Foreign Exchange Rates*, PAS 28, *Investments in Associates*, and PAS 31, *Interests in Joint Ventures*, resulting from PAS 27 (2008) should be applied prospectively, with the exception of amendments resulting from renumbering. The amendments are effective for annual periods beginning on or after July 1, 2010.
- PFRS 7, *Financial Instruments: Disclosures*. The amendments add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. In addition, the IASB amended and removed existing disclosure requirements. The amendments are effective for annual periods beginning on or after January 1, 2011.
- PAS 1. The amendments clarify that disaggregation of changes in each component of equity arising from transactions recognized in other comprehensive income also is required to be presented either in the statement of changes in equity or in the notes. The amendments are effective for annual periods beginning on or after January 1, 2011.
- PAS 34, *Interim Financial Reporting*. The amendments add examples to the list of events or transactions that require disclosure under PAS 34 and remove references to materiality in PAS 34 that describes other minimum disclosures. The amendments are effective for annual periods beginning on or after January 1, 2011.
- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*. The amendments clarify that the fair value of award credits takes into account the amount of discounts or incentives that otherwise would be offered to customers that have not earned the award credits. The amendments are effective for annual periods beginning on or after January 1, 2011.

None of the above amendments are expected to have a significant effect on the consolidated financial statements of the Group.

- Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*, applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. It provides guidance on the recognition of revenue among real estate developers for sales of units, such as apartments or houses, 'off plan'; i.e., before construction is completed. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of PAS 11, *Construction Contracts*, or PAS 18, *Revenue*, and the timing of revenue recognition. The interpretation is effective for annual periods beginning on or after January 1, 2012.
- *Disclosures — Transfers of Financial Assets (Amendments to PFRS 7)*, require additional disclosures about transfers of financial assets. The amendments require disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognized financial assets. Entities are required to apply the amendments for annual periods beginning on or after July 1, 2011.
- *Deferred Tax: Recovery of Underlying Assets (Amendments to PAS 12, Income Taxes)* introduces an exception to the current measurement principles of deferred tax assets and liabilities arising from investment property measured using the fair value model in accordance with PAS 40, *Investment Property*. The exception also applies to investment properties acquired in a business combination accounted for in accordance with PFRS 3 provided the acquirer subsequently measure these assets applying the fair value model. The amendments integrated the guidance of Philippine Interpretation Standards Interpretation Committee (SIC) — 21, *Income Taxes — Recovery of Revalued Non-*

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Depreciable Assets into PAS 12, and as a result Philippine Interpretation SIC — 21 has been withdrawn. The effective date of the amendments is for periods beginning on or after January 1, 2012 and is applied retrospectively.

- PFRS 9, *Financial Instruments* (2009) was issued as the first phase of the PAS 39 replacement project. The chapters of the standard released in 2009 only related to the classification and measurement of financial assets. PFRS 9 (2009) retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and contractual cash flow characteristics of the financial asset. In October 2010, a new version of PFRS 9, *Financial Instruments* (2010) was issued which now includes all the requirements of PFRS 9 (2009) without amendment. The new version of PFRS 9 also incorporates requirements with respect to the classification and measurement of financial liabilities and the derecognition of financial assets and financial liabilities. The guidance in PAS 39 on impairment of financial assets and hedge accounting continues to apply. The new standard is effective for annual periods beginning on or after January 1, 2013. PFRS 9 (2010) supersedes PFRS 9 (2009). However, for annual periods beginning before January 1, 2013, an entity may elect to apply PFRS 9 (2009) rather than PFRS 9 (2010).

None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for PFRS 9, *Financial Instruments*, which will be mandatory for the Group's 2013 consolidated financial statements and could change the classification and measurement of financial assets.

The Group will assess the impact of the new or revised standards, amendments to standards and interpretations on the consolidated financial statements upon adoption on their respective effective dates.

Financial Assets and Financial Liabilities

Date of Recognition. The Group recognizes a financial asset or a financial liability in the consolidated statements of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at fair value of the consideration given (in case of an asset) or received (in case of a liability). The initial measurement of financial instruments, except for those designated at fair value through profit or loss (FVPL), includes transaction costs.

The Group classifies its financial assets in the following categories: held-to-maturity (HTM) investments, AFS financial assets, financial assets at FVPL and loans and receivables. The Group classifies its financial liabilities as either financial liabilities at FVPL or other liabilities. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

Determination of Fair Value. The fair value of financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there is no significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison

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to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

‘Day 1’ Profit. Where the transaction price in a non-active market is different from the fair value of the other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a ‘Day 1’ profit) in profit or loss unless it qualifies for recognition as some other type of asset. In cases where use is made of data which are not observable, the difference between the transaction price and model value is only recognized in profit or loss when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the ‘Day 1’ profit amount.

Financial Assets

Financial Assets at FVPL. A financial asset is classified at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at FVPL if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group’s documented risk management or investment strategy. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Financial assets may be designated by management at initial recognition as at FVPL, when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis;
- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group carries financial assets at FVPL using their fair values. Attributable transaction costs are recognized in profit or loss as incurred. Fair value changes and realized gains or losses are recognized in profit or loss. Fair value changes from derivatives accounted for as part of an effective accounting hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. Any interest earned shall be recognized as part of “Interest income” in the consolidated statements of income. Any dividend income from equity securities classified as FVPL shall be recognized in profit or loss when the right to receive payment has been established.

The Group’s derivative assets and financial assets at FVPL are classified under this category (Notes 12 and 42).

The combined carrying amounts of financial assets under this category amounted to ₱442 and ₱202 as of December 31, 2010 and 2009, respectively (Note 42).

Loans and Receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

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Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables shall be recognized as part of “Interest income” in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of “Interest income” in the consolidated statements of income. Gains or losses are recognized in profit or loss when loans and receivables are derecognized or impaired, as well as through the amortization process.

Cash includes cash on hand and in banks which are stated at face value. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The Group’s cash and cash equivalents, trade and other receivables and noncurrent receivables and deposits are included in this category (Notes 9, 10 and 20).

The combined carrying amounts of financial assets under this category amounted to ₱225,875 and ₱264,426 as of December 31, 2010 and 2009, respectively (Note 42).

HTM Investments. HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group’s management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS financial assets. After initial measurement, these investments are measured at amortized cost using the effective interest rate method, less impairment in value. Any interest earned on the HTM investments shall be recognized as part of “Interest income” in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of “Interest income” in the consolidated statements of income. Gains or losses are recognized in profit or loss when the HTM investments are derecognized or impaired, as well as through the amortization process.

As of December 31, 2010 and 2009, the Group has no investments accounted for under this category.

AFS Financial Assets. AFS financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other financial asset categories. Subsequent to initial recognition, AFS financial assets are measured at fair value and changes therein, other than impairment losses and foreign currency differences on AFS debt instruments, are recognized in other comprehensive income and presented in the “Fair value reserve” in equity. The effective yield component of AFS debt securities is reported as part of “Interest income” in the consolidated statements of income. Dividends earned on holding AFS equity securities are recognized as “Dividend income” when the right to receive payment has been established. When individual AFS financial assets are either derecognized or impaired, the related accumulated unrealized gains or losses previously reported in equity are transferred to and recognized in profit or loss.

AFS financial assets also include unquoted equity instruments with fair values which cannot be reliably determined. These instruments are carried at cost less impairment in value, if any.

The Group’s investments in equity securities included under “Available-for-sale financial assets” account are classified under this category (Note 14).

The carrying amounts of financial assets under this category amounted to ₱3,597 and ₱351 as of December 31, 2010 and 2009, respectively (Note 42).

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Financial Liabilities

Financial Liabilities at FVPL. Financial liabilities are classified under this category through the fair value option. Derivative instruments (including embedded derivatives) with negative fair values, except those covered by hedge accounting relationships, are also classified under this category.

The Group carries financial liabilities at FVPL using their fair values and reports fair value changes in profit or loss. Fair value changes from derivatives accounted for as part of an effective accounting hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. Any interest expense incurred shall be recognized as part of “Interest expense” in the consolidated statements of income.

The Group’s derivative liabilities are classified under this category (Notes 22 and 42).

The carrying amounts of financial liabilities under this category amounted to ₱71 and ₱111 as of December 31, 2010 and 2009, respectively (Note 42).

Other Financial Liabilities. This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability.

Included in this category are the Group’s liabilities arising from its trade or borrowings such as drafts and loans payable, accounts payable and accrued expenses, long-term debt, finance lease liabilities and other noncurrent liabilities (Notes 21, 22, 23, 24 and 35).

The combined carrying amounts of financial liabilities under this category amounted to ₱536,828 and ₱179,882 as of December 31, 2010 and 2009, respectively (Note 42).

Debt Issue Costs

Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest rate method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are recognized in profit or loss.

Derivative Financial Instruments and Hedging

Freestanding Derivatives

For the purpose of hedge accounting, hedges are classified as either: a) fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk); b) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment; or c) hedges of a net investment in foreign operations.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

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Fair Value Hedge. Derivatives classified as fair value hedges are carried at fair value with corresponding change in fair value recognized in profit or loss. The carrying amount of the hedged asset or liability is also adjusted for changes in fair value attributable to the hedged item and the gain or loss associated with that remeasurement is also recognized in profit or loss.

When the hedge ceases to be highly effective, hedge accounting is discontinued and the adjustment to the carrying amount of a hedged financial instrument is amortized immediately.

The Group discontinues fair value hedge accounting if the hedging instrument expires, is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation.

As of December 31, 2010 and 2009, the Group has no outstanding derivatives accounted for as fair value hedges.

Cash Flow Hedge. Changes in the fair value of a hedging instrument that qualifies as a highly effective cash flow hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. The ineffective portion is immediately recognized in profit or loss.

If the hedged cash flow results in the recognition of an asset or a liability, all gains or losses previously recognized directly in equity are transferred from equity and included in the initial measurement of the cost or carrying amount of the asset or liability. Otherwise, for all other cash flow hedges, gains or losses initially recognized in equity are transferred from equity to profit or loss in the same period or periods during which the hedged forecasted transaction or recognized asset or liability affect profit or loss.

When the hedge ceases to be highly effective, hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been reported directly in equity is retained in equity until the forecasted transaction occurs. When the forecasted transaction is no longer expected to occur, any net cumulative gain or loss previously reported in equity is recognized in profit or loss.

As of December 31, 2010 and 2009, the Group has no outstanding derivatives accounted for as cash flow hedges.

Net Investment Hedge. As of December 31, 2010 and 2009, the Group has no hedge of a net investment in a foreign operation.

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

Embedded Derivatives

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at FVPL. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

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Derecognition of Financial Assets and Financial Liabilities

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

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

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Financial Liabilities. A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in profit or loss.

Impairment of Financial Assets

The Group assesses at reporting date whether a financial asset or group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Assets Carried at Amortized Cost. For assets carried at amortized cost such as loans and receivables, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets pooled according to their credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment for specific impairment purposes may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset’s original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the

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cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The impairment loss for the period shall be recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets. If an AFS financial asset is impaired, an amount comprising the difference between the cost (net of any principal payment and amortization) and its current fair value, less any impairment loss on that financial asset previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as AFS financial assets are not recognized in profit or loss. Reversals of impairment losses on debt instruments are recognized in profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

In the case of an unquoted equity instrument or of a derivative asset linked to and must be settled by delivery of an unquoted equity instrument, for which its fair value cannot be reliably measured, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows from the asset discounted using its historical effective rate of return on the asset.

Classification of Financial Instruments Between Debt and Equity

From the perspective of the issuer, a financial instrument is classified as debt instrument if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity;
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or
- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statements of financial position.

Inventories

Finished goods, goods in process and materials and supplies are valued at the lower of cost and net realizable value.

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Costs incurred in bringing each inventory to its present location and conditions are accounted for as follows:

Finished goods and goods in process	— at cost which includes direct materials and labor and a proportion of manufacturing overhead costs based on normal operating capacity but excluding borrowing costs; cost of goods in process includes unrealized gain (loss) on fair valuation of agricultural produce; costs are determined using the moving-average method.
Petroleum products (except lubes and greases, waxes and solvents), crude oil, and other products	— at cost which includes duties and taxes related to the acquisition of inventories; costs are determined using the first-in, first-out method.
Lubes and greases, waxes and solvents	— at cost which includes duties and taxes related to the acquisition of inventories; costs are determined using the moving-average method.
Materials, supplies and others	— at cost using the moving-average method.
Coal	— at cost using the first-in, first-out method.

Net realizable value of finished goods and goods in process is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

For petroleum products, crude oil, and tires, batteries and accessories (TBA), the net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs to complete and/or market and distribute.

Net realizable value of materials and supplies is the current replacement cost.

Containers (i.e., returnable bottles and shells) are stated at deposit values less any impairment in value. The excess of the acquisition cost of the containers over their deposit value is presented under deferred containers included under “Other noncurrent assets” account in the consolidated statements of financial position and is amortized over the estimated useful lives of two to ten years. Amortization of deferred containers is included under “Selling and administrative expenses” account in the consolidated statements of income.

Biological Assets and Agricultural Produce

The Group’s biological assets include breeding, growing poultry livestock, hogs and cattle and goods in process which are grouped according to their physical state, transformation capacity (breeding, growing or laying), as well as their particular stage in the production process.

Growing hogs, cattle and poultry livestock and goods in process are carried at accumulated cost while breeding stocks are carried at accumulated cost net of amortization and any impairment in value. The costs and expenses incurred up to the start of the productive stage are accumulated and amortized over the estimated productive lives of the breeding stocks. The Group uses this method of valuation since fair value cannot be measured reliably. The Group’s biological assets have no active market and no active market for similar assets prior to point of harvest are available in the Philippine poultry and hog industries. Further, the existing sector benchmarks are determined to be irrelevant and the estimates (i.e., revenues due to highly volatile prices, input costs, efficiency values, production) necessary to compute for the present value of expected net cash flows comprise a wide range of data which will not result to a reliable basis for determining the fair value.

The carrying amounts of the biological assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

The Group’s agricultural produce, which consists of grown broilers and marketable hogs and cattle harvested from the Group’s biological assets, are measured at their fair value less estimated costs to sell at the

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point of harvest. The fair value of grown broilers is based on the quoted prices for harvested mature grown broilers in the market at the time of harvest. For marketable hogs and cattle, the fair value is based on the quoted prices in the market at any given time.

The Group in general, does not carry any inventory of agricultural produce at any given time as these are either sold as live broilers, hogs and cattle or transferred to the different poultry or meat processing plants and immediately transformed into processed or dressed chicken and carcass.

Amortization is computed using straight-line method over the following estimated productive lives of breeding stocks:

	<u>Number of Years</u>
Hogs — sow	3 years or 6 births, whichever is shorter
Hogs — boar	2.5 - 3 years
Cattle	2.5 - 3 years
Poultry breeding stock	40 - 44 weeks

Business Combination

Acquisitions on or after January 1, 2010

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

For acquisitions on or after January 1, 2010, the Group measures goodwill at the acquisition date as: a) the fair value of the consideration transferred; plus b) the recognized amount of any non-controlling interests in the acquiree; plus c) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less d) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. When the excess is negative, a bargain purchase gain is recognized immediately in profit or loss. Subsequently, goodwill is measured at cost less any accumulated impairment in value. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognized in profit or loss. Costs related to the acquisition, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred. Any contingent consideration payable is recognized at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in profit or loss.

• *Goodwill in a Business Combination*

Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the

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combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than an operating segment determined in accordance with PFRS 8.

Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss with respect to goodwill is not reversed.

- *Intangible Asset Acquired in a Business Combination*

The cost of an intangible asset acquired in a business combination is the fair value as at the date of acquisition, determined using discounted cash flows as a result of the asset being owned.

Following initial recognition, intangible asset is carried at cost less any accumulated amortization and impairment losses, if any. The useful life of intangible asset is assessed to be either finite or indefinite.

Intangible asset with finite life is amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each reporting date. A change in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for as a change in accounting estimates. The amortization expense on intangible asset with finite life is recognized in profit or loss.

- *Loss of Control*

Upon the loss of control, the Group derecognizes the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognized in profit or loss. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently, it is accounted for as an equity-accounted investee or as an available-for-sale financial asset depending on the level of influence retained.

Acquisitions Prior to January 1, 2010

In comparison to the above-mentioned requirements, the following differences applied:

Business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs.

The non-controlling interest was measured at the proportionate share of the acquiree's identifiable net assets.

Business combinations achieved in stages were accounted for as separate steps. Any additional acquired share of interest did not affect previously recognized goodwill.

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Contingent consideration was recognized if, and only if, the Group had a present obligation, the economic outflow was more likely than not and a reliable estimate was determinable. Subsequent adjustments to the contingent consideration were recognized as part of goodwill.

Transactions Under Common Control

Transactions under common control entered into in contemplation of each other, and business combination under common control designed to achieve an overall commercial effect are treated as a single transaction.

Transfers of assets between commonly controlled entities are accounted for using the book value accounting.

Non-controlling Interests

For acquisitions of non-controlling interests on or after January 1, 2010, the acquisitions are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognized as a result of such transactions. Any difference between the purchase price and the net assets of acquired entity is recognized in equity. The adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary.

Investments in Associates

The Group's investments in associates are accounted for under the equity method of accounting from the date when it becomes an associate. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity.

Under the equity method, the investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share of the profit or loss of the associate after the date of acquisition. The Group's share of the profit or loss of the associate is recognized in the Group's profit or loss. Dividends received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount, may also be necessary for changes in the Group's proportionate interest in the associate arising from changes in the associate's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The Group's share of those changes is recognized in other comprehensive income.

Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized.

After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associate. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

Upon acquisition of the investment, any difference between the cost of the investment and the investor's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with PFRS 3. Consequently:

- a. goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. Instead, the entire amount of the investment in an associate is tested for impairment as a single asset when there is objective evidence that the investment in an associate may be impaired.

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b. any excess of the Group's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group discontinues applying the equity method when its investment in an associate is reduced to zero. Additional losses are provided only to the extent that the Group has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the Group has guaranteed or otherwise committed. If the associate subsequently reports profits, the Group resumes applying the equity method only after its share of the profits equals the share of net losses not recognized during the period the equity method was suspended.

The financial statements of the associates are prepared for the same reporting period as the Parent Company. The accounting policies of the associates conform to those used by the Group for like transactions and events in similar circumstances.

Interest in Joint Venture

The Group generally recognizes its interest in joint venture using proportionate consolidation. The Group combines its share in each of the assets, liabilities, income and expenses of the joint venture with similar items, line by line, in its consolidated financial statements. The financial statements of the joint venture are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The joint venture is proportionately consolidated until the date when the Group ceases to have joint control over the joint venture.

Property, Plant and Equipment

Property, plant and equipment, except land, are stated at cost less accumulated depreciation and amortization and any accumulated impairment in value. Such cost includes the cost of replacing part of the property, plant and equipment at the time that cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its construction cost or purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation (ARO) and interest incurred during the construction period on funds borrowed to finance the construction of the projects. Expenditures incurred after the asset has been put into operation, such as repairs, maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. Major repairs are capitalized as part of property, plant and equipment only when it is probable that future economic benefits associated with the items will flow to the Group and the cost of the items can be measured reliably.

Construction in progress represents structures under construction and is stated at cost. This includes the costs of construction and other direct costs. Borrowing costs that are directly attributable to the construction of plant and equipment are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are ready for use.

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Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

	<u>Number of Years</u>
Land improvements	5 - 50
Buildings and improvements	2 - 50
Power plants	3 - 43
Refinery and plant equipment	5 - 16
Service stations and other equipment	1½ - 10
Machinery and equipment	3 - 40
Transportation equipment	5 - 7
Tools and small equipment	2 - 5
Office equipment, furniture and fixtures	2 - 10
Molds	2 - 5
Leasehold improvements	5 - 50
	or term of the lease, whichever is shorter

The remaining useful lives, residual values, depreciation and amortization method are reviewed and adjusted, if appropriate, periodically to ensure that such periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation and amortization are recognized in profit or loss.

An item of property, plant and equipment is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its use or disposal. Any gain or loss arising on the retirement and disposal of an item of property, plant and equipment (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period of retirement or disposal.

Investment Properties

Investment properties consist of properties held to earn rentals and/or for capital appreciation. Investment properties, except for land, are measured at cost including transaction costs less accumulated depreciation and amortization and any accumulated impairment in value. The carrying amount includes the cost of replacing part of an existing investment property at the time the cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property. Land is stated at cost less any impairment in value.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

	<u>Number of Years</u>
Land improvements	5 - 50
Buildings and improvements	5 - 50
Machinery and equipment	3 - 40
Tools and small equipment	2 - 5

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The residual values, useful lives and method of depreciation and amortization of the assets are reviewed and adjusted, if appropriate, at each financial year-end.

Investment property is derecognized either when it has been disposed of or when it is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains and losses on the retirement and disposal of investment property are recognized in profit or loss in the period of retirement or disposal.

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

For a transfer from investment property to owner-occupied property or inventories, the cost of property for subsequent accounting is its carrying amount at the date of change in use. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Subsequently, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is recognized in profit or loss in the year in which the expenditure is incurred. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method used for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in profit or loss consistent with the function of the intangible asset.

Amortization is computed using the straight-line method over the following estimated useful lives of other intangible assets with finite lives:

	<u>Number of Years</u>
Computer software	2 - 8
Service concession rights	25
Mining rights	19 - 30
Leasehold rights	20 or term of the lease, whichever is shorter
Land use rights	25 - 50 or term of the lease, whichever is shorter

The Group assessed the useful life of licenses, trademarks and brand names to be indefinite because based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate cash inflows for the Group.

Licenses, trademarks and brand names with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortized. The useful life of

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an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in profit or loss when the asset is derecognized.

Service Concession Arrangements

Public-to-private service concession arrangements where: (a) the grantor controls or regulates what services the entities in the Group must provide with the infrastructure, to whom it must provide them, and at what price; and (b) the grantor controls [through ownership, beneficial entitlement or otherwise] any significant residual interest in the infrastructure at the end of the term of the arrangement are accounted for under the provisions of the Philippine Interpretation IFRIC 12, *Service Concession Arrangements*. Infrastructures used in a public-to-private service concession arrangement for its entire useful life (whole-of-life assets) are within the scope of this Interpretation if the conditions in (a) are met.

This Interpretation applies to both: (a) infrastructure that the entities in the Group constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the entity in the Group access for the purpose of the service arrangement.

Infrastructures within the scope of this Interpretation are not recognized as property, plant and equipment of the Group. Under the terms of contractual arrangements within the scope of this Interpretation, an entity acts as a service provider. An entity constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

An entity recognizes and measures revenue in accordance with PAS 11 and PAS 18, for the services it performs. If an entity performs more than one service (i.e. construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.

When an entity provides construction or upgrades services, the consideration received or receivable by the entity is recognized at its fair value. An entity accounts for revenue and costs relating to construction or upgrade services in accordance with PAS 11. Revenue from construction contracts is recognized based on the percentage-of-completion method, measured by reference to the percentage costs incurred to date to estimated total costs for each contract. The applicable entities account for revenue and costs relating to operation services in accordance with PAS 18.

An entity recognizes a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. An entity recognizes an intangible asset to the extent that it receives a right (a license) to charge users of the public service.

When the applicable entities have contractual obligations it must fulfill as a condition of its license (a) maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement, it recognizes and measures these contractual obligations in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, i.e. at the best estimate of the expenditure that would be required to settle the present obligation at the reporting date.

In accordance with PAS 23, *Borrowing Costs*, borrowing costs attributable to the arrangement are recognized as an expense in the period in which they are incurred unless the applicable entities have a

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contractual right to receive an intangible asset (a right to charge users of the public service). In this case, borrowing costs attributable to the arrangement are capitalized during the construction phase of the arrangement.

Intangible Asset — Service Concession Rights

The Group's intangible asset — service concession right pertains mainly to its right to charge users of the public service in connection with the service concession and related arrangements. This is recognized initially at the fair value of the construction services. Following initial recognition, the intangible asset is carried at cost less accumulated amortization and any accumulated impairment losses.

This includes the service concession right granted by the ROP to the Group to operate the Caticlan Airport, as expressly stated in the CA (Note 35). This includes the right to design and finance the development of the Caticlan Airport and operate and maintain the airport during the concession period. Except for the position that relates to the annual fee as defined in the CA, the right is earned and recognized by the Group as the project progresses. This also includes the present value of the obligation to pay the annual franchise fee to the ROP over the concession period (Note 4).

The intangible asset — service concession right is amortized using the straight-line method over the estimated useful economic life which is the service concession period, and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The service concession period is 25 years. The amortization period and the amortization method are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense is recognized in profit or loss in the expense category consistent with the function of the intangible asset.

Gains or losses from derecognition of an intangible asset — service concession right are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in profit or loss when the asset is derecognized.

Deferred Exploration and Evaluation Costs

Deferred exploration and evaluation costs comprise expenditures which are directly attributable to:

- Researching and analyzing existing exploration data;
- Conducting geological studies, exploratory drilling and sampling;
- Examining and testing extraction and treatment methods; and
- Compiling pre-feasibility and feasibility studies.

Deferred exploration and evaluation costs also include expenditures incurred in acquiring mineral rights, the entry premiums paid to gain access to areas of interest, amounts payable to third parties to acquire interests in existing projects.

Exploration assets are reassessed on a regular basis and tested for impairment provided that at least one of the following conditions is met:

- the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;

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- such costs are expected to be recouped in full through successful development and exploration of the area of interest or alternatively, by its sale; or
- exploration and evaluation activities in the area of interest have not yet reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in relation to the area are continuing, or planned for the future.

If the project proceeds to development stage, the amounts included within deferred exploration and evaluation costs are transferred to property and equipment under mine development costs.

Impairment of Non-financial Assets

The carrying amounts of investments and advances, property, plant and equipment, investment properties, containers, biological assets, other intangible assets with finite useful lives and idle assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. If any such indication exists, and if the carrying amount exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of fair value less costs to sell and value in use. The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses of continuing operations are recognized in profit or loss in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss. After such a reversal, the depreciation and amortization charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Cylinder Deposits

The liquefied petroleum gas cylinders remain the property of the Group and are loaned to dealers upon payment by the latter of an equivalent 100% of the acquisition cost of the cylinders.

The Group maintains the balance of cylinder deposits at an amount equivalent to three days worth of inventory of its biggest dealers, but in no case lower than ₱200 at any given time, to take care of possible returns by dealers.

At the end of each reporting period, cylinder deposits, shown under "Other noncurrent liabilities — others" account in the consolidated statements of financial position, are reduced for estimated non-returns. The reduction is credited directly to profit or loss.

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Provisions

Provisions are recognized when the Group has: a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or b) a present obligation that arises from past events but is not recognized because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and those risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognized for the reimbursement shall not exceed the amount of the provision. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

Infrastructure restoration obligation (IRO) represents the present value of the Group's obligation to keep the rehabilitated and upgraded Caticlan Airport at a serviceability level acceptable to the ROP through continuous maintenance and restoration prior to turnover to the ROP at the end of the concession period.

Share Capital

Common Shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

Preferred Shares

Preferred shares are classified as equity if they are non-redeemable, or redeemable only at the Parent Company's option, and any dividends thereon are discretionary. Dividends thereon are recognized as distributions within equity upon approval by the Parent Company's BOD.

Preferred shares are classified as a liability if they are redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as interest expense in profit or loss as accrued.

Treasury Shares

Own equity instruments which are reacquired are carried at cost and are deducted from equity. No gain or loss is recognized on the purchase, sale, issue or cancellation of the Parent Company's own equity instruments. When the shares are retired, the capital stock account is reduced by its par value and the excess of cost over par value upon retirement is debited to additional paid-in capital to the extent of the specific or average additional paid-in capital when the shares were issued and to retained earnings for the remaining balance.

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Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the amount of the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Sales. Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer, which is normally upon delivery and the amount of revenue can be measured reliably.

Agricultural Produce. Revenue from initial recognition of agricultural produce is measured at fair value less estimated costs to sell at the point of harvest. Fair value is based on the relevant market price at point of harvest.

Interest. Revenue is recognized as the interest accrues, taking into account the effective yield on the asset.

Dividend. Revenue is recognized when the Group's right as a shareholder to receive the payment is established.

Gain or Loss on Sale of Investments in Shares of Stock. Gain or loss is recognized if the Group disposes of its investment in a subsidiary or associate. Gain or loss is computed as the difference between the proceeds of the disposed investment and its carrying amount, including the carrying amount of goodwill, if any.

Rent. Revenue from investment properties is recognized on a straight-line basis over the term of the lease. Rent income is included as part of other income.

Cost and Expense Recognition

Costs and expenses are recognized upon receipt of goods, utilization of services or at the date they are incurred.

Share-based Payment Transactions

The cost of Long-term Incentive Plan for Stock Options (LTIP) is measured by reference to the option fair value at the date when the options are granted. The fair value is determined using Black-Scholes option pricing model. In valuing LTIP transactions, any performance conditions are not taken into account, other than conditions linked to the price of the shares of the Parent Company. The cost of Employee Stock Purchase Plan (ESPP) is measured by reference to the market price at the time of the grant less subscription price.

The cost of share-based payment transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date when the relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognized for share-based payment transactions, at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Parent Company's best estimate of the number of equity instruments that will ultimately vest. Where the terms of a share-based award are modified, as a minimum, an expense is recognized as if the terms had not been modified. In addition, an expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately.

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However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Leases

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

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

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

Finance Lease

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Obligations arising from plant assets under finance lease agreement are classified in the consolidated statements of financial position as finance lease liabilities.

Lease payments are apportioned between financing charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Financing charges are recognized in profit or loss.

Capitalized lease assets are depreciated over the estimated useful life of the assets when there is reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating Lease

Group as Lessee. Leases which do not transfer to the Group substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in profit or loss on a straight-line basis over the lease term. Associated costs such as maintenance and insurance are expensed as incurred.

Group as Lessor. Leases where the Group does not transfer substantially all the risks and benefits of ownership of the assets are classified as operating leases. Rent income from operating leases is recognized as income on a straight-line basis over the lease term. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as rent income. Contingent rents are recognized as income in the period in which they are earned.

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Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized.

Research and Development Costs

Research costs are expensed as incurred. Development costs incurred on an individual project are carried forward when their future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortized in line with the expected future sales from the related project.

The carrying amount of development costs is reviewed for impairment annually when the related asset is not yet in use. Otherwise, this is reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

Retirement Costs

The Parent Company and majority of its subsidiaries have separate funded, noncontributory retirement plans, administered by the respective trustees, covering their respective permanent employees. Retirement costs are actuarially determined using the projected unit credit method. This method reflects service rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement cost includes current service cost, interest cost, expected return on plan assets, amortization of unrecognized past service costs, recognition of actuarial gains and losses, effect of asset limit and effect of any curtailments or settlements. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to the plan, past service cost is recognized immediately as an expense. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceed the greater of 10% of the present value of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The transitional liability as of January 1, 2005, the date of adoption of PAS 19, *Employee Benefits*, is recognized as an expense over five years from date of adoption.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not recognized, reduced by past service costs not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate is negative, the resulting asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan.

If the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan, net actuarial losses of the current period and past service costs of the current period are recognized immediately to the extent that they exceed any reduction in the present value of those economic benefits. If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service costs of the current period are recognized immediately. Similarly, net actuarial gains of the current period after the deduction of past service costs of the current period exceeding any increase in the present value of the economic benefits stated above are

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recognized immediately if the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan. If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service costs of the current period are recognized immediately.

Foreign Currency

Foreign Currency Translations

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the end of the year.

Nonmonetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Nonmonetary items in a foreign currency that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of AFS equity investments, a financial liability designated as a hedge of the net investment in a foreign operation that is effective, or qualifying cash flow hedges, which are recognized in other comprehensive income.

Foreign Operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Philippine peso at exchange rates at the reporting date. The income and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated to Philippine peso at average exchange rates at the reporting dates.

Foreign currency differences are recognized in other comprehensive income, and presented in the foreign currency translation reserve ("Translation reserve") in equity. However, if the operation is not a wholly-owned subsidiary, then the relevant proportionate share of the translation difference is allocated to the non-controlling interests. When a foreign operation is disposed of such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. When the Group disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, the relevant proportion of the cumulative amount is reattributed to non-controlling interests. When the Group disposes of only part of its investment in an associate or joint venture that includes a foreign operation while retaining significant influence or joint control, the relevant proportion of the cumulative amount is reclassified to profit or loss.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income, and presented in the "Translation reserve" in equity.

Taxes

Current Tax. Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

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Deferred Tax. Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- with respect to taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits — Minimum Corporate Income Tax (MCIT) and unused tax losses — Net Operating Loss Carry Over (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- with respect to deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value Added Tax (VAT). Revenues, expenses and assets are recognized net of the amount of VAT, except:

- where the tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables that are stated with the amount of tax included.

The net amount of tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated statements of financial position.

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Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale or distribution rather than through continuing use, are classified as held for sale or distribution. Immediately before classification as held for sale or distribution, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter, the assets or disposal groups are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to remaining assets and liabilities on *pro rata* basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property or biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale or distribution and subsequent gains and losses on remeasurement are recognized in profit or loss. Gains are not recognized in excess of any cumulative impairment loss.

Intangible assets, property, plant and equipment and investment property once classified as held for sale or distribution are not amortized or depreciated. In addition, equity accounting of equity-accounted investees ceases once classified as held for sale or distribution.

Discontinued Operations

A discontinued operation is a component of the Group's business that represents a separate major line of business that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative consolidated statements of income are re-presented as if the operation had been discontinued from the start of the comparative period and show the results of discontinued operation separate from the results of continuing operation.

Related Parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities. Transactions between related parties are on an arm's length basis in a manner similar to transactions with non-related parties.

Basic and Diluted Earnings Per Common Share (EPS)

Basic EPS is computed by dividing the net income for the period attributable to equity holders of the Parent Company, net of dividends on preferred shares, by the weighted average number of issued and outstanding common shares during the period, with retroactive adjustment for any stock dividends declared.

Diluted EPS is computed in the same manner, adjusted for the effects of the shares issuable to employees and executives under the Parent Company's ESPP and LTIP, respectively, which are assumed to be exercised at the date of grant.

Where the effect of the assumed conversion of shares issuable to employees and executives under the Parent Company's stock purchase and option plans would be anti-dilutive, diluted EPS is not presented.

Operating Segments

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

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products and serves different markets. Financial information on operating segments is presented in Note 7 to the consolidated financial statements. The Chief Executive Officer (the chief operating decision maker) reviews management reports on a regular basis.

The measurement policies the Group used for segment reporting under PFRS 8 are the same as those used in its consolidated financial statements. There have been no changes from prior periods in the measurement methods used to determine reported segment profit or loss. All inter-segment transfers are carried out at arm's length prices.

Segment revenues, expenses and performance include sales and purchase between business segments and between geographical segments. Such sales and purchases are eliminated in consolidation.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to the consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

Events After the Reporting Date

Post year-end events that provide additional information about the Group's consolidated financial position at reporting date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the consolidated financial statements when material.

4. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the Group's consolidated financial statements in accordance with PFRS requires management to make judgments, estimates and assumptions that affect amounts reported in the consolidated financial statements at the reporting date. However, uncertainty about these estimates and assumptions could result in outcome that could require a material adjustment to the carrying amount of the affected asset or liability in the future.

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

Judgments

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

Finance Lease — Company in the Group as Lessee. In accounting for its Independent Power Producer (IPP) Administration Agreements with Power Sector Assets and Liabilities Management Corporation (PSALM), the Group's management has made a judgment that the IPP Administration Agreement is an agreement that contains a lease. In addition, TSML and TGT, the Group's joint venture in Thailand entered into lease agreements with Thai bank covering transportation equipment. The Group's management has made a judgment that it has substantially acquired all the risks and rewards incidental to ownership of the power plants and transportation equipment. Accordingly, the Group accounted for the agreements as finance lease and recognized the power plants and transportation equipment and finance lease liabilities at the present value of the agreed monthly payments (Notes 16 and 35).

Finance lease liabilities recognized in the consolidated statement of financial position amounted to ₱208,407 and ₱30 as at December 31, 2010 and 2009, respectively (Note 35). The carrying amount of power

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plants and transportation equipment under finance lease amounted to ₱209,301 and ₱30 as of December 31, 2010 and 2009, respectively (Note 16).

Operating Lease Commitments — Group as Lessor/Lessee. The Group has entered into various lease agreements as either a lessor or a lessee. The Group had determined that it retains all the significant risks and rewards of ownership of the properties leased out on operating leases while the significant risks and rewards for properties leased from third parties are retained by the lessors.

Rent expense charged to profit or loss amounted to ₱1,795, ₱2,120 and ₱1,796 in 2010, 2009 and 2008, respectively (Notes 27, 28 and 35).

Applicability of Philippine Interpretation IFRIC 12. In accounting for the Group's transactions in connection with its Concession Agreement (CA) with the Republic of the Philippines (ROP), significant judgment was applied to determine the most appropriate accounting policy to use. Management used Philippine Interpretation IFRIC 12, as guide and determined that the CA is within the scope of the interpretation since it specifically indicated that ROP will regulate what services the Group must provide and at what price those will be offered, and that at the end of the concession period, the entire infrastructure, as defined in the CA, will be transferred to the ROP. Reference was made to the terms of the CA in determining the consideration receivable from the ROP in exchange for the fulfillment of the Group's obligations under the CA.

Management determined that the consideration receivable is an intangible asset in the form of a license to operate the Caticlan Airport; i.e. license to charge fees to users. Judgment was further exercised by management in determining the components of the cost of acquiring the right. Further reference to the terms of the CA (Note 35) was made to determine such costs and it identified the following as the components: (i) total Project cost; (ii) present value of total franchise fees over 25 years amounting to ₱8 per year; and, (iii) present value of IRO.

Management also exercised judgment in determining the timing and manner of recognition of these costs. Project cost is recognized as part of intangible assets as the construction progresses (Note 19). It used the cost to cost method as it believes that the actual cost of construction is most relevant to the amount that should be recognized as cost of the intangible asset at the end of every reporting period as opposed to the other percentage of completion approach.

The present value of the IRO is recognized as part of intangible assets upon completion of the Project and amortized simultaneously with the cost related to the Project because only at that time would significant maintenance of the Caticlan Airport also commence. However, since the Group has already started the maintenance of the existing Caticlan Airport which is currently being rehabilitated, the entire present value of the annual fees have already been recognized in construction in progress — service concession arrangements and portion of which representing the actual amount incurred in the current year for the maintenance of the Caticlan Airport have been recognized as part of the cost of intangible assets and also subjected to amortization.

The present value of the obligation to pay annual franchise fees over 25 years has been immediately recognized as part of intangible assets because the right related to it has already been granted and is already being enjoyed by the Group as evidenced by its taking over the operations of the Caticlan Airport during the last quarter of 2010. Consequently, management has also started amortizing the related value of the intangible asset.

Difference in judgment with respect to the accounting treatment of the transactions would materially affect the assets, liabilities and operating results of the Group.

Assumption of Profit Margin on the Service Concession Project. The Group did not assume any profit margin for the Project as it believes that the fair value of the intangible asset related to it reasonably

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approximates the cost of the Project. It believes that the margin of its contractors is enough to cover any difference in the fair value and carrying amount.

Classification of Redeemable Preferred Shares. Based on the features of the preferred shares, particularly mandatory redemption that TADHC issued, management determined that the shares are in substance a financial liability. Accordingly, it was classified as part of “Other noncurrent liabilities” account in the 2010 consolidated statements of financial position (Note 24).

Accounting for SMPI’s Investment in SMPI-GSIS JVC. Under normal circumstances, the Group would account for its investment in a joint venture classified as jointly controlled entity using proportionate consolidation. In the recently consummated joint venture of SMPI with GSIS, however, significant judgment was exercised to determine whether SMPI’s interest in the joint venture should be accounted for as jointly controlled entity under PAS 31 or as a subsidiary under PAS 27. After considering the salient provisions of the Joint Venture Agreement (JVA), particularly, with respect to the option granted by SMPI to GSIS, i.e. GSIS to sell to SMPI its whole ownership interest in SMPI-GSIS JVC (the “Put Option”) at a pre-determined exercise price at different dates, management concluded that it is most appropriate to account for the investment as a subsidiary. The main factor considered by management was the potential voting rights brought about by the Put Option which gives SMPI control over the SMPI-GSIS JVC once exercised (Note 35). At present, although SMPI owns 52% of SMPI-GSIS JVC, the JVA clearly specified joint control of the entity but such was without due consideration to the Put Option yet; hence the SMPI-GSIS JVC was consolidated in the Group’s financial statements.

Determining Fair Values of Financial Instruments. Where the fair values of financial assets and financial liabilities recognized in the consolidated statements of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The Group uses judgments to select from variety of valuation models and make assumptions regarding considerations of liquidity and model inputs such as correlation and volatility for longer dated financial instruments. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair value.

Contingencies. The Group currently has several tax assessments, legal and administrative claims. The Group’s estimate of the probable costs for the resolution of these assessments and claims has been developed in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these matters and is based on an analysis of potential results. The Group currently does not believe that these tax assessments, legal and administrative claims will have a material adverse effect on its consolidated financial position and consolidated financial performance. It is possible, however, that future financial performance could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings. No accruals were made in relation to these proceedings (Note 45).

Estimates

The key estimates and assumptions used in the consolidated financial statements are based upon management’s evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from such estimates.

Allowance for Impairment Losses on Trade and Other Receivables. Provisions are made for specific and groups of accounts, where objective evidence of impairment exists. The Group evaluates these accounts on the basis of factors that affect the collectibility of the accounts. These factors include, but are not limited to, the length of the Group’s relationship with the customers and counterparties, the customers’ current credit status based on third party credit reports and known market forces, average age of accounts, collection experience, and historical loss experience. The amount and timing of recorded expenses for any period would differ if the

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Group made different judgments or utilized different methodologies. An increase in allowance for impairment losses would increase the recorded selling and administrative expenses and decrease current assets.

The allowance for impairment losses amounted to ₱4,519 and ₱2,729 as of December 31, 2010 and 2009, respectively. The carrying amounts of trade and other receivables amounted to ₱75,904 and ₱49,082 as of December 31, 2010 and 2009, respectively (Note 10).

Allowance for Inventory Losses. The Group provides an allowance for inventory losses whenever net realizable value becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made of the amount the inventories are expected to be realized. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after reporting date to the extent that such events confirm conditions existing at reporting date. The allowance account is reviewed periodically to reflect the accurate valuation in the financial records.

The allowance for inventory losses amounted to ₱1,297 and ₱1,149 as of December 31, 2010 and 2009, respectively. The carrying amounts of inventories amounted to ₱57,442 and ₱25,458 as of December 31, 2010 and 2009, respectively (Note 11).

Fair Value of Agricultural Produce. The Group determines the fair value of its agricultural produce based on most recent market transaction price provided that there has been no significant change in economic circumstances between the date of transactions and reporting date. Costs to sell are estimated based on most recent transaction and is deducted from the fair value in order to measure the fair value of agricultural produce at point of harvest.

Unrealized gain on fair valuation of agricultural produce included in the cost of inventories as of December 31, 2010 and 2009 amounted to ₱41 and ₱63, respectively (Note 11).

Financial Assets and Financial Liabilities. The Group carries certain financial assets and financial liabilities at fair value, which requires extensive use of accounting estimates and judgments. Significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates). The amount of changes in fair value would differ if the Group utilized different valuation methodologies and assumptions. Any change in the fair value of these financial assets and financial liabilities would affect profit or loss and equity.

Fair value of financial assets and financial liabilities are discussed in Note 42.

Estimated Useful Lives of Investment Properties, Containers and Property, Plant and Equipment. The Group estimates the useful lives of investment properties, containers and property, plant and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of investment properties, containers and property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

In addition, estimation of the useful lives of investment properties, containers and property, plant and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of investment properties, containers and property, plant and equipment would increase recorded cost of sales and selling and administrative expenses and decrease noncurrent assets.

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Accumulated depreciation and amortization of investment properties and property, plant and equipment amounted to ₱96,410 and ₱56,714 as of December 31, 2010 and 2009, respectively. Property, plant and equipment, net of accumulated depreciation and amortization amounted to ₱319,790 and ₱73,892 as of December 31, 2010 and 2009, respectively (Note 16). Investment properties, net of accumulated depreciation amounted to ₱2,524 and ₱2,263 as of December 31, 2010 and 2009, respectively (Note 17). Deferred containers net of accumulated amortization included under “Other noncurrent assets” account in the consolidated statements of financial position amounted to ₱4,420 and ₱4,446 as of December 31, 2010 and 2009, respectively (Note 20).

Fair Value of Investment Properties. The fair value of investment property presented for disclosure purposes is based on market values, being the estimated amount for which the property can be exchanged between a willing buyer and seller in an arm’s length transaction, or based on a most recent sale transaction of a similar property within the same vicinity where the investment property is located.

In the absence of current prices in an active market, the valuations are prepared by considering the aggregate estimated future cash flows expected to be received from leasing out the property. A yield that reflects the specific risks inherent in the net cash flows is then applied to the net annual cash flows to arrive at the property valuation.

Estimated fair values of investment properties amounted to ₱3,129 and ₱2,886 as of December 31, 2010 and 2009, respectively (Note 17).

Estimated Useful Lives of Intangible Assets. The useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Intangible assets are regarded to have an indefinite useful life when, based on analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group.

Intangible assets with finite useful lives amounted to ₱3,544 and ₱1,433 as of December 31, 2010 and 2009, respectively (Note 19).

Estimated Useful Lives of Intangible Asset — Service Concession Rights. The Group estimates the useful lives of intangible assets arising from service concessions based on the period over which the assets are expected to be available for use, which is 25 years. The Group has not included any renewal period on the basis of uncertainty as of reporting date of the probability of securing renewal contract at the end of the original contract term.

Impairment of Goodwill, Trademarks, Licenses, and Brand Names and Formulas and Recipes with Indefinite Lives. The Group determines whether goodwill, trademarks, licenses, and brand names and formulas and recipes are impaired at least annually. This requires the estimation of the value in use of the cash-generating units to which the goodwill is allocated and the value in use of the trademarks and brand names. Estimating value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and from the trademarks and brand names and to choose a suitable discount rate to calculate the present value of those cash flows.

The carrying amounts of goodwill as of December 31, 2010 and 2009 amounted to ₱30,251 and ₱6,408, respectively (Note 19).

The carrying amounts of trademarks, licenses and brand names and formulas and recipes amounted to ₱7,436 and ₱2,197 as of December 31, 2010 and 2009, respectively (Note 19).

Acquisition Accounting. The Group accounts for acquired businesses using the acquisition method of accounting which requires that the assets acquired and the liabilities assumed be recognized at the date of acquisition at their respective fair values.

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The application of the acquisition method requires certain estimates and assumptions especially concerning the determination of the fair values of acquired intangible assets and property, plant and equipment as well as liabilities assumed at the date of the acquisition. Moreover, the useful lives of the acquired intangible assets, property, plant and equipment have to be determined. Accordingly, for significant acquisitions, the Group obtains assistance from valuation specialists. The valuations are based on information available at the acquisition date.

Recoverability of Deferred Exploration and Development Costs. A valuation allowance is provided for estimated unrecoverable deferred exploration and development costs based on the Group's assessment of the future prospects of the mining properties, which are primarily dependent on the presence of economically recoverable reserves in those properties.

The Group's mining activities are all in the exploratory stages as of December 31, 2010. All related costs and expenses from exploration are currently deferred as exploration and development costs to be amortized upon commencement of commercial operations. The Group had not identified any facts and circumstances which suggest that the carrying amount of the deferred exploration and development costs exceeded recoverable amounts as of December 31, 2010.

Deferred exploration and development costs included in "Other noncurrent assets — others" in the consolidated statements of financial position amounted to ₱41 as of December 31, 2010 (Note 20). There were no impairment losses recognized for the year ended December 31, 2010.

Realizability of Deferred Tax Assets. The Group reviews its deferred tax assets at each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Group's assessment on the recognition of deferred tax assets on deductible temporary difference and carryforward benefits of MCIT and NOLCO is based on the projected taxable income in the following periods.

Deferred tax assets amounted to ₱7,134 and ₱8,883 as of December 31, 2010 and 2009, respectively (Note 25).

Impairment of Non-financial Assets. PFRS requires that an impairment review be performed on investments and advances, property, plant and equipment, investment properties, containers, biological assets, intangible asset — service concession rights, other intangible assets with finite useful lives and idle assets when events or changes in circumstances indicate that the carrying amount may not be recoverable. Determining the recoverable amount of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable amounts and any resulting impairment loss could have a material adverse impact on the financial performance.

Accumulated impairment losses of property, plant and equipment and investment properties amounted to ₱12,108 and ₱8,369 as of December 31, 2010 and 2009, respectively. The aggregate amount of investments and advances, AFS financial assets, property, plant and equipment, investment properties, biological assets, intangible assets — service concession rights and other intangible assets with finite useful lives, containers, and idle assets, amounted to ₱479,496 and ₱117,628 as of December 31, 2010 and 2009, respectively (Notes 13, 14, 16, 17, 18, 19 and 20).

Present Value of Defined Benefit Obligation. The present value of the retirement obligation depends on a number of factors that are determined on an actuarial basis using a number of assumptions. These assumptions are described in Note 36 to the consolidated financial statements and include discount rate, expected return on plan assets and salary increase rate. Actual results that differ from the assumptions are

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accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The assumption of the expected return on plan assets is determined on a uniform basis, taking into consideration the long-term historical returns, asset allocation and future estimates of long-term investment returns.

The Group determines the appropriate discount rate at the end of each year. It is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Group considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid. The terms to maturity of these bonds should approximate the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions.

While it is believed that the Group's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Group's retirement obligations.

The Group has a net cumulative unrecognized actuarial gain amounting to ₱25,846 and ₱3,271 as of December 31, 2010 and 2009, respectively (Note 36).

Present Value of Obligation Under a Put Option. In estimating the obligation, significant assumptions were made by management, such as the period in which the option would be exercised and the discount rate appropriate to determine the present value of such obligation. Management assumed that the option will be exercised within the next 12 months from the reporting date. Accordingly, the Group used a risk-free rate of 3.9% based on the Group's ordinary and short-term borrowing arrangements.

Management believes that the Group's estimated obligation arising from the Put Option is reasonable; however, subsequent changes in assumptions or circumstances may potentially result in significant increase or decrease in the obligation under the Put Option. Should there be changes in assumptions or circumstances and the amount of the estimated obligation will be recognized by the Group prospectively.

As of December 31, 2010, the estimated obligation of the Group under a Put Option arrangement, amounts to ₱386 (Note 22).

Asset Retirement Obligation. The Group has an ARO arising from leased service stations and depots. Determining ARO requires estimation of the costs of dismantling, installations and restoring leased properties to their original condition. The Group determined the amount of ARO, by obtaining estimates of dismantling costs from the proponent responsible for the operation of the asset, discounted at the Group's current credit-adjusted risk-free rate ranging from 4.81% to 11.17% depending on the life of the capitalized costs. While it is believed that the assumptions used in the estimation of such costs are reasonable, significant changes in these assumptions may materially affect the recorded expense or obligation in future periods.

The Group also has an ARO arising from its refinery. However, such obligation is not expected to be settled for the foreseeable future and therefore a reasonable estimate of fair value cannot be determined. Thus, the ARO included under "Other noncurrent liabilities" account in the consolidated statements of financial position amounting to ₱815 as of December 31, 2010, covers only the Group's leased services stations and depots (Note 24).

Present Value of Annual Franchise Fee and IRO — Service Concession Arrangements. Almost the entire amount of recognized intangible asset — service concession rights as of December 31, 2010 pertains to the present value of annual franchise fee payable to the ROP over the concession period. The recognition of the present value of the IRO is temporarily lodged in construction in progress — service concession arrangements until the completion of the Project.

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The present value of the annual franchise fee and IRO were determined based on the future value of the obligations discounted at the Group's internal borrowing rate which is believed to be a reasonable approximation of the applicable credit-adjusted risk-free market borrowing rate. The carrying amount of present value of annual franchise fee already recognized in the intangible asset and carrying amount of IRO recognized in construction in progress — service concession arrangements are presented in Notes 19 and 20. A significant change in such internal borrowing rate used in discounting the estimated cost would result in a significant change in the amount of liabilities recognized with a corresponding effect on profit or loss.

Amortization of Intangible Asset — Service Concession Rights. Management used 25 years to amortize portion of the intangible asset, together with the portion representing maintenance costs already incurred and recognized as intangible asset — service concession rights (Note 19).

Percentage of Completion — Service Concession Arrangements. The Group determines the percentage-of-completion of the contract by computing the proportion of actual contract costs incurred to date, to the latest estimated total Project cost. The Group reviews and revises when necessary the estimate of Project cost as it progresses to appropriately adjust the amount construction revenue recognized at the end of each reporting period (Note 20).

5. Business Combinations and Asset Acquisitions

Business Combinations:

Power and Mining

- **SMEC**

On October 26, 2009, SMEC's BOD approved the subscription by the Parent Company and Global 5000 Investment Inc. (SMC Global) (now named SMC Global Power Holdings Corp. as approved by the Securities and Exchange Commission (SEC) on October 15, 2010) of 15,000 and 60,000 shares, respectively, of SMEC's remaining unissued capital stock.

The Parent Company, on November 16, 2009, and SMC Global, on November 17, 2009, executed the Subscription Agreement setting forth their aforementioned subscription of the remaining unissued capital stock of SMEC. Prior to the subscription, the Parent Company beneficially owned the 25,000 subscribed common stock of SMEC representing 100% ownership interest. On November 26, 2009, the Parent Company paid in full its remaining unpaid subscription to the 24,995 common shares of stock in SMEC amounting to ₱1.835.

With the new subscription, SMC Global owned an aggregate of 60% equity ownership interest in SMEC, while the Parent Company retained an aggregate of 40% equity ownership interest in SMEC.

Mining Companies

Sultan Energy Phils. Corp. (SEPC)

On May 13, 2010, SMEC acquired 100% ownership interest in SEPC, which has a coal mining property and right over an aggregate area of 7,000 hectares, more or less composed of 7 coal blocks located in Lake Sebu, South Cotabato and Sen. Ninoy Aquino, Sultan Kudarat covered by Coal Operating Contract (COC) No. 134 with the Department of Energy (DOE) dated February 23, 2005. SEPC has an In-situ coal resources (measured plus indicative coal resources) of about 55 million metric tons based on exploratory drilling conducted by SEPC and confirmatory drilling conducted by an independent geologists from March 13 to April 19, 2010.

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Daguma Agro Minerals, Inc. (DAMI)

On January 29, 2010, SMEC acquired 100% ownership interest in DAMI, a coal mining company with coal property covered by COC No. 126 with the DOE, dated November 19, 2002, located in Barangay Ned, Lake Sebu, South Cotabato consisting of 2 coal blocks with a total area of 2,000 hectares, more or less, and has an In-situ coal resources (measured plus indicative coal resources) of about 95 million metric tons based on exploratory drilling conducted by DAMI and additional in-fill drilling being conducted by independent geologists which commenced last May 13, 2010.

Bonanza Energy Resources, Inc. (BERI)

On January 29, 2010, SMEC acquired BERI, a mining company with coal property covered by COC No. 138 with the DOE dated May 26, 2005. COC No. 138 is located in Maitum, Sarangani Province and Barangay Ned, Lake Sebu, South Cotabato consisting of 8 coal blocks with a total area of 8,000 hectares, more or less, and has an In-situ coal resources (measured plus indicative coal resources) of about 5 million metric tons based on initial exploratory drilling conducted by SMEC geologists in Maitum, Saranggani during the period from May to July 2010. The exploratory drilling to be conducted on 4 coal blocks of BERI located in Barangay Ned, Lake Sebu Municipality is projected to contain 30 million metric tons based on a geological setting and initial exploratory drilling conducted in Maitum.

The coal operating contracts met the contractual/legal criterion and qualified as intangible assets under PFRS 3.

On February 9, 2009, March 26, 2008 and December 15, 2009, the DOE approved the conversion of the COC for Exploration to COC for Development and Production of SEPC, DAMI and BERI, respectively.

As of December 31, 2010, SEPC, DAMI and BERI are in the exploratory stages of their mining activities. All related costs and expenses from exploration are currently deferred as exploration and development costs to be amortized upon commencement of commercial operations included as part of "Other noncurrent assets — others" account in the statements of financial position (Note 20).

The Group had not identified any facts and circumstances which suggest that the carrying amounts of the deferred exploration and development costs exceeded recoverable amounts as of December 31, 2010.

The following summarizes the recognized amounts of assets acquired and liabilities assumed from SEPC, DAMI and BERI at the acquisition date:

	<u>2010</u>
Assets	
Other receivables	P 1
Deferred exploration and development costs.	72
Other intangible assets — mining rights	81
Liabilities	
Accounts payable and accrued expenses.	(8)
Due to related parties	<u>(47)</u>
Total identifiable net assets at fair value.	<u>P 99</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Mining rights were recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total cash consideration transferred		P1,818
Total identifiable net liabilities at fair value		<u>(99)</u>
Other intangible asset — mining rights	19, 39	<u><u>P1,719</u></u>

• *SPDC*

On February 11, 2010, SPDC's BOD approved the subscription by the Parent Company and SMC Global of 1,500 and 6,000 shares, respectively, of SPDC's remaining unissued capital stock.

On March 15, 2010, the Parent Company and SMC Global executed the Subscription Agreement setting forth their aforementioned subscription of the remaining unissued capital stock of SPDC. Prior to the subscription, the Parent Company beneficially owned the 2,500 subscribed common stock of SPDC, representing 100% ownership interest. On March 19, 2010, the Parent Company paid in full its remaining unpaid subscription to the 2,495 common shares of stock in SPDC amounting to P0.1875.

With the new subscription, SMC Global owned an aggregate of 60% equity ownership interest in SPDC, while the Parent Company retained an aggregate of 40% equity ownership interest in SPDC.

• *PanAsia*

On November 3, 2009, as part of the corporate restructuring of the Parent Company's power and energy business cluster, PanAsia became a direct wholly-owned subsidiary of the Parent Company as a result of SMEC's sale of its 100% equity ownership interest in PanAsia in favor of the Parent Company for P2.5.

• *SPPC*

On May 19, 2010, the Parent Company paid in full its remaining unpaid subscription to the 2,495 common shares of stock in SPPC amounting to P0.1875.

• *SMC Global*

On August 9, 2010, the Parent Company obtained control of SMC Global by acquiring 75% of the shares and voting interests therein.

From the date of acquisition, SMC Global has contributed revenue of P25,665 and profit of P8,230 to the Group's results.

The Group has elected to measure non-controlling interest at proportionate interest in identifiable net assets.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
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The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Cash and cash equivalents	P 2,699
Trade and other receivables	5,578
Inventories	893
Prepaid expenses and other current assets	556
Investments and advances — net	12,824
Property, plant and equipment — net	140,260
Deferred tax assets	36
Other noncurrent assets — net	1,367
Liabilities	
Accounts payable and accrued expenses	(4,194)
Income and other taxes payable	(1,261)
Deferred tax liabilities	(225)
Other noncurrent liabilities	<u>(148,226)</u>
Total identifiable net assets at fair value	<u>P 10,307</u>

The fair value of the trade and other receivables amounts to P5,578. None of the receivables has been impaired and it is expected that the full amount can be collected.

Bargain purchase gain, which was presented as part of “Other income (charges)” in the consolidated statement of income, was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total cash consideration transferred		P 3,240
Non-controlling interest measured at proportionate interest in identifiable net assets		2,577
Total identifiable net assets at fair value		<u>(10,307)</u>
Bargain purchase gain	33	<u>P (4,490)</u>

Acquisition of Non-controlling Interests

On September 3 and 8, 2010, the Parent Company acquired the remaining 25% ownership in SMC Global, making it a wholly-owned subsidiary. A cash consideration of P1,080 was paid to non-controlling interest shareholders. The carrying amount of SMC Global’s net assets on the date of acquisition was P10,111, and the carrying amount of the additional interest acquired was P2,528. The difference of P1,448 between the consideration and the carrying amount of the interest acquired has been recognized in “Revaluation increment” in the consolidated statements of changes in equity.

SMEC, PanAsia, SPPC and SPDC

On May 17, 2010, the BOD of the Parent Company approved the sale of its entire 40% ownership interest in SMEC and SPDC and 100% ownership in PanAsia and SPPC. On September 21, 2010, the Parent Company and SMC Global executed Deed of Absolute Sale of Shares whereby the former’s entire interest in

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

SMEC, PanAsia, SPPC and SPDC were sold for a total price of ₱7.15. Following such sale, SMEC, PanAsia, SPPC and SPDC became wholly-owned subsidiaries of SMC Global.

Fuel and Oil

• *SRC and Petron*

The Parent Company entered into an option agreement with SEA Refinery Holdings B.V. (SEA BV) (the “Option Agreement”) dated December 24, 2008, as amended on March 4, 2010, pursuant to which SEA BV granted to the Parent Company an option to acquire and purchase up to 100% of its interests in SEA BV’s wholly-owned subsidiary, SRC, consisting of: (i) 16,000,000 common shares of SRC, representing 40% of the outstanding common shares of SRC on or before April 30, 2010; and (ii) 24,000,000 common shares of SRC, representing 60% of the outstanding common shares of SRC on or before December 23, 2010. SRC owns 4,696,885,564 common shares of Petron (representing approximately 50.1% of the outstanding common shares of Petron). The Parent Company conducted a tender offer as a result of its intention to exercise the option to acquire 100% of SRC from SEA BV. The tender offer period ended on June 2, 2010 and a total of 184,702,538 Petron common shares tendered were crossed at the PSE on June 8, 2010, which is equivalent to approximately 1.97% of the issued and outstanding common shares of Petron.

On June 15, 2010, the Parent Company executed the Deed of Absolute Sale for the purchase of the 16,000,000 common shares of SRC from SEA BV.

On August 31, 2010, the Parent Company purchased an additional 1,517,637,398 common shares of Petron from SEA BV through a special block sale crossed at the PSE. Said shares comprise approximately 16.19% of the outstanding common shares of Petron.

On October 18, 2010, the Parent Company also acquired from the public a total of 530,624 common shares of Petron, representing approximately 0.01% of the outstanding common shares of Petron.

On December 15, 2010, the Parent Company exercised its option to acquire the remaining 60% of SRC from SEA BV pursuant to the Option Agreement. With the exercise of the option, the Parent Company beneficially owns approximately 68.26% of the outstanding common shares of Petron.

From the date of acquisition, SRC and Petron has contributed revenue of ₱10,383 and profit of ₱284 to the Group’s results.

The Group has elected to measure non-controlling interest at proportionate interest in identifiable net assets.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Cash and cash equivalents	P39,948
Trade and other receivables — net	26,945
Inventories	34,422
Prepaid expenses and other current assets	3,177
Investments and advances — net	2,172
Property, plant and equipment — net	34,550
Investment properties — net	121
Assets held for sale	823
Deferred tax assets	394
Other noncurrent assets — net	23,422
Liabilities	
Drafts and loans payable	(34,987)
Accounts payable and accrued expenses	(21,604)
Income and other taxes payable	(6)
Current maturities of long-term debt — net of debt issue costs	(9,193)
Long-term debt — net of current maturities and debt issue costs	(43,452)
Deferred tax liabilities	(2,312)
Other noncurrent liabilities	(2,652)
Total identifiable net assets at fair value	<u>P51,768</u>

The fair value of the trade and other receivables amounts to P26,945. The gross amount of trade receivables is P27,883, of which P938 are expected to be uncollectible at the acquisition date (Note 10).

Goodwill was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total consideration transferred:		
Cash		P33,323
Equity interest held before business combination		<u>16,720</u>
		50,043
Non-controlling interest measured at proportionate interest in identifiable net assets		23,750
Total identifiable net assets at fair value		<u>(51,768)</u>
Goodwill	19,39	<u>P22,025</u>

Goodwill arising from the acquisition is attributable to the benefit of expected synergies with the Group's power generation and shipping businesses, revenue growth, future market development and the assembled workforce of Petron. These benefits are not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets. None of the goodwill recognized is expected to be deductible for income tax purposes.

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Infrastructure

• *ULC BVI*

On October 28, 2010, the Parent Company, through SMHC, signed a share sale and purchase agreement (the “Agreement”) with ULC BVI, pursuant to the authority of the BOD of the Parent Company on March 15, 2010. Under the terms of the Agreement, SMHC shall acquire up to 51% equity interest in ULC BVI, the corporation which 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 ROP, through the Department of Transportation and Communications (DOTC) (Note 35).

Closing of the Agreement was held on November 8, 2010. As of December 31, 2010, completion of the acquisition is still subject to the satisfaction of certain mandatory conditions by the counterparty.

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Cash and cash equivalents	P 1
Trade and other receivables — net	1
Other intangible assets — net	2,182
Liabilities	
Accounts payable and accrued expenses	(136)
Deferred tax liability	<u>(1)</u>
Total identifiable net assets at fair value	<u>P2,047</u>

The fair value of the trade and other receivables amounts to P1. None of the receivables has been impaired and it is expected that the full amount can be collected.

Goodwill was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total cash consideration transferred		P 2,508
Non-controlling interest measured at proportionate interest in identifiable net assets . .		1,003
Total identifiable net assets at fair value		<u>(2,047)</u>
Goodwill	19, 39	<u>P 1,464</u>

• *TADHC*

On April 8, 2010, the Parent Company, through its wholly-owned subsidiary, SMHC, executed a share sale purchase agreement relating to the purchase by SMHC of the rights, title and interests to a total of 2,025,000 common shares in CIADC (the “CIADC Shares”). On April 29, 2010, Deeds of Assignment of Shares were executed covering the CIADC Shares. CIADC holds the exclusive rights, obligations and privileges to finance, design, construct, operate and maintain the Caticlan Airport by virtue of the Concession Agreement, dated June 22, 2009, with the ROP, through the DOTC and the Civil Aviation Authority (Note 35). As of December 31, 2010, SMHC paid P675 for the acquisition of CIADC Shares. The balance of P350 is payable as follows: (i) P180, one year after closing of the transaction; (ii) P100, two years after the closing of the transaction; and (iii) P70, one year from the date of the previous payment.

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The current portion of the Group's outstanding payable related to the purchase as of December 31, 2010 amounting to ₱180, is included under "Accounts payable and accrued expenses" account (Note 22), while the noncurrent portion amounting to ₱170 as of December 31, 2010, is reported as part of "Other noncurrent liabilities" account (Note 24).

As approved by the SEC on September 23, 2010, CIADC was renamed to Trans Aire Development Holdings Corp.

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Prepaid expenses and other current assets	₱ 4
Property, plant and equipment — net	11
Other intangible assets — licenses	58
Liabilities	
Accounts payable and accrued expenses	(9)
Other noncurrent liabilities	<u>(4)</u>
Total identifiable net assets at fair value	<u>₱60</u>

Goodwill was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total consideration transferred		
Cash		₱ 675
Deferred consideration		<u>350</u>
		1,025
Non-controlling interest measured at proportionate interest in identifiable net assets . .		2
Total identifiable net assets at fair value		<u>(60)</u>
Goodwill	19, 39	<u>₱ 967</u>

Telecommunications

- *TCCI, PHC and PSCL*

On July 30, 2010, the Parent Company through its wholly-owned subsidiary, Vega, subscribed to unissued shares of stock of TCCI, PHC and PSCL, equivalent to 75% equity interests in each of said companies. TCCI, PHC and PSCL, in turn, collectively own 100% of the outstanding capital stock of Bell Telecommunications Philippines (BellTel).

BellTel is a grantee of a franchise to install, operate and maintain local exchange networks and wireless local loop (WLL) in several areas including special economic zones, inter-exchange networks, nationwide VSAT network, international gateway facilities, and cellular mobile telecommunications network (Note 35).

On August 1, 2010, Vega acquired the remaining 25% ownership interest in TCCI, PHC and PSCL, making TCCI, PHC and PSCL wholly-owned subsidiaries of Vega.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Cash and cash equivalents	P 68
Trade and other receivables — net.	429
Prepaid expenses and other current assets	55
Property, plant and equipment — net.	374
Other noncurrent assets.	6
Liabilities	
Accounts payable and accrued expenses	(1,181)
Deferred tax liabilities	(1)
Other noncurrent liabilities	<u>(256)</u>
Total identifiable net liabilities at fair value	<u>P (506)</u>

The fair value of the trade and other receivables amounts to P429. The gross amount of trade receivables is P456, of which P27 are expected to be uncollectible at the acquisition date (Note 10).

License was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2010</u>
Total cash consideration transferred		P4,715
Total identifiable net liabilities at fair value		<u>506</u>
Other intangible asset — license	19, 39	<u>P5,221</u>

• *AGNP*

On December 30, 2010, the Parent Company through its wholly-owned subsidiary, Vega, executed a Share Purchase Agreement (the “Agreement”) with ISM Communications Corporation (“ISMCorp.”), for the purchase of 100% of the outstanding and issued shares of stock of AGNP. The acquisition of AGNP was authorized by the BOD of Vega during the meeting held on December 16, 2010.

AGNP is the registered and beneficial owner of approximately 40% of Eastern Telecommunications Philippines, Inc. (Eastern Telecoms). Eastern Telecoms’ products included wireless access, services for high-end internet cafes, a new data center, business application and special packages for small and medium enterprises and corporations, besides the traditional bandwidth and connectivity solutions. The acquisition of Eastern Telecoms through AGNP, would complement the internet broadband service of Liberty Telecommunications Holdings, Inc. (LTHI), in which the Group holds 41.48% interest.

Upon the signing of the Agreement, Vega paid P320 as initial payment. Under the Agreement, the outstanding balance of P1,280 is payable in two installments. The first payment amounting to 50% of the outstanding balance is due on December 29, 2011 while the remaining balance is to be settled on December 29, 2012.

The current portion of the Group’s outstanding payable related to the purchase of AGNP shares as of December 31, 2010 amounted to P640, included under “Accounts payable and accrued expenses” account (Note 22), while the noncurrent portion amounting to P640 as of December 31, 2010 is reported as part of “Other noncurrent liabilities” account (Note 24).

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Total identifiable assets at fair value on the acquisition date pertains to its investment in Eastern Telecoms amounting to ₱1,600, which is also equal to the total consideration of the purchase made by Vega.

Properties

• *SMPI-GSIS*

On October 31, 2007, the Parent Company through SMPI entered into a JVA with GSIS to establish the SMPI-GSIS JVC. The SMPI-GSIS JVC will hold ownership and title to the real property owned by GSIS, develop the property into a first class high-rise service apartment and manage and operate the same. The SMPI-GSIS JVC will have an authorized capital stock of ₱600 divided into 600,000,000 shares with a par value of ₱1 per share. The parties agreed to an equal equity participation wherein the real estate property owned by GSIS is valued at ₱300 while SMPI has committed to contribute ₱300 to the SMPI-GSIS JVC. On October 23, 2008, SMPI-GSIS JVC was incorporated.

In 2010, the Articles of Incorporation of SMPI-GSIS JVC was amended accordingly to reflect the increase in its authorized capital stock from ₱600 divided into 600,000,000 shares to ₱625 divided into 625,000,000 shares, both with par value of ₱1. SMPI then completed the acquisition of the 52% equity ownership in SMPI-GSIS JVC by assigning its 100% equity ownership in Maison 17 Properties (MPI), one of its wholly-owned subsidiaries, plus additional cash consideration of ₱181, which is in accordance with the JVA. After this transaction MPI became a wholly-owned subsidiary of SMPI-GSIS JVC.

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2010</u>
Assets	
Cash	₱ 13
Prepaid expenses and other current assets	10
Property, plant and equipment — net.	<u>455</u>
Total identifiable net assets at fair value	<u><u>₱478</u></u>

In 2010, SMPI's ownership interest in Maison was diluted when SMPI assigned its entire interest in MPI to the SMPI-GSIS JVC. The effect of dilution in SMPI's share in MPI's net assets amounting to ₱52 was recognized in equity.

The dilution loss recognized as a result of the acquisition is as follows:

	<u>Note</u>	<u>2010</u>
Total cash consideration transferred		₱ 181
Non-controlling interest measured at proportionate interest in identifiable net assets. .		349
Total identifiable net assets at fair value		<u>(478)</u>
Dilution loss	39	<u><u>₱ 52</u></u>

Under the JVA, SMPI grants GSIS the option to sell to SMPI all the shares of stock of the SMPI-GSIS JVC issued in the name of GSIS and its nominees under certain terms and conditions (Note 35).

The SMPI-GSIS JVC has not yet started commercial operations as of March 14, 2011.

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Packaging

• *SMYK*

On December 3, 2009, SMYPIL's BOD approved the increase in the authorized capital stock of SMYPIL from US\$100 to US\$120. The proposed increase in capital stock would cover the additional capital to be issued by SMYPIL to finance the acquisition of JHK Investments and its subsidiaries.

On December 14, 2009, an amendment to the Articles of Association increasing SMYPIL's authorized capital from US\$100 to US\$120 was filed with the Registrar of Corporate Affairs of BVI.

Subsequently, while maintaining their respective ownership interests, the Parent Company through its wholly-owned subsidiary, San Miguel Holdings Ltd. (SMHL), and Nihon Yamamura Glass Co., Ltd. (NYG) made additional investments in SMYPIL amounting to US\$23.6 and US\$12.7, respectively.

On December 17, 2009, SMYPIL acquired from James Huntly Knox "JHK" 60,705,521 shares of SMYK, the parent company of the Cospak Group, for up to a maximum amount of Australian Dollar (A\$)34.65 (US\$31.64). Of the said purchase price, A\$9.91 (US\$9.05) is placed on escrow and will be released in favor of JHK based on the attainment of SMYK of an agreed earnings before interest, taxes, depreciation and amortization for the periods ended December 31, 2009 and June 30, 2010. On March 12, 2010 and November 22, 2010, the escrow account was released to JHK.

On the same date, SMYPIL also subscribed to an additional 12,269,939 shares in SMYK for A\$5 (US\$4.57). With this additional acquisition, SMYPIL owns an aggregate of 65% of the outstanding shares of SMYK.

The following summarizes the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

	<u>2009</u>
Assets	
Cash and cash equivalents	US\$ 4
Trade and other receivables — net.	20
Inventories	14
Prepaid expenses and other current assets	6
Property, plant and equipment — net.	11
Deferred tax assets	1
Liabilities	
Drafts and loans payable	(19)
Accounts payable and accrued expenses	(20)
Dividends payable	(2)
Income and other taxes payable	(1)
Noncurrent portion of finance lease liability	<u>(1)</u>
Total net identifiable assets	<u><u>US\$ 13</u></u>

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Goodwill was recognized as a result of the acquisition as follows:

	<u>Note</u>	<u>2009</u>
Total cash consideration transferred		US\$ 36
Non-controlling interest measured at proportionate interest in identifiable net assets		5
Total identifiable net assets at fair value		<u>(13)</u>
Goodwill	<i>19, 39</i>	<u><u>US\$ 28</u></u>

The following summarizes the major classes of consideration transferred:

Cash	US\$27.16
Contingent consideration	<u>9.05</u>
	<u><u>US\$36.21</u></u>

Identifiable assets acquired and liabilities assumed as a result of the foregoing acquisitions are disclosed in Note 39.

The Parent Company's diversification into new businesses such as power, fuel and oil, infrastructure and telecommunications are opportunities that will provide growth momentum and better earnings for the Group as a whole. If the acquisitions had occurred on January 1, 2010, management estimates that consolidated revenue would have been ₱474,427, and consolidated net income for the year would have been ₱34,895. In determining these amounts, management has assumed that the fair value adjustments, determined provisionally, that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2010.

Asset Acquisitions:

- *IPP Administration Agreement (Note 35)*
- *Sual Power Plant IPP Administration Agreement*

As a result of the bidding conducted by the PSALM on August 28, 2009 for the Appointment of the IPP Administrator for the Contracted Capacity of the Sual 2x500 MW Coal Fired Power Station (Sual Power Plant), SMEC was declared the winning bidder thereof as set out in the Notice of Award issued by PSALM on September 1, 2009. As of November 6, 2009, SMEC assumed the administration of the Contracted Capacity of the Sual Power Plant in accordance with the provisions of the IPP Administration Agreement for the Contracted Capacity of the Sual Power Plant with Execution Date of September 8, 2009.

- *San Roque IPP Administration Agreement*

Following the December 15, 2009 bidding conducted by PSALM for the Appointment of the IPP Administrator for the Contracted Capacity of the 345 MW San Roque Multi-Purpose Hydroelectric Power Plant located at Barangay San Roque, San Miguel, Pangasinan (San Roque Power Plant), PSALM issued on December 28, 2009 the Notice of Award to SPDC as the winning bidder thereof. As of January 26, 2010, SPDC assumed the administration of the Contracted Capacity of the San Roque Power Plant in accordance

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with the provisions of the IPP Administration Agreement for the Contracted Capacity of the San Roque Power Plant with Execution Date of December 29, 2009.

- *Ilijan IPP Administration Agreement*

On April 16, 2009, the Parent Company successfully bid for the Appointment of the IPP Administrator for the Contracted Capacity of the Ilijan Natural Gas Fired Combined Cycle Power Plant with an installed capacity of 1200 MW located at Ilijan, Batangas (Ilijan Power Plant) and received a notice of award on May 5, 2010. On June 10, 2010, the Parent Company and SPPC entered into an Assignment Agreement with Assumption of Obligations whereby the Parent Company assigned all its rights and obligations to SPPC under the IPP Administration Agreement for the Contracted Capacity of the Ilijan Power Plant with execution date of May 11, 2010. PSALM consented to the aforementioned assignment in its letter dated June 16, 2010.

On June 26, 2010, SPPC assumed the administration of the contracted capacity of the Ilijan Power Plant in accordance with the provisions of the IPP Administration Agreement for the Contracted Capacity of the Ilijan Power Plant with Execution Date of May 11, 2010.

The IPPA Agreements include, among others, the following common salient rights and obligations:

- i. The right and obligation to manage and control the Capacity for its own account and at its own cost and risks;
- ii. The right to trade, sell or otherwise deal with the Capacity (whether pursuant to the spot market, bilateral contracts with third parties or otherwise) and contract for or offer related ancillary services, in all cases for its own account and at its own risk and cost. Such rights shall carry the rights to receive revenues arising from such activities without obligation to account therefore to PSALM or any third party;
- iii. The right to receive a transfer of the Power Station in case of buy-out or termination of the Agreement for no consideration;
- iv. The right to receive an assignment of National Power Corporation (NPC) interest to existing short-term bilateral Power Supply Contracts;
- v. The obligation to supply and deliver, at its own cost, fuel required by the IPP and necessary for the Sual Power Station to generate the electricity required to be produced by the IPP;
- vi. Maintain the Performance Bond in full force and effect with a Qualified Bank; and
- vii. The obligation to pay PSALM the monthly payments and generation fees in respect of all electricity generated from the Capacity.

In view of the nature of the IPP Administration Agreements, the arrangement has been accounted for as finance lease (Note 35).

- *Independent Power Producer*
- *Limay Power Plant*

On September 11, 2009, PSALM issued the Notice of Award to SMEC as the winning buyer of the 620 MW Limay Combined Cycle Power Plant (Limay Power Plant). SMEC and PSALM entered into the Asset Purchase Agreement and Land Lease Agreement (collectively, the "Limay Agreements") with effective date of September 18, 2009, with an option to acquire the land.

On November 13, 2009, SMEC and PanAsia entered into an Assignment Agreement with Assumption of Obligations, wherein PanAsia assumed all the rights and obligations of SMEC under the Limay Agreements

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subject to the written consent of PSALM to such assignment. PSALM's consent to the assignment was secured by SMEC and PanAsia, as set out in the Amendment, Accession and Assumption Agreement executed by the parties on January 11, 2010.

On January 18, 2010, the physical possession of the Limay Power Plant was turned over and transferred to PanAsia. PanAsia started operations of the Limay Power Plant on February 16, 2010.

In July 2010, with the consent of PSALM, PanAsia's option to acquire the land was assigned to PCPI. Accordingly, PCPI assumed all the rights and obligations under the original contract between PanAsia and PSALM. On September 30, 2010, PCPI exercised the option and acquired ownership of the land.

6. Investment in Subsidiaries

The following are the developments relating to the Parent Company's investments in subsidiaries in 2010 and 2009:

Beverages

• ***SMB***

On July 24, 2007, the stockholders of the Parent Company, during the annual stockholders' meeting, approved the transfer of the Parent Company's domestic beer business assets (excluding land and brands) to a wholly-owned subsidiary of the Parent Company, in exchange for shares of stock. The transfer of such assets to a wholly-owned subsidiary is pursuant to the listing with the PSE and the public offering of the shares of SMB.

On July 26, 2007, the Parent Company incorporated SMB, a wholly-owned subsidiary with an initial authorized capital stock of ₱100 and paid-up capital of ₱6.25. Pursuant to the stockholders approval obtained on July 24, 2007, the Parent Company's domestic beer business net assets as of June 30, 2007, excluding land, brands and certain payables were transferred to SMB in exchange for additional shares of stock effective October 1, 2007. The transfer of the net assets is pursuant to a Master Deed of Assignment of Domestic Beer Assets dated August 23, 2007 between the Parent Company and SMB with amendments dated September 7, 2007.

On September 27, 2007, the SEC approved the increase in SMB's authorized capital stock from ₱100 to ₱25,000 and the decrease of the par value of its shares from ₱100.00 to ₱1.00. Shares totaling 15,308,416,960, were issued to the Parent Company pursuant to such transfer under a tax-free asset-for-share agreement, as confirmed by the Bureau of Internal Revenue (BIR) in its certification No. SN-300-2007.

As a standard condition of the SEC for approval of applications for increase in authorized capital stock, where the payment for the shares issued pursuant to such increase is made in the form of motor vehicles and receivables, 2,557,573,242 common shares that were issued by SMB to the Parent Company in exchange for motor vehicles and receivables, out of the 15,308,416,960 common shares issued by SMB, were held in escrow by the SEC pending the transfer of ownership of those motor vehicles in the name of SMB and proof of collection of receivables. In a letter dated May 26, 2010, the SEC ordered the release of the escrow on the said common shares.

On May 12, 2008, SMB listed its shares in the PSE pursuant to its listing application approved on March 26, 2008. In April to May 2008, SMB sold at ₱8.00 per share 77,052,000 shares to the public by way of a primary offer, and the Parent Company sold to the public 809,050,000 shares of its existing shares in SMB (including shares to cover for over-allotments) by way of a secondary offer, pursuant to a registration statement rendered effective by the SEC on April 28, 2008. The total shares offered represents 5.75% stake in SMB. The Group recognized a net gain of ₱5,650 from the transaction in 2008.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On February 20, 2009, the Parent Company signed a share purchase agreement for the acquisition by Kirin Holdings Company, Limited (“Kirin”), of a 43.2499% stake in SMB. Under the terms of the agreement, purchase price of the shares amounted to ₱8.841 per share, implying a total acquisition price at ₱58,924. Further to the agreement, the Parent Company, Kirin and SMB negotiated exclusively for SMB’s purchase of shares in Parent Company’s overseas beer business.

On April 30 and May 22, 2009, the Parent Company sold its 2,185,402,491 and 4,479,621,199 common shares, respectively, representing 43.2499% stake in SMB to Kirin at ₱8.841 per share for a total purchase price of ₱58,924. The Group recognized a net gain of ₱50,537 from the sale in 2009.

- *SMBIL*

On August 17, 2009, the Parent Company assigned its international trademarks, trade dress, know-how, copyrights, patents and other intellectual property rights used in connection with the international beer business of the Parent Company and its international subsidiaries (“International IP Rights”) valued at US\$31.5 to SMIL. Common shares totaling 2,863,636 were issued to the Parent Company under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-233-2009.

The value of International IP Rights was derived from the independent valuation study done by Fortman Cline Capital Markets (FCCM), in which FCCM applied one valuation methodology, the royalty relief method.

On December 18, 2009, SMB’s BOD approved the purchase of the international beer and malt-based beverages business of the Parent Company through the purchase of the shares of SMHL, a wholly-owned subsidiary of Parent Company, in SMBIL, comprising 100% of the issued and outstanding capital stock of SMBIL (“SMBIL Shares”), with an enterprise value of US\$300. On the same date, the Parent Company, SMB and SMHL entered into a Share Purchase Agreement (“SPA”) for the SMBIL Shares. The SPA includes contingent consideration that will be paid through an earn-out scheme based on the attainment by SMBIL and certain subsidiaries of SMBIL of EBITDA and sales volume targets at certain periods. The BOD of the Parent Company likewise approved the sale of its international beer and malt-based beverage business to SMB, through the sale by SMHL, its wholly-owned subsidiary, of the SMBIL shares to SMB, on the same day.

On December 21, 2009, SMIL’s BOD approved the assignment of International IP Rights to SMHL valued at US\$31.5 in exchange for 286,363 SMHL common shares. The assignment was also approved by SMHL’s BOD on the same date.

Also on the same date, SMHL’s BOD approved the assignment of International IP Rights to SMBIL valued at US\$31.5 in exchange for 2,863,636 SMBIL shares. The assignment was also approved by SMBIL’s BOD on the same date.

On January 28, 2010, SMB entered into a US\$300 unsecured loan facility agreement. Proceeds of the loan were used to finance SMB’s acquisition of SMBIL Shares. The sale was completed on January 29, 2010, with SMB acquiring the SMBIL Shares for a purchase price of US\$302 (₱13,941), after adjustments in accordance with the terms of the SPA. As a result, SMBIL became a wholly-owned subsidiary of SMB.

- *IBI*

On December 8, 2008, the BOD of the Parent Company approved the transfer of its domestic beer and malt-based beverages brands, including related trademarks, copyrights, patents and other intellectual property rights and know-how (“Domestic IP Rights”) to a wholly-owned subsidiary, in exchange for shares of stock.

On December 16, 2008, the Parent Company formed IBI, a wholly-owned subsidiary, with an authorized capital stock of ₱1. IBI was incorporated primarily to engage in the manufacturing, buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages and to own, purchase, license and/or acquire

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such trademarks and other intellectual property rights necessary for the furtherance of its business. On the same date, the BOD and stockholders of IBI approved the increase in its authorized capital stock from ₱1 to ₱10,000 divided into 100,005,000 shares at ₱100.00 par value per share. To fund such increase, the Parent Company and IBI executed a Deed of Assignment of Domestic Intellectual Rights dated December 16, 2008 as supplemented for the transfer of the Domestic IP Rights in exchange for common shares in IBI out of the existing and unissued capital stock and the increase in IBI's authorized capital stock.

On January 27, 2009, the Parent Company's BOD approved the sale of its Domestic IP Rights to SMB, through the sale of all its interests in IBI to SMB. SMB's BOD approved on the same date, the purchase of the Domestic IP Rights through the purchase of all of Parent Company's interests in IBI after the completion of such transfer to IBI by the Parent Company of the Domestic IP Rights to IBI.

On February 27, 2009, the SEC approved the increase in the authorized capital stock of IBI. With such approval, the SEC likewise approved the transfer of Parent Company's Domestic IP Rights to IBI in exchange for 100,000,000 additional common shares in IBI. Such shares were issued to Parent Company under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-405-2008 dated December 24, 2008.

On April 29, 2009, SMB acquired the Parent Company's shares in IBI comprising 100% of the outstanding capital stock of IBI, for a total purchase price of ₱32,000, thereby making IBI its wholly-owned subsidiary. For SMB, the value of the Domestic IP Rights represents the purchase price after giving due consideration to various factors and valuation methodologies including the independent valuation study and analysis prepared by UBS Investments Philippines, Inc. SMB, after considering said valuation methodologies, viewed the royalty relief (based on commercial rates) and advertising spent methodologies to be generally more relevant, compared to other methodologies that may be used to value the Domestic IP Rights on the basis that such methodologies require fewer assumptions and less reliance on subjective reasoning since key assumptions come from primary sources based on SMB's filings and projections, actual industry precedents and industry common practice. The purchase price agreed upon is within the value range yielded by said methodologies, which value range is ₱25,000 to ₱32,000. For the Parent Company, the value of the Domestic IP Rights was derived after considering the independent valuation study done by FCCM, in which FCCM applied several methodologies, including the replacement methodology.

• *BPI*

On December 8, 2008, the BOD of the Parent Company approved the transfer of certain parcels of land used in the domestic beer operations to a wholly-owned subsidiary, in exchange for shares of stock.

On December 16, 2008, the Parent Company formed BPI, a wholly-owned subsidiary, with an authorized capital stock of ₱1. BPI was incorporated primarily to own, use, improve, develop, sell, exchange, lease and hold investment or otherwise, real estate of all kinds, including buildings and other structures.

On January 27, 2009, SMB's BOD approved the purchase of all interest of the Parent Company in BPI after: (i) Parent Company has transferred certain land used in the domestic beer operations of SMB ("Land") to BPI in exchange for BPI common shares, and (ii) San Miguel Brewery Inc. Retirement Plan ("SMBRP") has transferred its shares in BLI to BPI preferred shares for the purchase price of ₱6,829, corresponding to the appraised value of the Land transferred by the Parent Company to BPI.

On January 28, 2009, the BOD of BPI approved the increase in the par value of its common shares from ₱100.00 to ₱350.00 per share and the increase in its authorized capital stock from ₱1 divided into 10,000 shares with a par value of ₱100.00 per share to ₱800 divided into 2,400,000 preferred shares and 1,600,000 common shares with a par value of ₱100.00 and ₱350.00 per share, respectively. To fund the increase in BPI's authorized capital stock, the Parent Company transferred certain parcels of land used in the domestic beer business of SMB to BPI in exchange for 1,592,281 common shares, out of its existing unissued

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capital stock and the increase in its authorized capital stock, and SMBRP transferred its 2,389,494 common shares (with a par value of ₱100.00 per share) in BLI as payment for its subscription to 2,389,494 preferred shares of BPI (with a par value of ₱100.00 per share).

On February 25, 2009, the Parent Company sold certain parcels of land used in the domestic beer business to BLI for a total consideration of ₱239 and recognized a gain of ₱232.

On September 10, 2009, the SEC approved the increase in the par value of BPI's common shares and the increase in its authorized capital stock. With such approval, the transfer of: (i) the certain parcels of land (used in the domestic beer business of SMB) of the Parent Company to BPI in exchange for additional common shares from the existing unissued authorized capital stock of BPI and the increase in authorized capital stock; and (ii) the common shares of SMBRP in BLI to BPI as payment for SMBRP's subscription to BPI preferred shares were also approved by the SEC. The transfer was under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-121-2009. Following the approval, BLI became a subsidiary of BPI.

BLI and BPI started commercial operations on February 25, 2009 and September 10, 2009, respectively.

On November 10, 2010, SMB and the Parent Company executed a Deed of Absolute Sale of Shares ("Deed") for the purchase by SMB of all the shares of the Parent Company in BPI (the "BPI Shares"), at the aggregate purchase price of ₱6,829 ("Purchase Price"). SMB paid ₱6,629, corresponding to the appraised value of the 128 Land titles transferred in the name of BPI to Parent Company upon execution of the Deed. The balance shall be paid by SMB to Parent Company upon transfer of the remaining eight (8) Land titles in the name of BPI. The BPI Shares comprise 40% of the issued and outstanding capital stock of BPI. The acquisition was financed using part of the proceeds of the bond offering of SMB.

SMB has the ability to govern BPI's financial and operating policies and conduct activities in order that SMB may obtain benefits from its operations. As such and in accordance with PAS 27, BPI is consolidated to SMB.

• *SMBI*

On November 1, 2008, GSMI entered into an Asset Purchase Agreement with SMBI for the purchase of SMBI's assets at net book value totaling ₱1,039, subject to adjustments as may be warranted by circumstances transpiring prior to closing date and which affect the value of the assets. Twenty-five percent (25%) of the purchase price was settled upon execution of the agreement, and thereafter the remaining balance shall be payable in six (6) equal monthly installments. On December 8, 2008, GSMI also entered into a service agreement with SMBI whereby the latter rendered various services to GSMI related to the production, promotion, sale and distribution of non-alcoholic beverages products as well as the operation of beverage assets. In consideration of the services rendered by SMBI, GSMI paid a monthly service fee in the amount of ₱21. The term of the agreement is for six (6) months commencing on November 1, 2008 and expired on April 30, 2009.

On December 31, 2008, the closing date of the transaction, the purchase price was adjusted to ₱1,117.

Foods

• *SMPFC*

On February 2, 2010, the Parent Company's BOD approved the following corporate actions:

- Sale to SMPFIL, a wholly-owned subsidiary of SMPFC, of the Parent Company's 51% interest in SMPFI at book value.
- Potential subscription of up to ₱5,200 worth of new SMPFC shares.

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- Sale of the Parent Company's food-related brands and intellectual property rights to SMPFC at a purchase price of ₱3,200.
- Sale of up to 40% of the Parent Company's interest in SMPFC, by way of a trade sale or marketed placements to investors, which may include investors outside the United States (Reg S) or and to not more than 19 non-qualified buyers domestically to be determined by Management.

On February 2, 2010, the BOD of SMPFC approved the proposal of SMPFC management to a) purchase food-related brands and intellectual property rights from the Parent Company at a purchase price of ₱3,200, and b) acquire, through SMPFIL, a BVI company and a wholly-owned subsidiary of SMPFC, the Parent Company's 51% interest, through SMFBIL, in SMPFI at book value. SMPFI owns 100% of SMPFVN.

On February 2, 2010 and March 12, 2010, SMPFC's stockholders approved, among others, the following corporate actions, subject to the necessary approvals of the SEC:

- Potential issuance of up to 75,000,000 new SMPFC shares to the Parent Company or third parties.
- Amendment of Amended Articles of Incorporation of SMPFC to reflect the following:
 - i. de-classification of SMPFC's common shares;
 - ii. increase in SMPFC's authorized capital stock by ₱1,000 or 100,000,000 shares at ₱10.00 par value; and
 - iii. denial of Pre-emptive rights to the proposed issuance of shares of up to 75,000,000 new SMPFC shares to the Parent Company or third parties.
- Declaration of 18% stock dividend based on the issued and outstanding shares to be taken out of the proposed increase in authorized capital stock.

On April 12, 2010, the SEC approved SMPFC's amendment to its Articles of Incorporation for the de-classification of common shares.

On May 21, 2010, the SEC issued to SMPFC the Certificate for the Approval of Increase of Capital Stock from 146,000,000 common shares to 246,000,000 common shares with par value of ₱10.00 per share and the Certificate of Filing of Amended Articles of Incorporation.

On July 6, 2010, the PSE approved the application of SMPFC to list additional 25,423,746 common shares, with a par value of ₱10.00 per share, to cover the 18% stock dividend declaration to stockholders. Stock dividend payment was made on July 26, 2010.

On July 21, 2010, the Parent Company and SMPFC entered into an Intellectual Property Rights Transfer Agreement (the "Agreement") for the transfer to SMPFC of the food-related brands and intellectual property rights at a purchase price of ₱3,200. Following the provision of the Agreement between the Parent Company and SMPFC, 10% of the purchase price was paid on July 30, 2010 and the balance payable (i) upon change in controlling interest of SMPFC to any third person other than an affiliate or (ii) two years from July 30, 2010, subject to floating interest rate based on 1 year PDSTF plus an agreed margin after one year, whichever comes first. On March 8, 2011, the remaining balance was fully paid by SMPFC.

In July 2010, the Parent Company, through its wholly-owned subsidiary, SMFBIL, sold to SMPFIL, (a wholly-owned subsidiary of SMPFC) its 51% interest in SMPFI for US\$18.6. SMPFI owns 100% of SMPFVN. Pursuant to the Sale and Purchase Agreement between SMFBIL and SMPFIL, 10% of the purchase price was paid in July 2010 and the balance of US\$16.8 (₱734.3 as at December 31, 2010) shall be payable (i) upon change in controlling interest of SMPFIL to any third person other than affiliate or (ii) two years from July 30, 2010, subject to floating interest rate based on one-year LIBOR plus an agreed margin after one year, whichever comes first.

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The Parent Company and SMPFC engaged FCCM as financial adviser to perform a third party valuation of the food-related brands. The Parent Company and SMPFC arrived at a purchase price of ₱3,200 after taking into account the valuation study.

On September 15, 2010, SMPFC's BOD approved, among others, the (i) reclassification of up to 75,000,000 authorized and unissued common shares into cumulative, non-participating, non-voting and non-convertible preferred shares with par value of ₱10.00 per share and with other features determined by management; (ii) issuance of preferred shares with total issue size of up to ₱50,000, part of the proceeds of which will be used to settle SMPFC's remaining 90% balance on the acquisition of food-related brands and intellectual property rights from the Parent Company and on the purchase of the Parent Company's 51% stake in SMPFI; (iii) listing of such preferred shares at the appropriate exchanges, and (iv) amendment of SMPFC's Articles of Incorporation to reflect the reclassification of such common shares to preferred shares and the denial of pre-emptive rights of shareholders for the proposed issuance of said preferred shares.

On November 3, 2010, SMPFC's stockholders approved, among others, the (i) reclassification of SMPFC's 40,000,000 authorized and unissued common shares into non-voting, cumulative and non-participating preferred shares with par value of ₱10.00 per share, (ii) issuance of such preferred shares and the listing thereof at the appropriate exchanges, and (iii) amendment of SMPFC's Articles of Incorporation to reflect the reclassification of such common shares to preferred shares and the denial of pre-emptive rights of shareholders for the proposed issuance of said preferred shares.

On December 23, 2010, the SEC approved the Amendment of the Articles of Incorporation of SMPFC to reflect the reclassification of SMPFC's 40,000,000 common shares to cumulative, non-participating, non-voting and non-convertible preferred shares with par value of ₱10.00 per share and the denial of the pre-emptive rights of shareholders to the issuance of the said preferred shares.

- *Highbreed Livestock Corporation (HLC)*

In April 2009, Monterey Food Corporation (MFC), a majority-owned subsidiary of SMPFC, acquired the subscription rights of certain individuals in HLC, a Philippine company engaged in livestock farming, processing, selling meat products (mainly pork and beef) and leasing of properties. As such, HLC became a subsidiary of MFC and was consolidated into SMPFC through MFC. On June 22, 2009, the respective BOD and stockholders of MFC and HLC approved the merger of HLC into MFC, with MFC as the surviving corporation. The consideration of the assignment of the subscription, net of the effect of the merger, amounted to ₱6.25. The SEC approved the merger on October 22, 2009. The BIR confirmed the tax-free merger of HLC into MFC in its certification No. S40-052-2009 dated December 18, 2009.

- *SMFI*

On May 1, 2009, the Parent Company ceased the operations of Centralized Key Accounts Group and transferred its receivables, inventories and fixed assets to SMFI for a total consideration of ₱2,353.

In August 2010, the SEC approved the merger of MFC into SMFI, with SMFI as the surviving corporation, following the approvals of the merger by the respective BOD and stockholders of MFC and SMFI in June 2010 and July 2010, respectively. The merger became effective September 1, 2010. SMFI's request for confirmation of the tax-free merger, filed in September 2010, is still pending with the BIR as at March 14, 2011.

- *SMMI*

Pursuant to the Deed of Assignment executed by SMFI and SMMI in 2005 transferring certain assets and liabilities of SMFI's Flour Division at historical book value of ₱1,646 in exchange for SMMI's shares to be effective January 1, 2006, and the SEC's approval of such transfer and SMMI's increase in its authorized

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capital stock on March 27, 2007, SMMI issued to SMFI 16,454,816 of its common shares on April 10, 2007 in exchange for the transfer of said assets and liabilities. SMFI subsequently declared as property dividend its shares in SMMI in favor of SMPFC.

In December 2010, the SEC approved the declaration of SMFI's 16,457,310 shares in SMMI as property dividend in favor of SMPFC. Prior to the SEC approval, a Deed of Assignment was executed by SMFI in January 2008 assigning its 16,457,310 shares in SMMI to SMPFC effective December 28, 2007.

- *PF-Hormel*

In December 2010, the BOD of PF-Hormel approved the declaration of cash dividends amounting to ₱450 million payable not later than January 31, 2011. Dividends payable to non-controlling interests of PF-Hormel amounting to ₱180 million was recognized as part of the Group's "Dividends payable" account in the statements of financial position. Dividends were subsequently paid in January 2011.

- *Philippine Nutrition Technologies, Inc. (PNTI)*

The SMPFC's application with the SEC for the dissolution of PNTI, a joint venture between SMPFC and the Great Wall Group of Taiwan, was approved on May 27, 2010. As a result of the said dissolution, SMPFC's investment in PNTI amounting to ₱12 was written off against its allowance for decline in value of investment.

Packaging

- *SMPPC and Mincorr*

On April 17, 2009, the Parent Company acquired Rengo Co. Ltd.'s 30% and 20% stake in SMPPC (then SMRPC) and Mincorr, respectively, for a total purchase price of ₱250. Subsequently, on April 29, 2009, the Parent Company acquired all the interests of Macondray Fibreboard Corporation in Mincorr for ₱27.1.

The acquisitions of the said interests by the Parent Company resulted in SMPPC and Mincorr becoming wholly-owned subsidiaries of the Parent Company in 2009.

SMRPC was renamed "San Miguel Paper Packaging Corporation", as approved by the SEC on September 3, 2009.

7. Segment Information

Operating Segments

The reporting format of the Group's operating segments is determined by the Group's risks and rates of return which are affected predominantly by differences in the products and services produced. The operating businesses are organized and managed separately according to the nature of the products produced and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The Group's reportable segments are beverage, food, packaging, power generation and distribution, fuel and oil, infrastructure and telecommunications.

The beverage segment produces and markets alcoholic and nonalcoholic beverages.

The food segment includes, among others, poultry, feeds production and selling, livestock farming, processing and selling of basic meat products, processing and marketing of refrigerated and canned meat products, manufacturing and marketing of flour product, premixes and flour-based products, dairy-based

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products, breadfill desserts, cooking oil, importation and marketing coffee and coffee-related products and processed meats.

The packaging segment is involved in the production and marketing of the following packaging products, among others, glass containers, glass molds, polyethylene terephthalate (PET) bottles and preforms, PET recycling, plastic closures, corrugated cartons, woven polypropylene, kraft sacks and paperboard, pallets, flexible packaging, plastic crates, plastic floorings, plastic films, plastic trays, plastic pails and tubs, crate and plastic pallet leasing, metal closures and two-piece aluminum cans, woven products, industrial laminates and radiant barriers. It is also involved in PET bottle filling graphics design, packaging research and testing, packaging development and consultation, contract packaging and trading.

The power generation and distribution segment is engaged in power generation and mining. The power generation assets supply electricity to a variety of customers, including the Manila Electric Company (Meralco), electric cooperatives, industrial customers and the Philippine Wholesale Electricity Spot Market (WESM).

The fuel and oil segment is engaged in refining and marketing of petroleum products.

The infrastructure segment is engaged in the business of construction and development of various infrastructure projects such as roads, highways, toll roads, freeways, skyways, flyovers, viaducts and interchanges.

The telecommunications segment is engaged in rendering all types of domestic and international telecommunications services.

Segment Assets and Liabilities

Segment assets include all operating assets used by a segment and consist principally of operating cash, receivables, inventories and property, plant and equipment, net of allowances and impairment. Segment liabilities include all operating liabilities and consist principally of accounts payable, wages, taxes currently payable and accrued liabilities. Segment assets and liabilities do not include deferred taxes.

Inter-segment Transactions

Segment revenues, expenses and performance include sales and purchases between operating segments. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transfers are eliminated in consolidation.

Major Customer

The Group does not have a single external customer from which sales revenue generated amounted to 10% or more of the total revenues of the Group.

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Operating Segments

Financial information about reportable segments follows:

For the Years Ended December 31, 2010, 2009 and 2008																				
Continuing Operations																		Discontinued Operations (Note 8)		
Power Generation and Fuel																				
Beverage		Food		Packaging		Infra-structure		Telecommu- nications		Others		Eliminations		Total						
2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008
Sales																				
Externalsales	P90,407	P82,735	P78,599	P80,415	P77,220	P73,830	P19,268	P14,258	P15,612	P10,383	P—	P—	P—	P—	P—	P—	P—	P246,109	P174,213	P168,041
Intersegment sales	139	1,067	—	3	15	50	4,172	5,413	4,246	246	—	—	—	(4,625)	(6,495)	(4,296)	—	—	—	
Totalsales	P90,546	P83,802	P78,599	P80,418	P77,235	P73,880	P23,440	P19,671	P19,858	P10,629	P—	P—	P—	P(4,625)	P(6,495)	P(4,296)	P246,109	P174,213	P168,041	
Result																				
Segmentresult	P19,194	P14,035	P14,556	P 5,905	P 4,559	P 865	P 1,999	P 1,562	P 1,315	P 679	P(73)	P(57)	P(2,727)	P(2,769)	P(2,216)	P 289	P 34,777	P 19,669	P 14,818	
Interest expense and financing charges																	(16,578)	(7,926)	(6,032)	
Interest income																	3,023	5,989	6,630	
Equity in net earnings (losses) of associates																	6,817	2,816	(1,132)	
Gain (loss) on sale of investments and property and equipment																	529	50,630	8,746	
Other income (charges) — net																	6,926	(6,843)	(2,271)	
Income tax benefit (expense)																	7	(11,438)	(3,706)	(6,091)
Gain (loss) from discontinued operations																	5,425	—	—	5,425
Net income																	P 24,056	P 60,629	P 20,083	
Attributable to:																				
Equity holders of the Parent Company																	P 20,091	P 57,799	P 19,348	
Non-controlling interests																	3,965	2,830	735	
Net income																	P 24,056	P 60,629	P 20,083	

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8. Assets Held for Sale and Discontinued Operations

Assets Held for Sale:

a. Petron Mega Plaza

Petron has an investment property consisting of office units located at Petron Mega Plaza which has a floor area of 21,216 square meters covering the 28th - 44th floors and 209 parking lots. On December 1, 2010, Petron's BOD approved the sale of these properties to provide cash flows for various projects. The carrying amount of the investment property as of December 31, 2010 of ₱823 is presented as "Assets held for sale" in the consolidated statement of financial position.

Total estimated fair value of the properties amounted to ₱1,242. Management expects to sell the properties within the next 12 months from the reporting date.

b. Bank of Commerce (BOC) (Note 13)

On February 15, 2010, SMPI's BOD authorized the divestment of SMPI's 31.23% interest in BOC. The carrying amount of the investment as of December 31, 2009 of ₱2,746 representing 16,396,689 common shares was presented as "Assets held-for-sale" in the consolidated statements of financial position.

In 2010, SMPI's management decided not to pursue the sale of its ownership interest in BOC and reclassified it back to "Investments and advances" account in the consolidated statements of financial position. The investment was valued at its adjusted carrying amount amounting to ₱2,746 which at the time of reclassification was also equivalent to its recoverable amount.

Discontinued Operations:

a. Agribusiness Division of the Parent Company

In 2008, the Parent Company ceased the operations of its Agribusiness Division, particular the operations of its Iligan Coconut Oil Mill.

b. San Miguel Australia Holdings Ltd. (SMAH)

On November 8, 2007, the Parent Company through San Miguel Beverages (L) Pte. Ltd. signed a definitive agreement to sell its SMAH shares including its premium Tasmanian brewer, J. Boag, to Lion Nathan Australia Pty. Ltd., an Australian alcoholic beverages company, for which enterprise value amounted to A\$325.

The closing audit was completed on January 2, 2008 and the Parent Company received A\$277 as payment of purchase price, net of adjustments. The Group recognized a gain of ₱5,425, net of deferred tax in 2008.

As required by PFRS 5, the financial performance of Agribusiness in 2008, was presented as a separate item under "Income after income tax from discontinued operations" in the consolidated statements of income.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The results of discontinued operations are presented below:

	<u>Note</u>	<u>2008</u>
Net sales		P 181
Cost of sales		<u>168</u>
Gross profit		13
Selling and administrative expenses		(23)
Other charges — net		<u>(9)</u>
Loss before income tax		(19)
Income tax benefit	25	<u>(7)</u>
Loss from discontinued operations		(12)
Gain on disposal of investment — net of tax of P2,921	25	<u>5,425</u>
Net income from discontinued operations, attributable to equity holders of the Parent Company	38	<u>P5,413</u>

Basic and diluted earnings per share from discontinued operations, attributable to equity holders of the Parent Company, are presented in Note 38.

Cash flows provided by discontinued operations are presented below:

	<u>2008</u>
Net cash flows provided by operating activities	P1,312
Net cash flows provided by investing activities	<u>7,786</u>
Net cash flows provided by discontinued operations	<u>P9,098</u>

The effect of disposal on the consolidated financial position follows:

	<u>2008</u>
Assets held for sale	P 5,324
Liabilities directly associated with assets held for sale	(3,642)
Amounts recognized directly in equity relating to assets held for sale	<u>(37)</u>
Net assets disposed of	<u>P 1,645</u>
Cash consideration received	<u>P 9,083</u>

9. Cash and Cash Equivalents

Cash and cash equivalents consist of:

	<u>2010</u>	<u>2009</u>
Cash in banks and on hand	P 17,344	P 25,926
Short-term investments	<u>107,844</u>	<u>183,485</u>
	<u>P125,188</u>	<u>P209,411</u>

Cash in banks earns interest at the respective bank deposit rates. Short-term investments include demand deposits which can be withdrawn at anytime depending on the immediate cash requirements of the Group, and earn interest at the respective short-term investment rates.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

10. Trade and Other Receivables

Trade and receivables consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Trade		₱39,112	₱17,188
Non-trade	35,40	30,072	31,453
Amounts owed by related parties	34	11,239	3,170
		80,423	51,811
Less allowance for impairment losses		4,519	2,729
	41,42	₱75,904	₱49,082

Trade receivables are non-interest bearing and are generally on a 30 to 45-day term.

The movements in the allowance for impairment losses are as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year		₱2,729	₱2,884
Charges for the year		697	398
Amounts written off		(257)	(257)
Acquisition of subsidiaries	5	965	—
Reversals and others	—	385	(296)
Balance at end of year		₱4,519	₱2,729

As at December 31, 2010 and 2009, the aging of receivables is as follows:

<u>2010</u>	<u>Total</u>	<u>Trade</u>	<u>Non-Trade</u>	<u>Owed by Related Parties</u>
Current	₱72,754	₱33,202	₱28,313	₱11,239
Past due				
Less than 30 days	2,625	2,413	212	—
30-60 days	1,067	849	218	—
61-90 days	476	387	89	—
Over 90 days	<u>3,501</u>	<u>2,261</u>	<u>1,240</u>	<u>—</u>
	₱80,423	₱39,112	₱30,072	₱11,239
<u>2009</u>	<u>Total</u>	<u>Trade</u>	<u>Non-Trade</u>	<u>Owed by Related Parties</u>
Current	₱43,988	₱11,142	₱29,676	₱3,170
Past due				
Less than 30 days	2,609	2,334	275	—
30-60 days	789	613	176	—
61-90 days	804	729	75	—
Over 90 days	<u>3,621</u>	<u>2,370</u>	<u>1,251</u>	<u>—</u>
	₱51,811	₱17,188	₱31,453	₱3,170

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Various collaterals for trade receivables such as bank guarantees, time deposit and real estate mortgages are held by the Group for certain credit limits.

The Group believes that the unimpaired amounts that are past due by more than 30 days are still collectible, based on historic payment behavior and extensive analyses of the underlying customer credit ratings. There are no significant changes in their credit quality.

The Parent Company has outstanding advances to San Miguel Corporation Retirement Plan (SMCRP) amounting to ₱3,997 and ₱2,785 as of December 31, 2010 and 2009, respectively, subject to interest of 6.5% per annum (Note 34). Interest pertaining to the said advances amounted to ₱82, ₱639 and ₱2,310 for the years ended December 31, 2010, 2009 and 2008, respectively (Note 32).

11. Inventories

Inventories at net realizable value consist of:

	<u>2010</u>	<u>2009</u>
Finished goods and goods in process (including petroleum products)	₱37,402	₱ 8,547
Materials and supplies (including coal)	18,427	15,355
Containers	<u>1,613</u>	<u>1,556</u>
	<u>₱57,442</u>	<u>₱25,458</u>

The cost of finished goods and goods in process amounted to ₱37,637 and ₱8,877 as of December 31, 2010 and 2009, respectively.

If the Group used the moving-average method (instead of the first-in, first-out method, which is the Group's policy), the cost of petroleum, crude oil and other products would have decreased by ₱715 as of December 31, 2010.

The cost of materials and supplies as of December 31, 2010 and 2009 amounted to ₱19,185 and ₱15,879, respectively.

Containers at deposit value amounted to ₱1,917 and ₱1,851 as of December 31, 2010 and 2009, respectively.

Finished goods and goods in process include net unrealized gain of ₱41 and ₱63 on fair valuation of agricultural produce as of December 31, 2010 and 2009, respectively (Note 4). The fair value of agricultural produce less costs to sell, which formed part of finished goods inventory, amounted to ₱416 and ₱287 as of December 31, 2010 and 2009, respectively, with corresponding cost at point of harvest amounting to ₱375 and ₱224, respectively.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

12. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Prepaid taxes and licenses		₱10,539	₱4,180
Raw land inventory and real estate projects		3,675	3,062
Prepaid rent		314	46
Derivative assets	41,42	249	202
Retirement assets — current portion	36	221	150
Prepaid interest		212	—
Prepaid insurance		198	66
Financial assets at FVPL	41,42	193	—
Construction in progress — service concession arrangements	4	119	—
Others		<u>1,194</u>	<u>1,185</u>
		<u>₱16,914</u>	<u>₱8,891</u>

“Others” consist of advances to officers and employees and prepayments for various operating expenses.

Construction in progress — service concession arrangements includes the Group’s accumulated costs incurred on the design of the upgrade component of the development of the Caticlan Airport (the “Project”) as described in Note 35, cost of a parcel of land earmarked for such upgrade and the present value of the obligation to maintain and restore the Caticlan Airport prior to transfer to the ROP at the end of the concession period. This will be transferred and recognized as cost of construction upon commencement of the construction of the new terminal and runway (Note 4). The interest expense related to the IRO (Note 24) in 2010 amounting to ₱0.9 was recognized and presented as part of “Interest expense and other financing charges” in the consolidated statements of income.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

13. Investments and Advances

Investments and advances consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Investments in associates — at equity:			
Acquisition cost			
Balance at beginning of year		P 36,461	P32,826
Additions		97,017	6,794
Acquisition of subsidiaries	5	15,383	—
Transfer to (from) assets held for sale	8	3,159	(3,159)
Disposals and reclassifications		(4)	—
		<u>152,016</u>	<u>36,461</u>
Accumulated equity in net earnings (losses):			
Balance at beginning of year		1,388	(1,163)
Equity in net earnings during the year		6,817	2,816
Dividends		(2,338)	(752)
Reclassification of investment in associate to investment in subsidiaries	5	(5,095)	—
Accumulated equity on investments transferred to (from) assets held for sale	8	(413)	413
Share in other comprehensive gains (losses)		(422)	252
Acquisition of subsidiaries		(154)	—
Impairment loss and others	33	—	(178)
Balance at end of year		<u>(217)</u>	<u>1,388</u>
		151,799	37,849
Advances		<u>1,015</u>	<u>1,156</u>
		<u>P152,814</u>	<u>P39,005</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The carrying amounts of investments in associates are as follows:

	Country of Incorporation	2010		2009	
		Percentage of Ownership	Amount	Percentage of Ownership	Amount
Top Frontier Investment Holdings, Inc (Top Frontier)	Philippines	49.00	P 92,480	—	P —
Meralco	Philippines	33.19	45,309	27.00	32,029
BOC	Philippines	32.77	6,253	31.23	—
LTHI	Philippines	41.48	3,525	32.70	3,714
Eastern Telecoms	Philippines	40.00	1,600	—	—
Private Infra Dev Corporation (PIDC) . . .	Philippines	35.00	1,581	35.00	1,575
Petrochemical Asia (HK) Limited (PAHL)	Hong Kong	33.00	591	—	—
Northpine Land, Inc.	Philippines	20.00	247	20.00	237
Limay Energen Corp. (LEC)	Philippines	40.00	213	—	—
SMEC	Philippines	—	—	40.00	294
			P151,799		P37,849

Following are the unaudited condensed and combined financial information of the associates:

	2010	2009	2008
Current assets	P355,184	P100,853	P 93,633
Current liabilities	151,072	140,332	131,582
Noncurrent assets	197,516	297,501	172,880
Noncurrent liabilities	110,527	182,838	82,829
Revenue	253,289	194,795	198,577
Net income (loss)	19,290	8,262	(3,493)

a. Top Frontier

On January 6, 2010, the Parent Company acquired a 49% stake via equity infusion in Top Frontier consisting of its subscription to 2,401,960 common shares of Top Frontier from its unissued capital stock. On January 7, 2010, the Parent Company paid P48,324 as deposit for future subscription in connection with the option granted to the Parent Company to apply the same to the subscription of 2,598,040 non-voting, redeemable, participating preferred shares of Top Frontier upon the increase in its authorized capital stock, amendment of its Articles of Incorporation and Top Frontier's compliance with its obligations related to the aforementioned investment.

The application for the increase in the authorized capital stock of Top Frontier was approved by the SEC on August 6, 2010.

The stock certificates covering the investment by the Parent Company in the 2,598,040 preferred shares of Top Frontier were issued in the name of the Parent Company on October 22, 2010.

The preferred shares are entitled to preferential dividends at a fixed rate per annum of 3% of the issue price which shall be payable quarterly in arrears and in cash. The dividends on the preferred shares shall be cumulative from and after the issue date of the preferred shares.

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The preferred shares are non-voting and participating. These are redeemable in whole or in part, at the sole option of Top Frontier, equal to its issue price plus any accrued and unpaid preferential dividends, upon notice to the holders.

b. Meralco

On October 27, 2008, the Parent Company entered into a sale and purchase agreement with the GSIS to acquire the latter's 300,963,189 shares in Meralco for a total consideration of ₱27,087 plus an additional fixed term interest of ₱3,758. On November 10, 2008, the Parent Company paid ₱5,417 representing down payment for said shares with the balance payable in three (3) years.

On August 9, 2010, the Parent Company's beneficial interest in Meralco increased by 6.19% upon acquisition of SMC Global, which owns 69,059,538 common shares of Meralco for a total consideration of ₱7,063, inclusive of transaction costs of ₱46. SMC Global paid ₱1,243 representing down payment for the said shares with balance payable in three (3) years.

The current portion of the Group's outstanding payable related to the purchase of Meralco shares as of December 31, 2010 and 2009 amounted to ₱14,019 and ₱6,527, respectively, included under "Accounts payable and accrued expenses" account, while the noncurrent portion amounting to ₱14,253 and ₱18,148 as of December 31, 2010 and 2009, respectively, is reported as part of "Other noncurrent liabilities" account.

The fair value of the Group's investment in Meralco amounted to ₱84,365 and ₱61,396 as of December 31, 2010 and 2009, respectively.

c. BOC

In 2008 and 2007, SMPI made a series of acquisitions of BOC shares and at the end of 2008, SMPI has acquired a total of 11,749,779 shares amounting to ₱1,749 and equivalent to 30% equity ownership interest in BOC. In 2009, SMPI subscribed to additional shares of BOC for a total consideration of ₱1 thereby increasing its equity ownership interest from 30% to 31.23% as of December 31, 2009. However, in the same year, SMPI's management decided to sell SMPI's entire ownership interest in BOC and reclassified the asset to "Assets held-for-sale" in the consolidated statements of position (Note 8).

In 2010, SMPI management decided not to pursue the sale of its ownership interest in BOC and reclassified it back to "Investments and advances" and made further acquisitions of BOC shares.

In 2010, SMPI acquired additional 20,383,210 shares amounting to ₱3,562 from various stockholders of BOC. These acquisitions increased SMPI's equity ownership interest in BOC to 32.77% as of December 31, 2010. Of the total acquisition cost, ₱1,800 and ₱542 were paid by SMCRP and Parent Company in behalf of SMPI. These amounts remained unpaid as of December 31, 2010 (Note 34). The unpaid subscription to BOC arising from the same transaction and amounting to ₱521 as of December 31, 2010, is presented as part of "Accounts payable and accrued expenses" account in the consolidated statements of financial position (Note 22).

As of December 31, 2010, SMPI also has pending share purchase transactions with certain other stockholders of BOC, for the acquisition of sufficient number of shares to increase further of SMPI's equity interest in BOC to 33.86%. Pending consummation of the shares purchase transactions, advance payments made by SMPI to the sellers amounting to ₱221 as of December 31, 2010 were presented as advances for acquisition of additional BOC shares under the "Investment and advances" account in the consolidated statements of financial position. Accordingly, this was not considered in the determination of SMPI's percentage of equity interest in BOC.

Share in BOC's accumulated fair value gains (losses) amounted to (₱201) and ₱54 in 2010 and 2009, respectively, and are presented as part of "Share in comprehensive income (losses) of associates" account in

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the consolidated statements of comprehensive income. Additionally, share in BOC's translation adjustment for losses and gains amounted to ₱8 and ₱9 in 2010 and 2009, respectively. As of December 31, 2010, cumulative translation adjustments for gains amounted to ₱1 and ₱9 in 2010 and 2009, and are presented as "Cumulative translation adjustments" in the consolidated statements of changes in equity.

Certain accounting policies applied by BOC in the preparation of its financial statements are not in accordance with PFRS. In computing for the equity in net earnings (losses) and comprehensive income (losses) of BOC, SMPI made adjustments to the 2010 and 2009 audited financial statements of BOC to conform with BOC's accounting policies with PFRS and make them consistent with the Group's accounting policies. The adjustments made by SMPI relate to the correction of: (a) inadequate reserves on non-performing assets, investment properties and financial assets; (b) deferral of losses on sale of non-performing loans; and (c) misstatement in the values of structured financial instruments and certain investment properties.

BOC is required to meet certain ratios under Bangko Sentral ng Pilipinas (BSP) regulations to manage the risks inherent in the banking business. As of December 31, 2010 and 2009, BOC has complied with the statutory and regulatory capital requirements which were computed based on the regulatory accounting policies that differ from PFRS in some aspects. BOC's retained earnings as of December 31, 2010 and 2009 is restricted from being declared as dividend to common stockholders to the extent of the amount of cumulative cash dividend in arrears of ₱320 declared by BOC's BOD on December 16, 2008 in favor of stockholders of certain redeemed preferred shares. The dividend declaration is pending approval from the BSP as of December 31, 2010 and 2009.

Based on the adjusted account balances of BOC as of December 31, 2009, management determined that the carrying amount of the investment is not fully recoverable, thus, an impairment loss on the investment amounting to ₱163 was recognized and is included in "Other income (charges)" account (Note 33). No impairment loss on the investment was recognized in 2010 and 2008.

d. LTHI

On July 8, 2009, Vega, a wholly-owned subsidiary of the Parent Company, acquired 579,111,669 common shares of LTHI from LTHI's existing stockholders for a total consideration of ₱2,041.

On July 21, 2009, Vega entered into a subscription agreement with LTHI for the subscription of 587,951,737 voting, nonredeemable and participating preferred shares out of the proposed increase in the authorized capital stock of LTHI at an issue price of ₱3.00 per share or approximately ₱1,764. As of December 31, 2009, Vega paid ₱735 as deposit for the subscription.

On January 5, 2010, Vega paid ₱588 as additional deposit for the subscription of LTHI's preferred shares.

The application for the increase in the authorized capital stock of LTHI was approved by the SEC on January 18, 2010.

On April 8, 2010, Vega paid the remaining subscription payable on LTHI's preferred shares amounting to ₱441.

The transaction was completed with a stock certificate covering the said preferred shares issued in the name of Vega on May 26, 2010.

On October 5, 2010, Vega also acquired from the public a total of 64,589,000 common shares of LTHI amounting to ₱221.

The fair value of the Group's capital stock investment in LTHI amounted to ₱4,152 and ₱1,564 as of December 31, 2010 and 2009, respectively.

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e. PIDC

On September 11, 2009, Rapid, a wholly-owned subsidiary of SMHC, acquired 35% stake in PIDC, a consortium of construction companies behind the Tarlac-Pangasinan-La Union Expressway Project. Rapid subscribed to 1,575,000 common shares of PIDC amounting to ₱1,575 and paid a portion of the subscription price amounting to ₱245 and ₱561 on November 30, 2010 and September 11, 2009, respectively.

f. PAHL

On March 13, 2010, Petron acquired 182,000,000 ordinary shares or 40% of the outstanding shares of PAHL from Vantage Stride (Mauritius) Limited (“Vantage Stride”).

PAHL is a company incorporated in Hong Kong. It has an authorized capital of Hong Kong Dollar (HK\$)585, consisting of 585,000,000 shares at HK\$1.00 per share. Of this, 455,000,000 shares are outstanding. Silverdale (Suisse), S.A. holds the remaining 60% of the outstanding shares of PAHL.

PAHL was incorporated in March 2008 and indirectly owns, among other assets, a 160,000 metric ton-polypropylene production plant in Mariveles, Bataan.

In June 2010, another investor acquired 102,142,858 new Class “B” ordinary shares of PAHL which reduced Petron’s ownership to 33%.

PAHL’s business operation is expected to commence in the first quarter of 2011.

g. LEC

On August 3, 2010, Petron together with Two San Isidro SIAI Assets, Inc. (Two San Isidro), formed LEC with an authorized capital stock of ₱3,400. Out of its authorized capitalization, ₱850 has been subscribed, of which ₱213 has been paid up. Petron subscribed to ₱340 worth of shares of LEC representing 40% of the total subscribed capital, while Two San Isidro subscribed to ₱510 worth of shares of LEC, representing the remaining 60% of the total subscribed capital.

LEC was formed to build, operate and maintain a cogeneration power plant that will engage in a generation of power and steam for the primary purpose of supplying the steam and power requirements of Petron Bataan Refinery.

h. SMPI Advances

IGI

In June 2009, SMPI entered into a JVA with certain individuals and corporations (collectively referred to as Co-Venturer) to transfer title of the properties and develop and later operate the properties into a mixed commercial and residential estate. On July 28, 2009, as part of the terms of the JVA, IGI was incorporated with an authorized capital stock of ₱1,000 divided into 1,000,000,000 common shares with a par value of ₱1.00 per share. On the same date, the Co-Venturer subscribed to 600,000,000 common shares of IGI for ₱600.

Pursuant to the terms and conditions of the JVA, SMPI made cash advances in favor of the Co-Venturer amounting to ₱311 as of December 31, 2009. Under a Deed of Assignment, such advances will be applied as payment for SMPI’s subscription to sufficient number of IGI shares of stock to give SMPI a 51% ownership interest in IGI. In 2010, the Deed of Assignment between SMPI and the Co-Venturer was consummated and SMPI became the parent company of IGI. Accordingly, the balance of its advances earmarked for such subscription was applied to the subscription price.

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Primeria Comercio Holdings, Inc. (PCHI)

In 2009, SMPI provided US dollar-denominated non-interest bearing cash advances to PCHI, a future investee of SMPI, amounting to ₱794 as of December 31, 2010 and 2009. These advances will be applied against future subscriptions of SMPI to the shares of stock of PCHI.

14. Available-for-sale Financial Assets

Available-for-sale financial assets consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Equity securities		₱2,292	₱103
Government securities		1,049	—
Proprietary membership shares and others		256	248
	<i>41, 42</i>	<u>₱3,597</u>	<u>₱351</u>

Acquisition of Indophil Resources NL (Indophil)

On October 8, 2010, the Parent Company entered into a share placement agreement with Indophil to subscribe to 48,016,960 common shares (Placement Shares) equivalent to approximately 10.1% of the currently issued common shares of Indophil, on a fully diluted basis.

Indophil is an Australian company listed in the Australian stock exchange, which owns a 37.5% beneficial interest in Sagitarius Mines, Inc. (SMI). SMI has the rights to the Tampakan gold and copper mine in South Cotabato.

On October 15, 2010, the Placement Shares were issued in the name of Coastal View Exploration Corporation, a subsidiary of SMHC. The total consideration for the purchase of the Placement Shares was A\$41.3 (approximately US\$40) or A\$0.86 per Placement Share.

As of December 31, 2010, the fair value of the investment in Indophil amounted to ₱2,188.

Government Securities

This account consists of investments in government securities of Petrogen and ROP9 bonds of Ovincor. Petrogen's investments bear fixed annual interest rates of 6.25% to 8.875% in 2010.

Ovincor's ROP9 bonds are maintained at the Bank of Bermuda with fixed interest rate of 8.3% to 8.9% and will mature in March 2015.

15. Interest in a Joint Venture

On August 27, 2008 and September 11, 2008, GSMI incorporated GBHL and SHL, respectively, as wholly-owned subsidiaries. GSMI subscribed to 1,000 shares of GBHL at par value of US\$1.00 per share for a total subscription value of US\$0.001 (₱0.05) and 1,000 shares of SHL at par value of US\$1.00 per share for a total subscription value of US\$0.001 (₱0.05). Both entities are established as holding companies for the acquisition of additional investment in Thai San Miguel Liquor Co. Ltd. (TSML) and Thai Ginebra Trading (TGT), both a joint venture by GSMI with Thai Life Group of Companies.

On October 14, 2008, GSMI, through SHL, acquired 24,500 shares representing 49% ownership of the outstanding shares of Siam Wine and Liquor Limited (SWL), a limited company organized under the laws of Thailand, for Thailand Baht THB2 (₱3). On the same date, SWL acquired 1,000,000 shares representing 10% ownership of the outstanding capital stock of TSML for THB106.48 (₱148). SHL's share on the share

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purchase is THB52.2 (₱72) for 490,000 shares at THB108.68 per share representing 4.9% ownership. Accordingly, GSMI group's share in TSML increased from 40% to 44.9%.

On October 14, 2008, GSMI advanced a total amount of US\$3 (₱147) to GBHL. On October 10, 2008, GBHL ("Lender") entered into a loan agreement with SWL ("Borrower") for the same amount, to finance the latter's working capital requirements and purchase of additional shares in TSML and TGT.

On March 9, 2009 and December 11, 2009, SHL ("Lender") entered into a loan agreement with SWL ("Borrower") for THB15 and THB10, respectively, to subscribe to the increase in capital stock of TSML.

On February 25, April 8 and December 7, 2010, the Lender entered into a loan agreement with the Borrower for a total of THB40 to subscribe to the increase in capital stock of TSML.

Presented below is the Group's share in the assets, liabilities, income and expenses of the joint venture as of and for the years ended December 31, 2010, 2009 and 2008 of TSML which is included in the Group's consolidated financial statements:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current assets	₱777	₱556	₱459
Noncurrent assets	894	896	911
Current liabilities	437	409	288
Noncurrent liabilities	310	416	526
Revenue	893	474	402
Cost of sales	826	397	398
Operating expenses	63	136	70
Other income	7	1	1
Net income (loss)	(11)	59	(65)

The Group's share in the cash flows of TSML for the years ended December 31, 2010, 2009 and 2008 are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net cash flows provided by (used in) operating activities	₱(259)	₱ (69)	₱ 88
Net cash flows provided by (used in) investing activities	792	17	(70)
Net cash flows used in financing activities	(106)	(111)	(20)

On October 14, 2008, SWL acquired 5,000 shares representing 10% ownership of the outstanding capital stock of TGT for THB0.5 (₱0.7). SHL's share on the share purchase is THB0.2 (₱0.3) for 2,450 shares at THB100.00 per share representing 4.9% ownership. Accordingly, the GSMI group's share in TGT increased from 40% to 44.9%.

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Presented below is the Group's share in the assets, liabilities, income and expenses of the joint venture as of and for the years ended December 31, 2010, 2009 and 2008 of TGT which is included in the Group's consolidated financial statements:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current assets	P 50	P102	P142
Noncurrent assets	14	30	44
Current liabilities	276	237	216
Noncurrent liabilities	2	16	29
Revenue	232	228	153
Cost of sales	207	206	121
Operating expenses	111	80	92
Other income	1	2	1
Net loss	85	57	60

The Group's share in the cash flows of TGT for the years ended December 31, 2010, 2009 and 2008 is as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net cash flows provided by (used in) operating activities	P(50)	P 1	P 18
Net cash flows provided by (used in) investing activities	27	14	(43)
Net cash flows provided by (used in) financing activities	(21)	(13)	29

TSML and TGT both started commercial operations in March 2008.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

16. Property, Plant and Equipment

Property, plant and equipment consist of:

Cost:	Land and Land Improvements	Buildings and Improvements	Power Plants	Refinery and Plant Equipment	Service Stations and Other Equipment	Machinery and Equipment	Transportation Equipment	Tools and Small Equipment	Office Equipment, Furniture and Fixtures	Molds	Leasehold Improvements	Construction in Progress	Total
December 31, 2008	P 9,189	P23,973	P	P	P	P77,345	P2,920	P1,854	P2,606	P 527	P 840	P5,379	P124,633
Additions	424	897	—	—	—	2,766	729	210	126	144	115	838	6,249
Disposals/reclassifications/ acquisition of subsidiaries	977	(245)	—	—	—	(781)	(349)	315	(190)	(17)	(35)	(513)	(838)
Currency translation adjustments	37	(219)	—	—	—	(439)	5	(25)	—	3	1	(30)	(667)
December 31, 2009	10,627	24,406	—	—	—	78,891	3,305	2,354	2,542	657	921	5,674	129,377
Additions	437	561	568	—	364	3,073	3,170	285	129	267	73	(409)	8,518
Disposals/reclassifications/ acquisition of subsidiaries	4,136	7,642	214,331	37,286	4,955	5,340	2,148	(334)	1,532	(219)	243	838	277,898
Currency translation adjustments	77	(385)	—	—	—	(539)	(8)	22	(9)	(3)	—	(6)	(851)
December 31, 2010	15,277	32,224	214,899	37,286	5,319	86,765	8,615	2,327	4,194	702	1,237	6,097	414,942
Accumulated depreciation and amortization:													
December 31, 2008	1,054	6,199	—	—	—	38,076	2,027	1,510	2,157	403	334	—	51,760
Additions	83	721	—	—	—	3,696	226	139	182	161	46	—	5,254
Disposals/reclassifications/ acquisition of subsidiaries	7	(132)	—	—	—	(732)	(270)	42	(166)	(55)	(9)	—	(1,315)
Currency translation adjustments	10	(57)	—	—	—	(156)	4	(23)	5	2	1	—	(214)
December 31, 2009	1,154	6,731	—	—	—	40,884	1,987	1,668	2,178	511	372	—	55,485
Additions	109	745	2,464	86	42	3,630	240	168	161	157	75	—	7,877
Disposals/reclassifications/ acquisition of subsidiaries	1,197	3,358	3,147	16,459	3,700	3,015	170	(203)	1,252	(125)	107	—	32,077
Currency translation adjustments	2	(102)	—	—	—	(199)	(8)	58	(6)	(33)	1	—	(287)
December 31, 2010	2,462	10,732	5,611	16,545	3,742	47,330	2,389	1,691	3,585	510	555	—	95,152

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	Land and Land Improvements	Buildings and Improvements	Power Plants	Refinery and Plant Equipment	Service Stations and Other Equipment	Machinery and Equipment	Transportation Equipment	Tools and Small Equipment	Office Furniture and Fixtures	Molds	Leasehold Improvements	Construction in Progress	Total
Accumulated impairment losses:													
December 31, 2008	P —	P 1,090	P —	P —	P —	P 3,442	P 1	P 10	P 15	P 2	P —	P —	P 4,560
Additions for the year	208	1,571	—	—	—	1,852	6	3	6	—	—	—	3,646
Disposals/reclassifications/ acquisition of subsidiaries	—	(280)	—	—	—	210	—	—	(1)	—	—	—	(71)
Currency translation adjustments	—	(68)	—	—	—	(94)	(1)	—	—	1	—	—	(162)
December 31, 2009	—	2,313	—	—	—	5,410	6	13	20	3	—	—	7,973
Additions for the year	—	1,574	—	—	—	2,248	6	—	20	—	—	—	3,848
Disposals/reclassifications/ acquisition of subsidiaries	204	(5)	—	—	—	(138)	—	7	2	(2)	—	—	68
Currency translation adjustments	—	(53)	—	—	—	(117)	—	—	(1)	(1)	—	—	(172)
December 31, 2010	412	3,829	—	—	—	7,403	12	20	41	—	—	—	11,717
Net book value:													
December 31, 2009	P 9,265	P15,362	P —	P —	P —	P32,597	P1,312	P673	P344	P143	P549	P5,674	P 65,919
December 31, 2010	P12,403	P17,663	P209,288	P20,741	P1,577	P32,032	P6,214	P616	P568	P192	P682	P6,097	P308,073

Depreciation, amortization and impairment losses recognized in profit or loss amounted to ₱11,725, ₱8,900 and ₱4,933 in 2010, 2009 and 2008, respectively (Notes 29 and 33). These amounts include annual amortizations of capitalized interest amounting to ₱2 in 2010, 2009 and 2008.

The Group has interest amounting to ₱15 and ₱6 which were capitalized to machinery and equipment in 2010 and 2009, respectively. The capitalization rate used to determine the amount of interest eligible for capitalization was 5.73% in 2010 and 5.96% in 2009. As of December 31, 2010 and 2009, the unamortized capitalized borrowing costs amounted to ₱97 and ₱94, respectively.

The carrying amount of power plants and transportation equipment under finance lease amounted to ₱209,301 and ₱30 as of December 31, 2010 and 2009, respectively (Note 35).

In 2008, the Group, through SMP1, sold its parcel of land, including improvements located along Aurora Boulevard, Quezon City for a total consideration of ₱1,616. The gain recognized by the Group relating to the sale amounting to ₱1,562, is presented as part of “Gain on sale of investments and property and equipment” in the consolidated statements of income.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Land and land improvements include a 144-hectare property in Bukidnon, acquired by SMFI in 2002, which later became the subject of a petition for revocation of conversion order filed by MAPALAD, a group of Sumilao farmers, with the Department of Agrarian Reform (DAR), and appealed to the Office of the President (OP). Total acquisition and development costs included in the account as of December 31, 2008 amounted to ₱37.

To settle the land dispute, a Memorandum of Agreement (MOA) was executed between SMFI, MAPALAD, OP and DAR on March 29, 2008. The MOA provided for the release of a 50-hectare portion of the property to qualified farmer-beneficiaries, and the transfer of additional 94 hectares outside of the property to be negotiated with other Sumilao landowners. Under the MOA, SMFI shall retain ownership and title to the remaining portion of the property for the completion and pursuit of the hog farm expansion.

SMFI fully complied with all the provisions of the MOA in October 2010. To formally close the pending cases filed by MAPALAD with the Supreme Court and OP, SMFI forwarded in November 2010 to the Sumilao farmers' counsels the draft of the Joint Manifestation and Motion for Dismissal for their concurrence. As of March 14, 2011, finalization of the Joint Manifestation and Motion for Dismissal is still ongoing.

The cost of farm improvements, buildings, machinery and equipment and construction in progress incurred for Monterey's hog farm expansion project situated in Sumilao amounted to ₱889 and ₱676 in 2010 and 2009, respectively.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

17. Investment Properties

The movements in investment properties, including the effects of currency translation adjustments are as follows:

	<u>Land and Land Improvements</u>	<u>Buildings and Improvements</u>	<u>Machinery and Equipment</u>	<u>Tools and Small Equipment</u>	<u>Total</u>
Cost:					
December 31, 2008	P1,765	P671	P1,013	P 9	P3,458
Additions/reclassifications	71	7	—	—	78
Disposals	(2)	(38)	—	—	(40)
Currency translation adjustments	<u>7</u>	<u>(11)</u>	<u>—</u>	<u>—</u>	<u>(4)</u>
December 31, 2009	1,841	629	1,013	9	3,492
Additions/reclassifications	289	28	2	—	319
Disposals	(3)	(39)	—	—	(42)
Currency translation adjustments	<u>31</u>	<u>(18)</u>	<u>—</u>	<u>—</u>	<u>13</u>
December 31, 2010	<u>2,158</u>	<u>600</u>	<u>1,015</u>	<u>9</u>	<u>3,782</u>
Accumulated depreciation:					
December 31, 2008	73	222	901	9	1,205
Additions	8	11	15	—	34
Disposals/reclassifications	—	(7)	—	—	(7)
Currency translation adjustments	<u>—</u>	<u>(3)</u>	<u>—</u>	<u>—</u>	<u>(3)</u>
December 31, 2009	81	223	916	9	1,229
Additions	8	22	13	—	43
Disposals/reclassifications	—	(6)	—	—	(6)
Currency translation adjustments	<u>(2)</u>	<u>(6)</u>	<u>—</u>	<u>—</u>	<u>(8)</u>
December 31, 2010	<u>87</u>	<u>233</u>	<u>929</u>	<u>9</u>	<u>1,258</u>
Accumulated impairment losses:					
December 31, 2008	342	73	—	—	415
Additions	3	—	—	—	3
Disposals	—	(24)	—	—	(24)
Currency translation adjustments	<u>4</u>	<u>(2)</u>	<u>—</u>	<u>—</u>	<u>2</u>
December 31, 2009	349	47	—	—	396
Additions	—	—	—	—	—
Disposals/reclassifications	(6)	(11)	—	—	(17)
Currency translation adjustments	<u>13</u>	<u>(1)</u>	<u>—</u>	<u>—</u>	<u>12</u>
December 31, 2010	<u>356</u>	<u>35</u>	<u>—</u>	<u>—</u>	<u>391</u>
Net book value:					
December 31, 2009	<u>P1,411</u>	<u>P359</u>	<u>P 97</u>	<u>P—</u>	<u>P1,867</u>
December 31, 2010	<u>P1,715</u>	<u>P332</u>	<u>P 86</u>	<u>P—</u>	<u>P2,133</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Impairment losses amounting to ₱3 in 2009 is included under “Other income (charges)” account in the consolidated statements of income (Note 33). No impairment loss was recognized in 2010.

There are no other direct selling and administrative expenses other than depreciation and real property taxes arising from investment properties that generated income in 2010, 2009 and 2008.

18. Biological Assets

Biological assets consist of poultry, hogs and cattle as follows:

	<u>2010</u>	<u>2009</u>
Current:		
Growing stocks	₱2,559	₱2,309
Goods in process	<u>708</u>	<u>216</u>
Total Current	3,267	2,525
Noncurrent breeding stocks — net.	<u>1,479</u>	<u>1,847</u>
	<u>₱4,746</u>	<u>₱4,372</u>

The amortization of breeding stocks recognized in profit or loss amounted to ₱1,081, ₱909 and ₱863 in 2010, 2009 and 2008, respectively.

Growing stocks pertain to growing broilers, hogs and cattle and goods in process pertain to hatching eggs and carcass.

The movements in biological assets, including the effects of foreign exchange adjustments are as follows:

	<u>2010</u>	<u>2009</u>
Gross:		
Balance at beginning of year	₱ 4,598	₱ 6,767
Increase (decrease) due to:		
Purchases	13,101	13,391
Production	11,308	11,147
Mortality	(414)	(492)
Sales	(4,693)	(7,535)
Harvest	(17,884)	(15,957)
Currency translation adjustments	<u>(1,006)</u>	<u>(2,723)</u>
Balance at end of year	<u>5,010</u>	<u>4,598</u>
Accumulated amortization:		
Balance at beginning of year	226	2,021
Additions	1,081	909
Disposals and others	<u>(1,043)</u>	<u>(2,704)</u>
Balance at end of year	<u>264</u>	<u>226</u>
Net book value	<u>₱ 4,746</u>	<u>₱ 4,372</u>

The Group harvested approximately 392.2 million and 348.1 million kilograms of grown broilers, in 2010 and 2009, respectively, and 0.35 million and 0.78 million heads of marketable hogs and cattle in 2010 and 2009, respectively.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

19. Goodwill and Other Intangible Assets

The movements in goodwill, including effects of currency translation adjustments are as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year		P 6,408	P5,201
Additions	5	24,456	1,296
Impairment	33	(461)	(33)
Currency translation adjustments		(152)	(56)
Balance at end of year		<u>P30,251</u>	<u>P6,408</u>

The movements in other intangible assets with indefinite useful lives, including the effects of currency translation adjustments are as follows:

	<u>Note</u>	<u>Trademarks and Brand Names</u>	<u>Licenses</u>	<u>Formulas and Recipes</u>	<u>Total</u>
Cost:					
December 31, 2008		P 2,251	P —	P58	P2,309
Currency translation adjustments		<u>21</u>	<u>—</u>	<u>—</u>	<u>21</u>
December 31, 2009		2,272	—	58	2,330
Additions and acquisition of subsidiaries . . .	5	—	5,221	—	5,221
Disposals and reclassifications		(1,839)	1,917	—	78
Currency translation adjustments		<u>(3)</u>	<u>—</u>	<u>—</u>	<u>(3)</u>
December 31, 2010		<u>430</u>	<u>7,138</u>	<u>58</u>	<u>7,626</u>
Accumulated amortization and impairment losses:					
December 31, 2008		—	—	—	—
Additions	33	133	—	—	133
December 31, 2009		133	—	—	133
Additions	33	64	—	—	64
Currency translation adjustments		<u>(7)</u>	<u>—</u>	<u>—</u>	<u>(7)</u>
December 31, 2010		<u>190</u>	<u>—</u>	<u>—</u>	<u>190</u>
Net book value:					
December 31, 2009		<u>P 2,139</u>	<u>P —</u>	<u>P58</u>	<u>P2,197</u>
December 31, 2010		<u>P 240</u>	<u>P7,138</u>	<u>P58</u>	<u>P7,436</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The movements in other intangible assets with finite useful lives, including the effects of currency translation adjustments are as follows:

	<u>Note</u>	<u>Service Concession Rights</u>	<u>Licenses</u>	<u>Mining Rights</u>	<u>Land Use Rights</u>	<u>Others</u>	<u>Total</u>
Cost:							
December 31, 2008.		P—	P118	P —	P1,820	P618	P2,556
Additions		—	—	—	—	6	6
Disposals and reclassifications		—	21	—	118	65	204
Currency translation adjustments		—	—	—	(48)	—	(48)
December 31, 2009.		—	139	—	1,890	689	2,718
Additions and acquisition of subsidiaries	5	91	—	1,800	—	69	1,960
Disposals and reclassifications		—	62	—	—	3	65
Currency translation adjustments		—	2	—	(73)	(3)	(74)
December 31, 2010		<u>91</u>	<u>203</u>	<u>1,800</u>	<u>1,817</u>	<u>758</u>	<u>4,669</u>
Accumulated amortization and impairment losses:							
December 31, 2008.		—	43	—	477	533	1,053
Additions	33	—	9	—	37	38	84
Disposals and reclassifications		—	—	—	144	22	166
Currency translation adjustments		—	—	—	(17)	(1)	(18)
December 31, 2009.		—	52	—	641	592	1,285
Additions and acquisition of subsidiaries	33	1	12	—	(202)	51	(138)
Disposals and reclassifications		—	(3)	—	—	11	8
Currency translation adjustments		—	1	—	(29)	(2)	(30)
December 31, 2010		<u>1</u>	<u>62</u>	<u>—</u>	<u>410</u>	<u>652</u>	<u>1,125</u>
Net book value:							
December 31, 2009.		<u>P—</u>	<u>P 87</u>	<u>P —</u>	<u>P1,249</u>	<u>P 97</u>	<u>P1,433</u>
December 31, 2010		<u>P90</u>	<u>P141</u>	<u>P1,800</u>	<u>P1,407</u>	<u>P106</u>	<u>P3,544</u>

Intangible asset-service concession right substantially represents the present value of the annual franchise fee payable to the ROP over 25 years discounted using 9% internal borrowing rate, net of accumulated amortization (Notes 4, 20 and 24).

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Mining rights and licenses with finite lives and licenses, goodwill, trademarks and brand names with indefinite lives acquired through business combinations have been allocated to individual cash-generating units, for impairment testing as follows:

	2010			2009	
	Goodwill	Licenses, Trademarks and Brand Names	Mining Rights	Goodwill	Licenses, Trademarks and Brand Names
Fuel and Oil	P22,025	P —	P —	P —	P —
Food	2,936	227	—	2,943	233
Packaging	2,026	—	—	2,139	—
Beverage	772	1,930	—	1,265	1,906
Power Generation and Distribution . .	—	—	1,800	—	—
Infrastructure	2,431	—	—	—	—
Telecommunications	—	5,221	—	—	—
Others	61	—	—	61	—
Total	<u>P30,251</u>	<u>P7,378</u>	<u>P1,800</u>	<u>P6,408</u>	<u>P2,139</u>

The recoverable amount of goodwill has been determined based on a valuation using cash flow projections covering a five-year period based on long range plans approved by management. Cash flows beyond the five-year period are extrapolated using a constant growth rate determined per individual cash-generating unit. This growth rate is consistent with the long-term average growth rate for the industry. The discount rate applied to after tax cash flow projections ranged from 6% to 14% for 2010 and 2009. The discount rates also impute the risk of the cash-generating units compared to the respective risk of the overall market and equity risk premium.

Impairment loss on goodwill amounting to P461, P33 and P322 was recognized and is included in “Other income (charges)” account in 2010, 2009 and 2008, respectively (Note 33).

Management believes that any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause its carrying amount to exceed its recoverable amount.

The calculations of value in use are most sensitive to the following assumptions:

Gross Margins. Gross margins are based on average values achieved in the period immediately before the budget period. These are increased over the budget period for anticipated efficiency improvements. Values assigned to key assumptions reflect past experience, except for efficiency improvement.

Discount Rates. The Group uses the weighted average cost of capital as the discount rate, which reflects management’s estimate of the risk specific to each unit. This is the benchmark used by management to assess operating performance and to evaluate future investments proposals.

Raw Material Price Inflation. Forecast consumer price is obtained from indices during the budget period from which raw materials are purchased. Value assigned to key assumption is consistent with external sources of information.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

20. Other Noncurrent Assets

Other noncurrent assets consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Noncurrent receivables and deposits — net	40, 41, 42	₱24,783	₱ 5,933
Deferred containers — net	4	4,420	4,446
Project development costs	4, 5	2,186	—
Retirement assets	36	147	160
Others		<u>2,265</u>	<u>1,929</u>
		<u>₱33,801</u>	<u>₱12,468</u>

Noncurrent receivables and deposits include advances to Petron Corporation Employee Retirement Plan (PCERP) and deposits to Meralco amounting to ₱22,435 and ₱87, respectively, as of December 31, 2010, and advances to SMEC and deposits to Meralco amounting to ₱2 and ₱68 as of December 31, 2009 (Note 34).

Project development costs consist of expenses related to the development of the MRT 7 Project (Note 35) which are capitalized. These include manpower costs, engineering service costs, financing fees, technology development and consultancy service costs, overhead costs and other related project costs.

“Others” include noncurrent prepaid rent and insurance, catalysts, deferred exploration and development costs and idle assets.

Idle assets included under “Others” amounted to ₱169 and ₱235 as of December 31, 2010 and 2009, respectively (Note 33).

21. Drafts and Loans Payable

Drafts and loans payable consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Parent Company			
Peso-denominated		₱22,422	₱34,331
Foreign currency-denominated		—	3,188
Subsidiaries			
Peso-denominated		48,214	16,125
Foreign currency-denominated		<u>3,492</u>	<u>3,145</u>
	41, 42	<u>₱74,128</u>	<u>₱56,789</u>

Drafts and loans payable mainly represent unsecured peso and foreign currency-denominated amounts payable to local and foreign banks. Interest rates for peso-denominated loans range from 3.05% to 4.50% and 3.10% to 6.79% in 2010 and 2009, respectively. Interest rates for foreign currency-denominated loans range from 1.8% to 16.5% and 1.32% to 12.08% in 2010 and 2009, respectively.

Drafts and loans payable of the Group are not subject to covenants and warranties.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

22. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Trade		P34,591	P 8,791
Payables on the purchase of shares of stock	5, 13	14,839	7,280
Non-trade		12,383	10,783
Amounts owed to related parties	34	1,843	32
Subscriptions payable	13	1,290	—
Retirement liabilities	36	503	572
Obligation under a put option	4, 35	386	—
Others		3,939	3,933
	41, 42	<u>P69,774</u>	<u>P31,391</u>

Derivative liabilities included under “Others” amounted to P71 and P111 as of December 31, 2010 and 2009, respectively (Notes 41 and 42).

Non-trade payables include freight payable, contract growers/breeders’ fee, guarantee deposits, utilities, rent and other expenses payable to external parties, as supported by invoices, which were not paid in the month in which they are incurred.

The current portion of IRO included in “Non-trade” amounted to P2 as of December 31, 2010 (Note 35).

Others include payroll-related accruals and accrued interest payable.

23. Long-term Debt

Long-term debt consist of:

	<u>2010</u>	<u>2009</u>
Parent Company		
Unsecured term notes:		
Foreign currency-denominated:		
Floating interest rate based on LIBOR plus an agreed margin, with maturities up to 2015 ^(a)	P 42,810	P26,397
Peso-denominated:		
Floating interest rate based on PDST-F plus an agreed margin, with maturities up to 2012, 2014 and 2015 ^(b)	10,838	2,982
	<u>53,648</u>	<u>29,379</u>
Subsidiaries		
Peso-denominated:		
Bonds:		
Fixed interest rate of 8.25%, 8.875% and 10.5% maturing in 2012, 2014 and 2019, respectively ^(c)	38,425	38,416
Unsecured term notes:		
Fixed interest rate of 7% maturing in 2017 ^(d)	19,779	—
Fixed interest rate of 8.88%, 8.14% and 9.33% maturing in 2011, 2014 and 2016, respectively ^(e)	16,162	—

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	<u>2010</u>	<u>2009</u>
Fixed interest rate of 6.50% and 7.25% maturing in 2012 and 2014, respectively ^(f)	2,217	2,214
Fixed interest rate of 7.63% and 8.30% maturing in 2015 ^(g)	1,493	—
Fixed interest rate of 6.73% maturing in 2012 ^(h)	767	—
Fixed interest rate of 5.4885% maturing in 2015 ⁽ⁱ⁾	793	—
Floating interest rate based on PDST-F plus an agreed margin, with maturities up to 2011 and 2014 ^(j)	2,466	—
Floating interest rate based on PDST-F plus an agreed margin, with maturities up to 2015 ⁽ⁱ⁾	3,668	—
Foreign currency-denominated:		
Unsecured term notes:		
Floating interest rate based on LIBOR plus an agreed margin, with maturities up to 2015 ^(k)	15,229	—
Floating interest rate based on LIBOR plus an agreed margin, with maturities up to 2014 ^(l)	12,840	—
Floating interest rate based on VNIBOR and THBFIX plus an agreed margin, with maturities up to 2014 ^(m)	1,440	2,953
	<u>115,279</u>	<u>43,583</u>
	168,927	72,962
Less current maturities	<u>12,549</u>	<u>1,077</u>
	<u><u>₱156,378</u></u>	<u><u>₱71,885</u></u>

- ^a. The amount represents drawdown by the Parent Company in 2010 and 2009 from the US\$1,000 loan and US\$600 loan facility, respectively. The drawdown was used to refinance its existing financial indebtedness and for general working capital purposes. The balance of the US\$600 loan was paid off by the Parent Company on July 26, 2010 out of the proceeds of the US\$1,000 loan facility.
- Unamortized debt issue costs related to these loans amounted to ₱1,030 and ₱1,323 as of December 31, 2010 and 2009, respectively.
- ^b. The amount represents drawdown by the Parent Company in 2010 and 2009 for general financing and corporate requirements. Unamortized debt issue costs related to these loans amounted to ₱12 and ₱18 as of December 31, 2010 and 2009, respectively.
- ^c. SMB offered for sale and subscription to the public Philippine peso-denominated fixed rate bonds in the aggregate principal amount of ₱38,800 (Bonds) on April 3, 2009 (Issue Date). The Bonds was issued in three (3) series: Series A Bonds with an aggregate principal amount of ₱13,590 having a term of 3 years beginning on Issue Date and ending on April 3, 2012, with a fixed interest rate of 8.25% per annum; Series B Bonds with an aggregate principal amount of ₱22,400 having a term of 5 years and 1 day beginning on Issue Date and ending on April 4, 2014, with a fixed interest rate of 8.875% per annum; and Series C Bonds with an aggregate amount of ₱2,810 having a term of 10 years beginning on Issue Date and ending on April 3, 2019, with a fixed interest rate of 10.50% per annum. Proceeds from the issuance of the Bonds were used to finance SMB's acquisition of the interest of the Parent Company in IBI and in BPI. Unamortized debt issue costs related to these bonds amounted to ₱276 and ₱384 as of December 31, 2010 and 2009, respectively.
- On November 17, 2009, the Philippine Dealing & Exchange Corp. (PDEX) approved SMB's application to list its peso-denominated fixed rate bonds for trading on the PDEX.
- ^d. The amount represents ₱20,000 peso-denominated notes issued by Petron in 2010. The principal and interest will be translated into and paid in US dollars based on the average representative market rate at the applicable rate calculation date at the time of each payment. Unamortized debt issue cost related to this loan amounted to ₱222 as of December 31, 2010.
- ^e. The amount represents fixed rate corporate notes issued by Petron amounting to ₱6,300 in 2006 and ₱5,200 and ₱4,800 in 2009. The ₱6,300 fixed rate corporate note was used to finance the construction of its Petro Fluidized Catalytic Cracker Unit and Propylene Recovery Unit and for other general financing purposes. Unamortized debt issue cost related to this loan amounted to ₱89 as of December 31, 2010.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- f. The amount represents syndicated loans obtained by SMYAC which were used for capital expenditures. Unamortized debt issue costs related to these loans amounted to ₱8 and ₱11 as of December 31, 2010 and 2009, respectively.
- g. The amount represents drawdown by GSMI in 2010, from a local bank, used for working capital requirements. Unamortized debt issue costs related to these bonds amounted to ₱7 as of December 31, 2010.
- h. The amount represents a club loan agreement of Petron with Metropolitan Bank and Trust Company and Citibank amounting to ₱1,000 each in 2007. The loan bears interest of 6.73% per annum payable in 13 quarterly installments starting January 2009 up to 2012. In December 2007, Citibank assigned ₱900 of its interest in the Club loan agreement to the following financial institutions:

<u>Bank Name</u>	<u>Amount</u>
MayBank Phils.	₱500
Mega International Commercial Bank of China	300
Robinsons Bank	<u>100</u>
	<u>₱900</u>

In May 2008, Citibank assigned its remaining ₱100 interest to Insular Life Assurance Co. Ltd. Unamortized debt issue costs related to these loans amounted to ₱2 as of December 31, 2010.

- i. SMFI offered for sale and subscription to the public Philippine peso-denominated fixed rate and floating rate corporate notes with principal in the aggregate amount of ₱800 and ₱3,700, respectively. Both types of bonds have a term of 5 years and 1 day beginning on December 10, 2010 and ending in December 11, 2015. The fixed rate bonds has a fixed interest rate of 5.4885% per annum, while the floating rate bond has a floating interest rate based on 3-month PDST-F plus an agreed margin. Proceeds from the issuance of the bonds will be used to fund any expansion or any investment in new businesses by SMFI and for other general corporate financing purposes. Unamortized debt issue costs related to these bonds amounted to ₱39 as of December 31, 2010.
- j. The amount includes a loan agreement entered into by Petron with Land Bank of the Philippines in 2006 amounting to ₱2,000, used for capital expenditures. Unamortized debt issue costs related to these notes amounted to ₱1 as of December 31, 2010. It also includes a loan agreement entered into by Petron with Development Bank of the Philippines in 2010 amounting to ₱1,800. The loan was obtained to finance Petron's general corporate requirements.
- k. The amount represents drawdown by Petron in 2010 from the US\$355 loan facility for general corporate purposes and refinancing of peso-denominated debts. Unamortized debt issue costs related to this loan facility amounted to ₱334 as of December 31, 2010.
- l. The amount represents an unsecured loan facility agreement entered into by SMB with an aggregate amount of US\$300, used to finance SMB's acquisition of the international beer and malt-based beverages business from the Parent Company, through SMB's purchase of SMH's shares in SMBIL, comprising 100% of the issued and outstanding capital stock of SMBIL. Unamortized debt issue costs related to this loan facility amounted to ₱312 as of December 31, 2010.
- m. The amount includes loan obtained by SMFBIL's subsidiaries, which was used to finance their capital expenditures. It also includes the 44.9% share of the loan of TSML in 2010 and 2009 to finance its plant constructions and start up operations. Unamortized debt issue costs related to these loans amounted to ₱1 and ₱2 as of December 31, 2010 and 2009, respectively.

The debt agreements contain, among others, covenants relating to merger and consolidation, maintenance of certain financial ratios, working capital requirements, restrictions on loans and guarantees, disposal of a substantial portion of assets, significant changes in the ownership or control of subsidiaries, payments of dividends and redemption of capital stock.

As of December 31, 2010 and 2009, the Group is in compliance with the covenants of the debt agreements.

The movements in debt issue costs are as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Balance at beginning of year		₱ 1,738	₱ 424
Additions and reclassification		2,404	1,889
Amortization	31	<u>(1,808)</u>	<u>(575)</u>
Balance at end of year		<u>₱ 2,334</u>	<u>₱1,738</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Repayment Schedule

As of December 31, 2010, the annual maturities of long-term debt are as follows:

<u>Year</u>	<u>Gross Amount</u>	<u>Debt Issue Costs</u>	<u>Net</u>
2011	₱12,722	₱173	₱12,549
2012	21,084	589	20,495
2013	5,059	351	4,708
2014	33,569	578	32,991
2015	71,505	535	70,970
2016	4,512	42	4,470
2017	20,000	36	19,964
2019	2,810	30	2,780
Total	<u>₱171,261</u>	<u>₱2,334</u>	<u>₱168,927</u>

Contractual terms of the Group's interest-bearing loans and borrowings and exposure to interest rate, foreign currency and liquidity risks are discussed in Note 41.

24. Other Noncurrent Liabilities

Other noncurrent liabilities consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Payables on the purchase of shares of stock	5, 13	₱15,063	₱18,148
ARO	4	815	—
Retirement liabilities	36	132	192
Obligation to the Philippine Government — service concession agreement	4, 19, 20	77	—
IRO	4, 20	45	—
Redeemable preferred shares	4	12	—
Subscriptions payable		—	1,014
Cash bonds, cylinder deposits and others		<u>1,016</u>	<u>231</u>
		<u>₱17,160</u>	<u>₱19,585</u>

Redeemable preferred shares represent preferred shares of TADHC. The preferred shares are cumulative, non-voting, redeemable and with liquidation preference. The shares shall be preferred as to dividends, which shall be given on the face of coupons, at the rate of 90% of the 1 year PDST-F rate. The dividends shall be cumulative from and after the date of issue of the preferred shares, whether or not in any period the amount thereof is covered by available unrestricted retained earnings.

The preferred shares are mandatorily redeemable at the end of the ten-year period from and after the issuance of the preferred shares. The redemption price is equivalent to the principal amount, plus all unpaid coupons. At the sole option of TADHC, the preferred shares may be redeemed earlier in whole or in part.

In the event of liquidation, dissolution, bankruptcy or winding up of the affairs of TADHC, the holders of the preferred shares shall be entitled to be paid in full or proportionately to the extent that the remaining assets of TADHC will permit, an amount equivalent to the issue price of such preferred shares plus all accumulated and unpaid dividends up to the current dividend period, before any assets of TADHC shall be paid or distributed to the holders of the common shares.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

25. Income Taxes

Deferred tax assets and liabilities arise from the following:

	<u>2010</u>	<u>2009</u>
Allowance for impairment losses on trade and other receivables and inventory	P 1,745	P 1,163
MCIT	434	1,145
NOLCO	392	753
Undistributed net earnings of foreign subsidiaries	(10,137)	(11,213)
Unrealized intercompany charges and others	948	4,998
	<u>P (6,618)</u>	<u>P (3,154)</u>

The above amounts are reported in the consolidated statements of financial position as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Deferred tax assets	4	P 7,134	P 8,883
Deferred tax liabilities		<u>(13,752)</u>	<u>(12,037)</u>
		<u>P (6,618)</u>	<u>P (3,154)</u>

The undistributed earnings of foreign subsidiaries and cumulative translation adjustments for which deferred tax liabilities have not been recognized totaled P10,291 and P11,425 as of December 31, 2010 and 2009, respectively.

As of December 31, 2010, the NOLCO and MCIT of the Group that can be claimed as deduction from future taxable income and deduction from corporate income tax due, respectively, are as follows:

<u>Year Incurred/Paid</u>	<u>Carryforward Benefits up to</u>	<u>NOLCO</u>	<u>MCIT</u>
2008	December 31, 2011	P 3	P122
2009	December 31, 2012	<u>1,304</u>	<u>312</u>
		<u>P1,307</u>	<u>P434</u>

The components of income tax expense are shown below:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current		P11,517	P10,254	P 7,907
Deferred		<u>(79)</u>	<u>(6,548)</u>	<u>(1,809)</u>
Income tax expense from continuing operations		11,438	3,706	6,098
Income tax benefit from ordinary activities of discontinued operations	8	—	—	(7)
Income tax expense from gain on disposal of discontinued operations	8	<u>—</u>	<u>—</u>	<u>2,921</u>
		<u>P11,438</u>	<u>P 3,706</u>	<u>P 9,012</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The reconciliation between the statutory income tax rate on income tax before income tax from continuing operations and the Group's effective income tax rate is as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Statutory income tax rate	30.00%	30.00%	35.00%
Increase (decrease) in income tax rate resulting from:			
Equity in net losses (earnings) of associates	(5.76)	(1.31)	1.91
Interest income subject to final tax	(2.56)	(2.79)	(11.17)
Loss (gain) on derivatives	(0.56)	(0.45)	18.06
Gain on sale of investments subject to final or capital gains tax	—	(23.52)	(12.05)
Others, mainly income subject to different tax rates and change in tax rate — net	11.10	3.83	(2.38)
Effective income tax rate	<u>32.22%</u>	<u>5.76%</u>	<u>29.37%</u>

26. Stockholders' Equity

a. On July 24, 2007, the stockholders of the Parent Company approved the increase in the Parent Company's authorized capital stock from ₱22,500 to ₱37,500, which will be made up of 3,600,000,000 Class "A" common shares, 2,400,000,000 Class "B" common shares and 1,500,000,000 preferred shares, all with a par value of ₱5.00 per share.

On July 23, 2009, during the Parent Company's annual stockholders' meeting, the stockholders approved amendments to the Parent Company's Articles of Incorporation providing for the reclassification of the common shares comprising the authorized capital stock of ₱22,500. The authorized capital stock of the Parent Company was divided into 2,034,000,000 Class "A" common shares, 1,356,000,000 Class "B" common shares and 1,110,000,000 Series "1" preferred shares, and defined the terms and features of the Series "1" preferred shares. The preferred shares shall be peso-denominated, perpetual, cumulative and non-voting with an issue price of ₱75.00 per share and a dividend rate of 8% per annum computed in reference to the issue price. The SEC approved these amendments to the Amended Articles of Incorporation of the Parent Company on August 20, 2009. The stockholders also approved in the same stockholders' meeting, further amendments to the resolutions on the increase in the authorized capital stock of the Parent Company which were passed during the 2007 annual stockholders' meeting to provide for the division of the increased authorized capital stock of the Parent Company into common shares and two series of preferred shares. The proposed increase in the authorized capital stock of the Parent Company has not been submitted to the SEC for approval.

Also, on July 23, 2009, the stockholders of the Parent Company approved the Offer by the Parent Company to exchange existing common shares of up to approximately 35% of the issued and outstanding capital stock of the Parent Company with Series "1" preferred shares. The exchange ratio was one (1) common share for one (1) Series "1" preferred share and the qualified shareholders of record as of July 2, 2009, were vested with the right to participate on the exchange.

On October 5, 2009, the Parent Company completed the exchange of 476,296,752 Class "A" common shares and 396,876,601 Class "B" common shares for Series "1" preferred shares.

On October 15, 2009, the Parent Company's BOD approved the issuance, through private placement, of up to 226,800,000 Series "1" preferred shares.

On December 22, 2009, the Parent Company issued 97,333,000 Series "1" preferred shares to qualified buyers and by way of private placement to not more than 19 non-qualified buyers at the issue price of ₱75.00 per Series "1" preferred share.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On July 27, 2010, the Parent Company's BOD approved the offer to issue approximately 1,000,000,000 common shares (from unissued capital stock and treasury shares) at a price of not less than ₱75.00 per share. The proceeds will be used to finance investments and acquisitions of the Parent Company.

b. Capital Stock

Common Stock

Effective August 26, 2010, all Class "A" common shares and Class "B" common shares of the Parent Company shall be considered as common shares without distinction, as approved by the SEC. Both shall be available for foreign investors, subject to the foreign ownership limit.

The movements in the number of issued and outstanding shares of common stock are as follows:

	<u>2010</u>	
Balance at beginning of year	3,229,944,942	
Issuances during the year	<u>38,649,312</u>	
Issued shares at end of year	3,268,594,254	
Less treasury shares	<u>938,648,724</u>	
Issued and outstanding shares at end of year	<u><u>2,329,945,530</u></u>	
	<u>2009</u>	<u>2008</u>
Class "A"		
Balance at beginning of year	1,975,940,615	1,975,292,245
Issuances during the year	<u>4,652,540</u>	<u>648,370</u>
Issued shares at end of year	1,980,593,155	1,975,940,615
Less treasury shares	<u>530,959,512</u>	<u>54,662,760</u>
Issued and outstanding shares at end of year	<u><u>1,449,633,643</u></u>	<u><u>1,921,277,855</u></u>
Class "B"		
Balance at beginning of year	1,246,527,833	1,246,527,833
Issuances during the year	<u>2,823,954</u>	<u>—</u>
Issued shares at end of year	1,249,351,787	1,246,527,833
Less treasury shares	<u>407,689,212</u>	<u>10,812,611</u>
Issued and outstanding shares at end of year	<u><u>841,662,575</u></u>	<u><u>1,235,715,222</u></u>

Preferred Shares

Series "1" preferred shares have a par value of ₱5.00 per share and are entitled to receive cash dividends upon declaration by and at the sole option of the Parent Company's BOD at a fixed rate of 8% per annum calculated in respect of each Series "1" preferred share by reference to the Issue Price thereof in respect of each dividend period. Unless the Series "1" preferred shares are redeemed by the Parent Company, the dividend rate shall be adjusted at the end of the fifth year after the date of issue.

Series "1" preferred shares are non-voting except as provided for under the Corporation Code. The Series "1" preferred shares are redeemable in whole or in part, at the sole option of the Parent Company, at the end of three years from the issue date at ₱75.00 plus any accumulated and unpaid cash dividends.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

All shares rank equally with regard to the Parent Company's residual assets, except that holders of preferred shares participate only to the extent of the issue price of the shares plus any accumulated and unpaid cash dividends.

On December 8, 2010, the Parent Company listed 873,173,353 Series "1" preferred shares worth ₱65,488, representing 27.6% of its outstanding stock.

As of December 31, 2010 and 2009, the Parent Company has 970,506,353 outstanding Series "1" preferred shares.

c. Treasury shares, totaling 65,475,371 Class "A" and "B" common shares, are stated at acquisition cost, while 873,173,353 Class "A" and "B" common shares were acquired through the exchange of common shares to preferred shares on a one-for-one basis at ₱75.00 per share.

Out of the total treasury shares, 25,450,000 common shares (15,274,484 Class "A" common shares and 10,175,516 Class "B" common shares), with an acquisition cost of ₱481, [net of the cost of the 1,000,000 shares paid to Presidential Commission on Good Government (PCGG) as arbitral fee pursuant to the Compromise Agreement, as herein defined] 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 Parent Company shares 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.

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 ₱2,100; 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 compromised 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.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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 Case No. 033-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 are 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.

The Supreme Court affirmed its resolution, issued on September 17, 2009, allowing the PCGG to convert the 24% sequestered shares of the Parent Company in the name of CIIF into Series "1" preferred shares. The Court held that the conversion is necessary to preserve the value of the 753,848,312 common shares.

On February 11, 2010, the Supreme Court amended its Resolution dated September 17, 2009 and authorized the PCGG to exercise discretion in depositing on 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, having in mind the greater interest of the government and the coconut farmers.

In the meantime, the Parent Company has available cash and shares of stock for the dividends payable on the treasury shares.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The movements in the number of acquired shares of treasury stock are as follows:

	<u>2009</u>	<u>2008</u>
Class “A”		
Balance at beginning of year	54,662,760	54,662,760
Acquisition through exchange of common shares to preferred shares during the year	<u>476,296,752</u>	<u>—</u>
Balance at end of year	<u><u>530,959,512</u></u>	<u><u>54,662,760</u></u>
Class “B”		
Balance at beginning of year	10,812,611	10,812,611
Acquisition through exchange of common shares to preferred shares during the year	<u>396,876,601</u>	<u>—</u>
Balance at end of year	<u><u>407,689,212</u></u>	<u><u>10,812,611</u></u>

As of December 31, 2010, the Parent Company holds 938,648,724 common treasury shares.

d. The Group’s unappropriated retained earnings includes its accumulated equity in net earnings of subsidiaries and associates amounting to ₱16,429, ₱18,184 and ₱57,482 in 2010, 2009 and 2008, respectively. Such amounts are not available for declaration as dividends until declared by the respective investees.

The Parent Company’s unappropriated retained earnings as of December 31, 2010 and 2009 is restricted in the amount of ₱69,541, representing the cost of shares held in treasury.

e. The BOD of certain subsidiaries approved additional appropriations amounting to ₱200, ₱15 and ₱176 in 2010, 2009 and 2008, respectively, to finance future capital expenditure projects. Reversal of appropriations in 2010, 2009 and 2008 amounted to ₱27, ₱40 and ₱688, respectively.

27. Cost of Sales

Cost of sales consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Inventories		₱102,166	₱ 75,051	₱ 76,205
Taxes and licenses		23,343	21,515	19,703
Fuel and oil		17,504	2,170	3,267
Depreciation and amortization	29	7,287	4,994	4,660
Contracted services		5,929	4,682	4,296
Freight, trucking and handling		5,504	4,392	4,230
Communications, light and water		4,585	3,662	4,232
Personnel	30	3,827	3,802	3,815
Repairs and maintenance		1,962	1,827	1,584
Rent	4, 35	507	455	550
Others		<u>1,292</u>	<u>1,745</u>	<u>1,530</u>
		<u>₱173,906</u>	<u>₱124,295</u>	<u>₱124,072</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

28. Selling and Administrative Expenses

Selling and administrative expenses consist of:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Selling	₱18,239	₱12,905	₱13,518
Administrative	19,187	17,344	15,633
	<u>₱37,426</u>	<u>₱30,249</u>	<u>₱29,151</u>

Selling expenses consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Freight, trucking and handling		₱ 5,922	₱ 2,021	₱ 2,049
Advertising and promotions		4,977	4,980	5,697
Personnel	30	4,180	3,635	3,251
Rent	4, 35	1,200	1,060	995
Depreciation and amortization	29	419	221	248
Supplies		326	251	281
Taxes and licenses		271	249	213
Communications, light and water		193	218	169
Professional fees		131	45	43
Others		620	225	572
		<u>₱18,239</u>	<u>₱12,905</u>	<u>₱13,518</u>

Administrative expenses consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Personnel	30	₱ 8,081	₱ 7,385	₱ 6,771
Depreciation and amortization	29	2,403	2,110	1,859
Professional fees		1,750	2,383	1,283
Advertising and promotion		1,201	822	1,614
Taxes and licenses		794	673	617
Supplies		755	711	710
Communications, light and water		713	644	692
Repairs and maintenance		680	952	867
Freight, trucking and handling		513	270	316
Research and development		236	212	299
Rent	4, 35	88	605	251
Others	40	1,973	577	354
		<u>₱19,187</u>	<u>₱17,344</u>	<u>₱15,633</u>

“Others” consist of entertainment and amusement, gas and oil, and other operating and administrative expenses.

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29. Depreciation, Amortization and Impairment

Depreciation and amortization are distributed as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cost of sales:				
Property, plant and equipment	16	₱ 6,192	₱3,852	₱3,604
Deferred containers, biological assets and others	18, 20	<u>1,095</u>	<u>1,142</u>	<u>1,056</u>
	27	<u>7,287</u>	<u>4,994</u>	<u>4,660</u>
Selling and administrative expenses:				
Property, plant and equipment	16	1,685	1,402	1,329
Deferred containers and others	20, 33	<u>1,137</u>	<u>929</u>	<u>778</u>
	28	<u>2,822</u>	<u>2,331</u>	<u>2,107</u>
		<u>₱10,109</u>	<u>₱7,325</u>	<u>₱6,767</u>

“Others” include amortization of computer software, land use rights, licenses and investment properties.

30. Personnel Expenses

Personnel expenses consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Salaries and wages		₱ 7,990	₱ 7,205	₱ 6,440
Retirement costs	36	285	594	857
Other employee benefits		<u>7,813</u>	<u>7,023</u>	<u>6,540</u>
		<u>₱16,088</u>	<u>₱14,822</u>	<u>₱13,837</u>

Personnel expenses are distributed as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cost of sales	27	₱ 3,827	₱ 3,802	₱ 3,815
Selling expenses	28	4,180	3,635	3,251
Administrative expenses	28	<u>8,081</u>	<u>7,385</u>	<u>6,771</u>
		<u>₱16,088</u>	<u>₱14,822</u>	<u>₱13,837</u>

31. Interest Expense and Other Financing Charges

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Interest expense	₱13,870	₱6,780	₱5,370
Other financing charges	<u>2,708</u>	<u>1,146</u>	<u>662</u>
	<u>₱16,578</u>	<u>₱7,926</u>	<u>₱6,032</u>

Amortization of debt issue costs in 2010, 2009 and 2008 included in other financing charges amounted to ₱1,808, ₱575 and ₱374, respectively (Note 23).

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Interest expense on drafts and loans payable and long-term debt are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Drafts and loans payable	₱ 3,035	₱2,916	₱2,960
Long-term debt	<u>10,835</u>	<u>3,864</u>	<u>2,410</u>
	<u>₱13,870</u>	<u>₱6,780</u>	<u>₱5,370</u>

32. Interest Income

Interest income consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Interest from short-term investments, cash in banks and others		₱2,941	₱5,350	₱4,320
Interest on amounts owed by a related party	10	<u>82</u>	<u>639</u>	<u>2,310</u>
		<u>₱3,023</u>	<u>₱5,989</u>	<u>₱6,630</u>

33. Other Income (Charges)

Other income (charges) consist of:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Foreign exchange gains (losses).		₱ 6,097	₱(3,364)	₱ 8,684
Gain on acquisition of a subsidiary	5, 39	4,490	—	—
Gains (losses) on derivatives — net	42	660	962	(10,718)
Loss on impairment of goodwill, trademark and brand name, property, plant and equipment and idle assets ^(a, b, c, d)	16, 17, 19	(4,233)	(4,756)	(322)
Others ^(b)		<u>(88)</u>	<u>315</u>	<u>94</u>
		<u>₱ 6,926</u>	<u>₱(6,843)</u>	<u>₱ (2,262)</u>

a. In 2010 and 2009, the Group recognized impairment loss on noncurrent assets of SMBHK and San Miguel (Guangdong) Brewery Company Limited (SMGB). Over the past three years, the Group's business performance of SMBHK and SMGB had been adversely affected by factors including economic downturns, fierce market competition, counterfeit products and poor weather conditions.

SMBHK

In 2010, the recoverable amount of SMBHK cash-generating unit (CGU) has been determined using the value in use calculation derived on the cash flow projections based on the business forecasts approved by the management covering a period of five years on which cash flows beyond the covered periods are extrapolated using a steady growth rate of 2%.

Key assumptions used for value in use calculation are as follows:

	<u>2010</u>
Sales volume growth rate	1.7 - 12.6%
Gross contribution rate	40 - 42%
Pre-tax discount rate	9.85%

SMGB

In 2010, the estimates of recoverable amount of SMGB CGU were based on the assets' fair values less costs to sell, determined by reference to the observable market prices for similar assets on which the Group engaged an independent firm of surveyors, LCH (Asia-Pacific) Surveyors Limited, who have among their staff Members of the Hong Kong Institute of Surveyors. In 2009 however, the

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estimated recoverable amount of the mainland China CGU was determined using value in use calculation. This calculation uses the discounted value of the projected cash flows to be generated over the remaining useful life of the CGU. Cash flows beyond the six-year period were extrapolated using a steady growth rate of 4%.

Key assumptions used for value in use calculation are as follows:

	<u>2009</u>
Sales volume growth rate	5.5 - 7.3%
Gross contribution rate	39 - 40%
Pre-tax discount rate.	13.17%

Management determined the growth rate and gross contribution rate based on past experiences, future expected market trends and an intermediate holding company's import plan of beer brewed by the Group.

As of December 31, 2010 and 2009, the Group assessed the recoverable amounts of the CGUs to which these assets belong, and as a result, the carrying amounts of the assets in the CGUs were written down by P4,333 and P3,705, respectively, presented as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Other charges		P4,182	P3,705
Selling and administrative expenses	29	151	—
		<u>P4,333</u>	<u>P3,705</u>

- b. In 2010 and 2009, the Group recognized provisions for impairment loss on land and idle assets (included under "Other noncurrent assets") amounting to P51 and P54, respectively, computed as the difference between the carrying amount of the assets and their fair value based on reports by qualified property appraisers, less costs to sell (Note 20). In 2010, following the recent appraisal reports, the Group reversed the impairment loss on land amounting to P46 which was included under "Others".
- c. In 2009, the Group reduced the carrying amount of certain assets of SMPPC by a total of P694 after the latter ceased its commercial operations on July 27, 2009.
- d. On December 31, 2008, the Group reviewed the recoverable amount of its investment in shares of stock of Star Dari, Inc. (SDI). It was determined that the carrying amount of the investment is higher than its value in use and an impairment loss of P322 was recognized. The discount rate applied to after tax cash flow projections of SDI was 12%. The impairment loss was allocated fully to goodwill (Note 19).

34. Related Party Disclosures

Transactions with related parties are made at normal market prices. For the years ended December 31, 2010, 2009 and 2008, the Group did not provide any allowance for impairment losses relating to amounts owed by related parties. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

- a. The Parent Company has advances to SMCRP amounting to P3,997 and P2,785 as of December 31, 2010 and 2009, respectively, included as part of "Trade and other receivables" account (Note 10).
- b. The Parent Company has advances to Top Frontier amounting to P2,543 as of December 31, 2010, included as part of "Trade and other receivables" account (Note 10).
- c. SMPI has advances from SMCRP amounting to P1,800 as of December 31, 2010, included as part of "Accounts payable and accrued expenses" account (Notes 13 and 22). SMPI used the proceeds of the advances mainly for the acquisition of additional BOC shares. As of December 31, 2010, SMPI also has outstanding advances to SMCRP amounting to P2 included as part of "Trade and other receivables" account (Note 10).

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d. The significant transactions of the Group and Meralco include the following:

<u>Year</u>	<u>Sales</u>	<u>Purchases of Utilities</u>	<u>Included under “Trade and Other Receivables” Account (Note 10)</u>	<u>Included Under “Accounts Payable and Accrued Expenses” Account (Note 22)</u>
2010	<u><u>₱17,103</u></u>	<u><u>₱490</u></u>	<u><u>₱4,548</u></u>	<u><u>₱43</u></u>
2009	<u><u>₱ —</u></u>	<u><u>₱692</u></u>	<u><u>₱ 72</u></u>	<u><u>₱32</u></u>

In 2010 and 2009, the Group has noncurrent receivables and deposits from Meralco amounting to ₱87 and ₱68, respectively (Note 20).

e. As of December 31, 2010, Vega has advances to LTHI which amounted to ₱145 included as part of “Trade and other receivables” account (Note 10).

f. As of December 31, 2010, the Group has outstanding receivables from BOC amounting to ₱4 included as part of “Trade and other receivables” account (Note 10).

g. As of December 31, 2010, Petron has noncurrent receivables of ₱22,435 from PCERP (Note 20). Such advance is subject to interest of 4% per annum.

h. As of December 31, 2009, the Parent Company has advances to SMEC which amounted to ₱313 and ₱2 included as part of “Trade and other receivables” and “Other noncurrent assets” accounts, respectively (Notes 10 and 20).

i. The compensation of key management personnel of the Group, by benefit type, follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Short-term employee benefits	<u><u>₱ 408</u></u>	<u><u>₱378</u></u>	<u><u>₱200</u></u>
Retirement costs (income)	<u><u>(147)</u></u>	<u><u>37</u></u>	<u><u>19</u></u>
Share-based payments	<u><u>31</u></u>	<u><u>56</u></u>	<u><u>53</u></u>
	<u><u>₱ 292</u></u>	<u><u>₱471</u></u>	<u><u>₱272</u></u>

Some of the personnel performing key management functions in certain subsidiaries are employed by the Parent Company. This is covered by a management agreement executed by and between the Parent Company and the subsidiaries. The salaries and benefits of these personnel are billed to the subsidiaries through management fees, with details as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Short-term employee benefits		<u><u>₱30</u></u>	<u><u>₱46</u></u>	<u><u>₱118</u></u>
Retirement costs	36	<u><u>—</u></u>	<u><u>1</u></u>	<u><u>9</u></u>
Share-based payments	40	<u><u>24</u></u>	<u><u>43</u></u>	<u><u>55</u></u>
	28	<u><u>₱54</u></u>	<u><u>₱90</u></u>	<u><u>₱182</u></u>

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35. Significant Agreements and Lease Commitments

Significant Agreements:

Power

Market Participation Agreements (MPA)

SMEC, SPDC, SPPC and PEHI have entered into MPA with the Philippine Electricity Market Corporation (PEMC) to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member.

Under the WESM Rules, the cost of administering and operating the WESM shall be recovered through a charge imposed on all WESM members or transactions, as approved by Energy Regulatory Commission.

The Group purchases power from WESM during periods when the power generated from power plants are not sufficient to meet customers' power requirements.

Power Supply Agreements

SMEC and SPPC have Power Supply Agreements with various counterparties to supply or sell electricity produced by the power plants. All agreements provide for renewals or extensions subject to mutually agreed terms and conditions by both parties.

The customers are billed based on the time-of-use per kilowatt hour (TOU/kWh). However, as stipulated in the contracts, each customer has to pay the minimum charge based on the contracted power using the basic energy charge and adjustments if customer has not fully taken or failed to consume the contracted power. As of December 31, 2010, all customers are above their minimum contracted power requirements.

Coal Supply Agreement

SMEC entered into a Supply Agreement for Steaming Coal with PT Bumi Resources Tbk's subsidiary PT Kaltim Prima Coal through Topcoal Trading Corporation for the coal requirements of the Sual Power Plant from October 1, 2009 to September 30, 2010. Under the agreement, the parties shall negotiate and agree on the contract price of the coal at least 30 days prior to the delivery. The agreement is renewable at such terms and conditions as agreed upon by the parties in writing. The agreement was renewed on September 30, 2010.

Fuel and Oil

Supply Agreement

Petron and Arabian American Oil Company ("Saudi Aramco") have a term contract to purchase and supply, respectively, 90% of Petron's monthly crude oil requirements at Saudi Aramco's standard far east selling prices. The contract is for a period of one year from October 28, 2008 to October 27, 2009 with automatic one-year extensions thereafter unless terminated at the option of either party, within 60 days written notice. Outstanding liabilities of Petron for such purchases are shown as part of "Accounts payable and accrued expenses — trade" account in the consolidated statements of financial position. The contract was extended until October 27, 2011.

Fuel Supply Contract with NPC

Petron entered into various fuel supply contracts with NPC. Under the agreements, Petron supplies the bunker fuel and diesel fuel oil requirements to selected NPC plants and NPC-supplied IPP plants.

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Infrastructure

Concession Agreement

• ***TADHC***

In 2009, the ROP awarded TADHC the Project through a Notice of Award (NOA) issued on May 15, 2009. The Project is proposed to be implemented through a Contract-Add-Operate and Transfer Arrangement, a variant of the Build-Operate-Transfer (BOT) contractual arrangement under Republic Act (RA) No. 6957, as amended by RA 7718, otherwise known as the BOT Law, and its Revised Implementing Rules and Regulations.

On June 22, 2009, TADHC entered into a CA with the ROP, through the DOTC and Civil Aviation Authority of the Philippines. Based on the CA, TADHC has been granted with the concession of the Project which includes the extension or expansion of the Caticlan Airport. Subject to existing law, the CA also grants to TADHC the Franchise to operate and maintain the Caticlan Airport up to the end of the concession period, which is for a period of 25 years, and to collect the fees, rentals and other charges as may be agreed from time to time based on the Parametric Formula as defined in the CA. The CA may be renewed or extended for another 25 years upon written agreement of the parties hereto through the execution of a renewal or extension contract.

The following are the salient features of the CA:

1. The operations and management of the Caticlan Airport shall be transferred to TADHC, provided that the ROP shall retain the operations and control of air traffic services, national security matters, immigration, customs and other governmental functions and the regulatory powers insofar as aviation security, standards and regulations are concerned at the Caticlan Airport.
2. As concessionaire, TADHC shall have full responsibility in all aspect of the operation and maintenance of the Caticlan Airport and shall collect the regulated and other fees generated from it and from the end users. To guarantee faithful performance of its obligation in respect to the operation and maintenance of the Caticlan Airport, TADHC shall post in favor of the ROP an Operations and Maintenance Performance Security (OMPS) amounting to ₱25, which must be valid for the entire concession period of 25 years. As of December 31, 2010, TADHC has not paid the OMPS yet since it is due only after the completion of the construction of the Project.
3. Immediately upon receiving the Notice to Commerce Implementation (NCI) and provided all conditions precedent in the CA are fulfilled and waived, TADHC shall start all the activities necessary to upgrade and rehabilitate the Caticlan Airport in to a larger and more technologically advanced aviation facility to allow international airport operations.
4. TADHC shall finance the Project cost, while maintaining a debt-to-equity ratio of 70:30. TADHC's estimated capital commitment to develop the Project amounts to ₱2,500, including possible advances to the ROP for the right of way up to the amount of ₱466. Such ratio is complied with by TADHC as of December 31, 2010.
5. TADHC shall post a ₱250 Work Performance Security in favor of the ROP as guarantee for faithful performance by TADHC to develop the Project. This performance security shall be partially released by the ROP from time to time to the extent of the percentage of completion of the Project. In 2010, TADHC has paid ₱1 premium for the Work Performance Security. The unamortized portion of which was presented as part of the "Prepaid expenses and other current assets — Others" in the consolidated statements of financial position (Note 12).
6. In consideration for allowing TADHC to operate and manage the Caticlan Airport, TADHC shall pay ROP ₱8 annually. The first payment shall be made immediately upon the turnover by the ROP of the

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operations and management of the Caticlan Airport to TADHC, and every year thereafter until the end of the concession period. The operations and management of the airport was turned over to TADHC on October 16, 2010.

After the fulfillment of all contractual and legal requirements, the CA became effective on December 7, 2009. The Notice to Commence Implementation issued to TADHC by the DOTC was accepted by TADHC on December 18, 2009.

In accordance with the license granted by the ROP, as expressly indicated in the CA, TADHC presently operates the Caticlan Airport and has started the rehabilitation of the existing airport building and facilities which is part of the Project. However, the upgrade component of the Project has yet to be started as of December 31, 2010.

• *ULC BVI*

In 2008, the ROP awarded ULC BVI the financing, design, construction, supply, completion, testing, commissioning and operation and maintenance of the MRT Line 7 Project (the “MRT 7 Project”) through a NOA issued on January 31, 2008. The MRT Project is proposed to be an integrated transportation system, under a Build-Gradual Transfer-Operate, Maintain and Manage (BGTOM) scheme which is a modified Build-Transfer-Operate (BTO) arrangement under (RA) No. 6957, as amended by RA 7718, otherwise known as the BOT Law, and its Implementing Rules and Regulations, to address the transportation needs of passengers and to alleviate traffic in Metro Manila, particularly traffic going to and coming from North Luzon.

On June 18, 2008, ULC BVI entered into a CA (MRT 7 Agreement) with the ROP, through the DOTC, for a 25-year concession period, subject to extensions as may be provided for under the CA and by law. Based on the CA, ULC BVI has been granted the right to finance, construct, Operate and Maintain (O&M) the proposed MRT Line 7, which consists of 44-kilometer of road and rail transportation from the Bocaue exit on the North Luzon Expressway to LRT 1 and Metro Rail Transit 3 at North Avenue - Epifanio delos Santos Avenue.

The following are the salient features of the CA:

1. The MRT 7 Project cost shall be financed by ULC BVI through debt and equity at a ratio of approximately 75:25 and in accordance with existing BSP regulations on foreign financing components, if any. Based on the CA, ULC BVI’s estimated capital commitment to develop the Project amounts to US\$1,235.60. ULC BVI shall endeavor to have signed the financing agreements not later than 18 months from the signing of the CA.
2. ULC BVI shall post a Performance Security for Construction and O&M in favor of the ROP as guarantee for faithful performance by ULC BVI to develop the Project. This performance security for O&M shall be reduced every year of the concession period to the amounts as specified in the CA.
3. In the event that the MRT 7 Project is not completed by the end of the grace period, which is 100 calendar days following the project completion target as defined in the CA, ULC BVI shall pay the ROP liquidated damages of US\$0.1 for every calendar day of delay.
4. As payment for the gradual transfer of the ownership of the assets of the MRT 7 Project, the ROP shall pay ULC BVI a fixed amortization payment on a semi-annual basis in accordance with the schedule of payment described in the CA. The ROP’s amortization payment to ULC BVI shall start when the MRT 7 Project is substantially completed.
5. Net passenger revenue shall be shared by the ROP and ULC BVI on a 30/70 basis.
6. All rail-based revenues above 11.90% internal rate of return of ULC BVI for the MRT 7 Project over the cooperation period, which means the period covering the construction and concession period,

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shall be shared equally by ULC BVI and the ROP at the end of the concession period. All rail-based revenues above 14% internal rate of return shall wholly accrue to the ROP.

7. The ROP grants the ULC BVI exclusive and irrevocable commercial development rights (including the right to lease or sublease or assign interests in, and to collect and receive any and all income from, but not limited to, advertising, installation of cables, telephone lines, fiber optics or water mains, water lines and other business or commercial ventures or activities over all areas and aspects of the MRT 7 Project with commercial development potentials) from the effectivity date of the CA until the end of the concession period, extendible for another 25 years, subject to the ROP's approval. In consideration of the development rights granted, ULC BVI or its assignee shall pay the ROP 20% of the net income before tax actually realized from the exercise of the development rights.

The Group has determined that the provisions of IFRIC 12 apply to this CA and will be accounted for under the financial asset model. However, as of December 31, 2010, construction of the MRT 7 Project has not yet started.

Telecommunications

Franchise with National Telecommunications Commission (NTC)

In 1994, the Philippine Congress passed RA No. 7692 which granted a franchise to BellTel to install, operate and maintain telecommunications systems throughout the Philippines and for other purposes.

On October 28, 1997, the NTC, under NTC Case No. 92-339, granted a Provisional Authority (PA) to BellTel, valid for eighteen (18) months, or until April 27, 1999, to install, operate and maintain the following telecommunication services, to wit:

- international gateway facility;
- inter-exchange carrier facility;
- VSAT system nationwide;
- Telephone systems in the selected cities and municipalities in the Luzon area;
- Wireless Local Loop telephone systems in the Cities of Muntinlupa, Las Piñas, Pasig, Mandaluyong, Makati, Pasay, Parañaque, Taguig and Marikina; and in the Municipalities of Pateros and San Juan; and
- telephone systems in all economic zones identified under RA No. 7916.

Since then, this PA had been extended several times, the latest extension of which is valid until December 22, 2010 as contained in NTC's order dated September 19, 2009.

In an Order dated October 19, 2007 (CCC Case No. 94-223), the NTC granted BellTel a PA, valid for 18 months or until April 19, 2009, to install, operate and maintain a Mobile Telecommunication Network as set forth in the said Order. This PA was later extended for a period of three (3) years or until April 17, 2012 as per NTC Order dated August 14, 2009.

Prior to the extension of the PA in CCC Case No. 94-229, the NTC has issued a show cause order in January 2009 against BellTel for non-usage of assigned frequencies within the 1710-1720/1805-1815 megahertz band, which are within the wireless local loop band and this was regarded as in violation of the PA and the provisions of RA No. 3846 and NTC Memorandum Circular No. 3-3-96. However, in a decision dated August 4, 2009, the NTC resolved that BellTel has not violated the NTC Order and thus is not liable as charged and the case filed against BellTel was dismissed and closed.

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Properties

SMPI-GSIS Put Option

The Put Option between SMPI and GSIS can be exercised within a period of 10 years starting October 2008, which is the first anniversary of the original issuance of the shares to GSIS but effectively became exercisable only in 2010. The option exercise price is equivalent to ₱300 plus interest on such amount at the rate specified below.

<u>Year</u>	<u>Annual Interest Rate</u>	<u>Amount</u>
1	10%	₱330
2	10%	363
3	10%	399
4	10%	439
5	10%	483
6	8%	522
7	8%	564
8	8%	609
9	8%	657
10	8%	710

Any dividends declared and paid to stockholders prior to the exercise of the Put Option by GSIS will be deducted from interest provided above upon exercise of the option. As of December 31, 2010, the carrying amount of the obligation related to the Put Option amounts to ₱386 and is presented under “Accounts payable and accrued expenses” account in the 2010 consolidated statement of financial position (Note 22). Accretion expense of the obligation under a put option amounts to ₱2 and is presented as part of “Interest expense and other financing charges” in the consolidated statements of income.

Lease Commitments:

a. Finance Leases

Leases as Lessee

i. IPP Administration Agreements (Note 5)

The IPP Administration Agreements are with the conformity of NPC, a government-owned and controlled corporation created by virtue of Republic Act (RA) No. 6395, as amended, whereby NPC confirms, acknowledges, approves and agrees the terms of the Agreement and further confirms that for so long as it remains the IPP Counterparty it will comply with its obligations and exercise its rights and remedies under the original agreement with the IPP at the request and instruction of PSALM.

The SMEC, SPDC and SPPC have opened a performance bond of US\$58, US\$20 and US\$60, respectively, with the bank which expires on November 3, 2011, January 25, 2012 and June 16, 2011, respectively.

Relative to the IPPA Agreements, SMEC, SPDC and SPPC have to pay PSALM monthly fees for 15 years until October 1, 2024, 18 years until April 26, 2028 and 12 years until June 26, 2022, respectively.

The IPPA Agreements provide the Group with a right to receive a transfer of the power station in case of buyout or termination.

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In accounting for the Group's IPP Administration Agreements with PSALM, the Group's management has made a judgment that the IPP Administration Agreement is an agreement that contains a finance lease. The Group's management has made a judgment that it has substantially acquired all the risks and rewards incidental to ownership of the power plants. Accordingly, the Group recognized the capitalized asset and related liability of ₱209,303 and ₱208,394 (equivalent to the present value of the minimum lease payments using the Group's incremental borrowing rates for US dollar and Philippine peso payments) as "Power plants" and "Finance lease liabilities" in the consolidated statements of financial position.

The Group's incremental borrowing rates are as follows:

	<u>US Dollar</u>	<u>Philippine Peso</u>
SMEC	3.89%	8.16%
SPDC	3.30%	7.90%
SPPC.....	3.85%	8.05%

The discount determined at inception of the agreement is amortized over the period of the IPP Administration Agreement and recognized as "Interest expense" in the consolidated statements of income. Interest expense in 2010 amounted to ₱5,299.

The future minimum lease payments for each of the following periods are as follows:

	<u>Dollar Payments</u>	<u>Peso Equivalent of Dollar Payments</u>	<u>Peso Payments</u>	<u>Total</u>
Not later than one year	US\$ 129	P 5,671	P 6,109	P 11,780
More than one year and not later than five years	861	37,731	41,203	78,934
Later than five years	<u>2,486</u>	<u>108,981</u>	<u>114,966</u>	<u>223,947</u>
	3,476	152,383	162,278	314,661
Less: Future finance charges on finance lease liabilities	<u>897</u>	<u>32,888</u>	<u>73,379</u>	<u>106,267</u>
Present values of finance lease liabilities. . .	<u>US\$2,579</u>	<u>₱119,495</u>	<u>₱ 88,899</u>	<u>₱208,394</u>

The present values of minimum lease payments for each of the following periods are as follows:

	<u>Dollar Payments</u>	<u>Peso Equivalent of Dollar Payments</u>	<u>Peso Payments</u>	<u>Total</u>
Not later than one year	US\$ 123	P 5,406	P 5,529	P 10,935
More than one year and not later than five years	743	32,566	30,316	62,882
Later than five years	<u>1,713</u>	<u>81,523</u>	<u>53,054</u>	<u>134,577</u>
	<u>US\$2,579</u>	<u>₱119,495</u>	<u>₱88,899</u>	<u>₱208,394</u>

ii. Automobiles

The Group's finance leases also cover automobiles needed for business operations. These agreements do not allow subleasing. Some leases provide the Group with the option to purchase the equipment at a beneficial price. As of December 31, 2010 and 2009, the net carrying amount of leased transportation equipment was ₱13 and ₱30, respectively.

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The Group's minimum lease payments of the finance lease liabilities relating to automobiles are as follows:

<u>2010</u>	<u>Minimum Lease Payable</u>	<u>Interest</u>	<u>Principal</u>
Within one year	<u>P14</u>	<u>P3</u>	<u>P11</u>
After one year but not more than five years	<u>3</u>	<u>1</u>	<u>2</u>
	<u><u>P17</u></u>	<u><u>P4</u></u>	<u><u>P13</u></u>

<u>2009</u>	<u>Minimum Lease Payable</u>	<u>Interest</u>	<u>Principal</u>
Within one year	<u>P14</u>	<u>P1</u>	<u>P13</u>
After one year but not more than five years	<u>19</u>	<u>2</u>	<u>17</u>
	<u><u>P33</u></u>	<u><u>P3</u></u>	<u><u>P30</u></u>

Leases as Lessor

The Group leases some of its machinery and equipment under finance lease agreements to a third party logistics provider. The Group provides the lessee the option to purchase the equipment at the end of the lease term.

The current finance lease receivables included under "Trade and other receivables" in the consolidated statements of financial position are as follows:

	<u>December 31, 2009</u>		
	<u>Minimum Lease Receivable</u>	<u>Interest</u>	<u>Principal</u>
Within one year	<u>P5</u>	<u>P—</u>	<u>P5</u>

The Group does not have future lease receivable under finance lease as of December 31, 2010.

b. Operating Leases

Leases as Lessor

The Group has entered into lease agreements on its investment property portfolio, consisting of surplus office spaces (Note 17). These non-cancellable leases will expire up to year 2014. All leases include a clause to enable upward revision of the rental charge on an annual basis based on prevailing market conditions.

As of December 31, 2010, 2009 and 2008, the future minimum lease receipts under non-cancellable operating leases are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Within one year	<u>P380</u>	<u>P 78</u>	<u>P 94</u>
After one year but not more than five years	<u>541</u>	<u>62</u>	<u>114</u>
After five years	<u>52</u>	<u>—</u>	<u>—</u>
	<u><u>P973</u></u>	<u><u>P140</u></u>	<u><u>P208</u></u>

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Rent income recognized in profit or loss amounted to ₱267, ₱545 and ₱402 in 2010, 2009 and 2008, respectively.

Leases as Lessee

The Group leases a number of office, warehouse and factory facilities under operating leases. The leases typically run for a period of two to seven years. Some leases provide an option to renew the lease at the end of the lease term and are being subjected to reviews to reflect current market rentals.

As of December 31, 2010, 2009 and 2008, non-cancellable operating lease rentals are payable as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Within one year	₱ 866	₱ 35	₱ 290
After one year but not more than five years	2,412	109	748
More than five years	<u>7,196</u>	<u>409</u>	<u>35</u>
	<u><u>₱10,474</u></u>	<u><u>₱553</u></u>	<u><u>₱1,073</u></u>

36. Retirement Plans

The Parent Company and majority of its subsidiaries have funded, noncontributory, defined benefit retirement plans covering all of their permanent employees. Contributions and costs are determined in accordance with the actuarial studies made for the plans. Annual cost is determined using the projected unit credit method. Majority of the Group's latest actuarial valuation date is December 31, 2010. Valuations are obtained on a periodic basis.

Retirement costs (benefits) charged by the Parent Company to operations amounted to (₱371), ₱65 and ₱422 in 2010, 2009 and 2008, respectively, while those charged by the subsidiaries amounted to ₱656, ₱529 and ₱435 in 2010, 2009 and 2008, respectively. The Group's annual contribution to the retirement plans consists of payments covering the current service cost and amortization of past service costs.

The components of retirement costs recognized in profit or loss in 2010, 2009 and 2008 and the amounts recognized in the consolidated statements of financial position as of December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current service cost	₱ 652	₱ 486	₱ 532
Interest cost	1,082	992	834
Expected return on plan assets	(1,170)	(868)	(772)
Net actuarial loss (gain)	(282)	(64)	49
Effect of curtailment	3	(24)	—
Amortization of transitional liability	—	66	173
Past service costs	<u>—</u>	<u>6</u>	<u>41</u>
Net retirement costs	<u><u>₱ 285</u></u>	<u><u>₱ 594</u></u>	<u><u>₱ 857</u></u>
Actual return on plan assets	<u><u>₱25,920</u></u>	<u><u>₱6,099</u></u>	<u><u>₱ 477</u></u>

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The retirement costs are recognized in the following line items in the consolidated statements of income:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cost of sales	27	P143	P123	P144
Selling and administrative expenses	28	142	471	713
	30	P285	P594	P857

The reconciliation of the assets and liabilities recognized in the consolidated statements of financial position is as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Present value of defined benefit obligation		P 18,386	P12,362
Fair value of plan assets		43,964	15,178
		(25,578)	(2,816)
Unrecognized actuarial gain	4	25,846	3,271
Unrecognized past service costs		(1)	(1)
Net retirement liabilities		P 267	P 454

Net retirement assets and liabilities in 2010 are included as part of “Prepaid and other current assets” and “Others” under “Other noncurrent assets” accounts amounting to P221 and P147, respectively (Notes 12 and 20), and under “Accounts payable and accrued expenses” and “Other noncurrent liabilities” accounts amounting to P503 and P132, respectively as of December 31, 2010 (Notes 22 and 24).

Net retirement assets and liabilities in 2009 are included as part of “Prepaid expenses and other current assets” and “Others” under “Other noncurrent assets” accounts amounting to P150 and P160, respectively (Notes 12 and 20), and under “Accounts payable and accrued expenses — others” and “Other noncurrent liabilities” accounts amounting to P572 and P192, respectively (Notes 22 and 24).

The movements in the present value of defined benefit obligation are as follows:

	<u>2010</u>	<u>2009</u>
Balance at beginning of year	P12,362	P11,080
Benefit obligation of a new subsidiary	4,264	—
Interest cost	1,346	992
Current service cost	652	486
Past service costs	—	4
Benefits paid	(2,324)	(1,817)
Actuarial losses	1,919	1,628
Effect of curtailment	163	(11)
Translation adjustments	4	—
Balance at end of year	P18,386	P12,362

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The movements in the fair value of the plan assets are as follows:

	<u>2010</u>	<u>2009</u>
Balance at beginning of year	P15,178	P10,232
Plan assets of a new subsidiary	4,443	—
Expected return	1,469	868
Contributions by employer	698	660
Benefits paid	(2,324)	(1,813)
Effect of curtailment	41	—
Actuarial gains	24,451	5,231
Translation adjustments	8	—
Balance at end of year	<u>P43,964</u>	<u>P15,178</u>

Plan assets consist of the following:

	<u>In Percentages</u>	
	<u>2010</u>	<u>2009</u>
Stock trading portfolio	2	4
Fixed income portfolio	52	62
Others	46	34

As of December 31, 2010, the plan assets include 551,670 common shares of the Parent Company with fair market value per share of P163.80.

As of December 31, 2009, the plan assets include 10,000 Class “A” common shares and 20,000 Class “B” common shares of the Parent Company with fair market values per share of P68.50 for Class “A” and Class “B” common shares.

On October 5, 2009, SMCRP exchanged on a one-for-one basis its 6,715,543 Class “A” common shares and 78,606,542 Class “B” common shares to Series “1” preferred shares of the Parent Company at an issue price of P75.00 per share. The fair market value per preferred share was P87.00 as of December 31, 2010.

SMCRP’s 38.19% and 21% investment in shares of stock of BOC as of December 31, 2010 and 2009, respectively, is included in the above list of plan assets under “Others”.

The overall expected rate of return is determined based on historical performance of investments.

The principal actuarial assumptions used to determine retirement benefits are as follows:

	<u>In Percentages</u>	
	<u>2010</u>	<u>2009</u>
Discount rate	5 - 8	8 - 11
Salary increase rate	8	8
Expected return on plan assets	10	10

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The historical information for the current and previous four annual periods is as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Present value of the defined benefit obligation	P 18,386	P12,362	P11,080	P11,332	P14,236
Fair value of plan assets	43,964	15,178	10,232	10,726	10,241
Deficit (excess) in the plan	(25,578)	(2,816)	848	606	3,995
Experience adjustments on plan liabilities	(132)	927	6	933	(188)

The Group expects to contribute P285 to its defined benefit plans in 2011.

37. Cash Dividends

Cash dividends declared by the Parent Company's BOD to common shareholders amounted to P6.75 per share and P0.70 per share as of December 31, 2010 and 2009, respectively.

Cash dividends declared by the Parent Company's BOD to preferred shareholders amounted to P6.00 per share as of December 31, 2010.

On February 10, 2011, the Parent Company's BOD declared cash dividends at P1.50 per share, payable on February 18, 2011 to all preferred shareholders as of February 4, 2011.

On March 14, 2011, the Parent Company's BOD declared cash dividends at P0.35 per share, payable on April 11, 2011 to all common shareholders as of March 28, 2011.

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38. Basic and Diluted Earnings Per Share

Basic and Diluted EPS is computed as follows:

	<u>Note</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Income from continuing operations attributable to equity holders of the Parent Company		P20,091	P57,799	P13,935
Dividends on preferred shares for the period(a)		<u>(5,823)</u>	<u>(1,281)</u>	<u>—</u>
Net income from continuing operations attributable to common shareholders(b)		<u>14,268</u>	<u>56,518</u>	<u>13,935</u>
Income from discontinued operations attributable to equity holders of the Parent Company(c)	8	<u>—</u>	<u>—</u>	<u>5,413</u>
Net income attributable to common shareholders of the Parent Company(d)		<u>P14,268</u>	<u>P56,518</u>	<u>P19,348</u>
Weighted average number of common shares outstanding (in millions) — basic(e)		2,310	2,942	3,157
Effect of dilution — common		<u>14</u>	<u>17</u>	<u>12</u>
Weighted average number of common shares outstanding (in millions) — diluted(f)		<u>2,324</u>	<u>2,959</u>	<u>3,169</u>
Common:				
Basic EPS from continuing operations (b/e)		P 6.18	P 19.21	P 4.41
Basic EPS from discontinued operations (c/e)		<u>—</u>	<u>—</u>	<u>1.72</u>
		<u>P 6.18</u>	<u>P 19.21</u>	<u>P 6.13</u>
Diluted EPS from continuing operations (b/f)		P 6.14	P 19.10	P 4.40
Diluted EPS from discontinued operations (c/f)		<u>—</u>	<u>—</u>	<u>1.71</u>
		<u>P 6.14</u>	<u>P 19.10</u>	<u>P 6.11</u>

39. Supplemental Cash Flow Information

Supplemental information with respect to the consolidated statements of cash flows is presented below:

a. Changes in noncash current assets and certain current liabilities and others are as follows (amounts reflect actual cash flows rather than increases or decreases of the accounts in the consolidated statements of financial position):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Trade and other receivables	P12,241	P 558	P 728
Inventories	2,178	1,085	(4,100)
Prepaid expenses and other current assets	(3,686)	(874)	759
Accounts payable and accrued expenses	7,581	6,393	1,779
Income and other taxes payable and others	<u>(5,202)</u>	<u>(8,345)</u>	<u>(457)</u>
	<u>P13,112</u>	<u>P(1,183)</u>	<u>P(1,291)</u>

b. Acquisition of subsidiaries — SMC Global, SRC, Petron, TCCI, PHC, PSCL, BellTel, TADHC, ULCBM, AGNP, IGI and SMPI-GSIS JVC in 2010 and JHK Investments and HLC in 2009 (Note 5).

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	<u>Note</u>	<u>2010</u>	<u>2009</u>
Cash and cash equivalents		P 42,729	P 193
Trade and other receivables — net		32,953	1,243
Inventories		35,315	664
Prepaid expenses and other current assets		4,599	23
Investment and advances — net		16,092	—
Property, plant and equipment — net		175,650	1,430
Investment properties — net		121	—
Assets held for sale		823	—
Other intangible assets — net		9,279	20
Deferred tax assets		430	72
Other noncurrent assets — net		23,437	—
Drafts and loans payable		(34,987)	(839)
Accounts payable and accrued expenses		(28,114)	(2,076)
Income and other taxes payable		(1,267)	—
Current maturities of long-term debt — net of debt issue costs		(9,193)	—
Deferred tax liabilities		(2,539)	(40)
Long-term debt — net of current maturities and debt issue costs		(43,452)	—
Other noncurrent liabilities		(151,777)	(88)
Non-controlling interests		<u>(25,518)</u>	<u>(211)</u>
Net assets		44,581	391
Cash and cash equivalents		(42,729)	(193)
Goodwill in subsidiaries	5, 19	24,456	1,296
Investment at equity		(1,444)	—
Revaluation increment		(1,396)	—
Gain on acquisition of a subsidiary	5, 33	<u>(4,490)</u>	<u>—</u>
Net cash flows		<u><u>P 18,978</u></u>	<u><u>P 1,494</u></u>

40. Share-Based Transactions

ESPP

Under the ESPP, 80,396,659 shares (inclusive of stock dividends declared) of the Parent Company's unissued shares have been reserved for the employees of the Group until 2010. All permanent Philippine-based employees of the Group, who have been employed for a continuous period of one year prior to the subscription period, will be allowed to subscribe at 15% discount to the market price equal to the weighted average of the daily closing prices for three months prior to the offer period. A participating employee may acquire at least 100 shares of stock through payroll deductions.

The ESPP requires the subscribed shares and stock dividends accruing thereto to be pledged to the Parent Company until the subscription is fully paid. The right to subscribe under the ESPP cannot be assigned or transferred. A participant may sell his shares after the second year from the exercise date. The current portion of subscriptions receivable as of December 31, 2010 and 2009 amounted to P170 and P141, respectively, presented as part of "Non-trade" under "Trade and other receivables" account (Note 10). The noncurrent

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portion of ₱1,002 and ₱363 as of December 31, 2010 and 2009, respectively, is reported as part of “Noncurrent receivables and deposits” under “Other noncurrent assets” account (Note 20).

The ESPP also allows subsequent withdrawal and cancellation of participants’ subscriptions under certain terms and conditions. The shares pertaining to withdrawn or cancelled subscriptions shall remain issued shares and shall revert to the pool of shares available under the ESPP.

The table below shows the number and weighted average exercise prices of grants:

	2010	
	Number of Shares	Weighted Average Exercise Price
Class “A”		
Subscribed during the year.	24,323,050	₱ 60.31
Cancelled during the year	(173,250)	(59.09)
Class “B”		
Subscribed during the year.	1,272,800	₱ 58.39
Cancelled during the year	(11,600)	(50.45)

Effective August 26, 2010, all Class “A” common shares and Class “B” common shares of the Parent Company shall be considered as common shares without distinction.

	2009		2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Class “A”				
Subscribed during the year.	2,189,450	₱ 42.46	3,745,100	₱ 42.36
Cancelled during the year	(248,100)	(50.62)	(3,125,900)	(53.07)
Class “B”				
Subscribed during the year.	2,688,750	44.92	2,602,450	41.53
Cancelled during the year	(383,700)	(60.18)	(2,602,450)	(62.10)

The average market prices of the shares granted were ₱70.96, ₱49.95 and ₱49.83 per share in 2010, 2009 and 2008, respectively, for Class “A” common shares and ₱68.69, ₱52.84 and ₱48.87 per share in 2010, 2009 and 2008, respectively, for Class “B” common shares.

The average remaining contractual life of the ESPP was 1.55, 1.41 and 0.60 years as of December 31, 2010, 2009 and 2008, respectively, for Class “A” common shares and 0.83, 1.66 and 0.46 years as of December 31, 2010, 2009 and 2008, respectively, for Class “B” common shares.

LTIP

The Parent Company also maintains LTIP for executives of the Group. The options are exercisable at the fair market value of the Parent Company shares as of date of grant, with adjustments depending on the average stock prices of the prior three months. A total of 54,244,905 shares, inclusive of stock dividends declared, are reserved for the LTIP over its 10-year life. The LTIP is administered by the Executive Compensation Committee of the Parent Company’s BOD.

On June 26, 2008, the Parent Company approved the grant of stock options to 742 executives consisting of 7,456,452 shares based on the closing price of the Parent Company’s share, computed in accordance with the provisions of LTIP. Also on June 25, 2009, the Parent Company approved the grant of stock options to 755 executives consisting of 5,750,941 shares.

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Options to purchase 14,038,733 shares and 17,211,921 shares in 2010 and 2009, respectively, were outstanding at the end of each year. Options which were exercised and cancelled totaled about 13,232,699 shares and 3,230,094 shares in 2010 and 2009, respectively.

The stock options granted under the LTIP cannot be assigned or transferred by a participant and are subject to a vesting schedule. After one complete year from the date of the grant, 33% of the stock option becomes vested. Another 33% is vested on the second year and the remaining option lot is fully vested on the third year.

Vested stock options may be exercised at any time, up to a maximum of eight years from the date of grant. All unexercised stock options after this period are considered forfeited.

A summary of the status of the outstanding share stock options and the related weighted average exercise price under the LTIP is shown below:

	2010	
	Number of Share Stock Options	Weighted Average Exercise Price
Class "A"		
Balance at beginning of year	22,054,784	₱ 57.39
Exercised during the year	(8,734,635)	(58.74)
Expired during the year.	(180,290)	(56.94)
Balance at end of year	<u>13,139,859</u>	<u>₱ 56.50</u>
Class "B"		
Balance at beginning of year	11,998,933	₱ 70.21
Exercised during the year	(4,503,677)	(70.83)
Expired during the year.	(266,520)	(74.39)
Balance at end of year	<u>7,228,736</u>	<u>₱ 69.66</u>

Effective August 26, 2010, all Class "A" common shares and Class "B" common shares of the Parent Company shall be considered as common shares without distinction.

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	2009		2008	
	Number of Share Stock Options	Weighted Average Exercise Price	Number of Share Stock Options	Weighted Average Exercise Price
Class “A”				
Balance at beginning of year	20,203,940	₱ 56.71	16,056,434	₱ 62.36
Granted during the year	4,922,958	58.05	5,219,517	40.50
Exercised during the year	(2,711,190)	(52.61)	(29,170)	(56.53)
Expired during the year	<u>(360,924)</u>	<u>(62.58)</u>	<u>(1,042,841)</u>	<u>(62.58)</u>
Balance at end of year	<u>22,054,784</u>	<u>₱ 57.39</u>	<u>20,203,940</u>	<u>₱ 56.71</u>
Class “B”				
Balance at beginning of year	11,911,370	₱ 69.94	10,359,853	₱ 76.79
Granted during the year	843,627	58.05	2,236,935	40.50
Exercised during the year	(518,904)	(41.30)	—	—
Expired during the year	<u>(237,160)</u>	<u>(84.71)</u>	<u>(685,418)</u>	<u>(77.39)</u>
Balance at end of year	<u>11,998,933</u>	<u>₱ 70.21</u>	<u>11,911,370</u>	<u>₱ 69.94</u>

The shares covered by the LTIP are offered for subscription to the participants for three years from approval of the LTIP by the SEC.

The fair value of equity-settled share options granted is estimated as at the date of grant using Black-Scholes option-pricing model, taking into account the terms and conditions upon which the options were granted. Expected volatility is estimated by considering average share price volatility.

The inputs to the model used to measure the fair value of the shares granted in 2009 are as follows:

	2009 Grant	
	Class “A”	Class “B”
Dividend yield	2.41%	2.41%
Expected volatility	53%	43%
Historical volatility	53%	43%
Risk-free interest rate	5.15% to 7.76%	5.15% to 7.76%
Expected life option	1 to 8 years	1 to 8 years
Weighted average share price	58.05	58.05

The weighted average fair value of options granted in 2009 was ₱19.24 for Class “A” common shares and ₱16.19 for Class “B” common shares.

The range of exercise prices for options outstanding was ₱58.05 to ₱40.50 as of December 31, 2010 and 2009 for Class “A” common shares and ₱58.05 to ₱40.50 as of December 31, 2010 and 2009 for Class “B” common shares.

The average remaining contractual life of the LTIP was 1.05, 1.11 and 1.43 years as of December 31, 2010, 2009 and 2008, respectively, for Class “A” common shares and 0.83, 0.63 and 1.30 years as of December 31, 2010, 2009 and 2008, respectively, for Class “B” common shares.

Share-based payment charged to operations, included under “Administrative expenses — others” account, amounted to ₱315, ₱236 and ₱258 in 2010, 2009 and 2008, respectively.

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41. Financial Risk Management Objectives and Policies

Objectives and Policies

The Group has significant exposure to the following financial risks primarily from its use of financial instruments:

- Interest Rate Risk
- Foreign Currency Risk
- Commodity Price Risk
- Liquidity Risk
- Credit Risk

This note presents information about the Group's exposure to each of the foregoing risks, the Group's objectives, policies and processes for measuring and managing these risks, and the Group's management of capital.

The Group's principal non-trade related financial instruments include cash and cash equivalents, AFS financial assets, short-term and long-term loans, and derivative instruments. These financial instruments, except derivative instruments, are used mainly for working capital management purposes. The Group's trade-related financial assets and financial liabilities such as trade and other receivables, noncurrent receivables and deposits, accounts payable and accrued expenses, finance lease liabilities and other noncurrent liabilities arise directly from and are used to facilitate its daily operations.

The Group's outstanding derivative instruments such as commodity and currency options, forwards and swaps are intended mainly for risk management purposes. The Group uses derivatives to manage its exposures to foreign currency, interest rate and commodity price risks arising from the Group's operating and financing activities.

The BOD has the overall responsibility for the establishment and oversight of the Group's risk management framework. The BOD has established the Risk Management Committee, which is responsible for developing and monitoring the Group's risk management policies. The committee reports regularly to the BOD on its activities.

The Group's risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The Group's accounting policies in relation to derivatives are set out in Note 3 to the consolidated financial statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Interest Rate Risk

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group's exposure to changes in interest rates relates primarily to the Group's long-term borrowings and investment securities. Investments acquired or borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, investment securities acquired or borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest cost by using an optimal combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rate and ensures that the mark-up rates charged on its borrowings are optimal and benchmarked against the rates charged by other creditor banks.

On the other hand, the Group's investment policy is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the Group's operations and working capital management. However, the Group invests only in high-quality securities while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term fluctuations on the Group's earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios. Interest rate movements affect reported equity in the following ways:

- retained earnings arising from increases or decreases in interest income or interest expense as well as fair value changes reported in profit or loss, if any;
- fair value reserves arising from increases or decreases in fair values of AFS financial assets reported as part of other comprehensive income; and
- hedging reserves arising from increases or decreases in fair values of hedging instruments designated in qualifying cash flow hedge relationships reported as part of other comprehensive income.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by ₱910 and ₱301 in 2010 and 2009, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. These changes are considered to be reasonably possible given the observation of prevailing market conditions in those periods. There is no impact on the Group's other comprehensive income.

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Interest Rate Risk Table

As at December 31, 2010 and 2009, the terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

December 31, 2010	<1 Year	1-<2 Years	>2-<3 Years	>3-<4 Years	>4-<5 Years	>5 Years	Total
Fixed rate							
Philippine peso-denominated	P6,963	P15,004	P476	P29,249	P1,234	P27,322	P80,248
Interest rate	6.73% - 9.33%	6.5% - 9.33%	7.25% - 9.33%	7.25% - 9.33%	5.4885% - 9.33%	7% - 10.5%	
Floating rate							
Philippine peso-denominated	1,667	2,000	1,000	800	11,550	—	17,017
Interest rate	PDST-F +margin	PDST-F +margin	PDST-F +margin	PDST-F +margin	PDST-F +margin		
Foreign currency-denominated (expressed in Philippine peso)	4,092	4,080	3,583	3,520	58,721	—	73,996
Interest rate	LIBOR, THBFX and VNIBOR +margin	LIBOR, THBFX and VNIBOR +margin	LIBOR and THBFX +margin	LIBOR and THBFX +margin	LIBOR +margin		
	<u>P12,722</u>	<u>P21,084</u>	<u>P5,059</u>	<u>P33,569</u>	<u>P71,505</u>	<u>P27,322</u>	<u>P171,261</u>
December 31, 2009	<1 Year	1-<2 Years	>2-<3 Years	>3-<4 Years	>4-<5 Years	>5 Years	Total
Fixed rate							
Philippine peso-denominated	P—	P—	P14,545	P—	P23,670	P2,810	P41,025
Interest rate			6.50% - 8.25%		7.25% - 8.875%	10.50%	
Floating rate							
Philippine peso-denominated	—	PDST-F +margin	400	400	800	—	3,000
Interest rate			PDST-F +margin	PDST-F +margin	PDST-F +margin		
Foreign currency-denominated (expressed in Philippine peso)	1,081	1,081	28,335	119	59	—	30,675
Interest rate	THBFX, VNIBOR +margin; and discount from PBOC lending rate	THBFX, VNIBOR +margin; and discount from PBOC lending rate	LIBOR, THBFX, VNIBOR +margin	THBFX +margin	THBFX +margin		
	<u>P1,081</u>	<u>P1,481</u>	<u>P44,280</u>	<u>P519</u>	<u>P24,529</u>	<u>P2,810</u>	<u>P74,700</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Foreign Currency Risk

The Group's functional currency is the Philippine peso, which is the denomination of the bulk of the Group's revenues. The Group's exposure to foreign currency risk results from significant movements in foreign exchange rates that adversely affect the foreign currency-denominated transactions of the Group. The Group's risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity. The Group enters into foreign currency hedges using a combination of non-derivative and derivative instruments such as foreign currency forwards, options or swaps to manage its foreign currency risk exposure.

Short-term currency forward contracts (deliverable and non-deliverable) and options are entered into to manage foreign currency risks arising from importations, revenue and expense transactions, and other foreign currency-denominated obligations. Currency swaps are entered into to manage foreign currency risks relating to long-term foreign currency-denominated borrowings.

Information on the Group's foreign currency-denominated monetary assets and liabilities and their Philippine peso equivalents are as follows:

	2010		2009	
	US Dollar	Peso Equivalent	US Dollar	Peso Equivalent
Assets				
Cash and cash equivalents	US\$1,456	P 63,812	US\$2,817	P130,134
Trade and other receivables	299	13,120	96	4,413
Noncurrent receivables	3	151	101	4,656
	<u>1,758</u>	<u>77,083</u>	<u>3,014</u>	<u>139,203</u>
Liabilities				
Drafts and loans payable	139	6,065	137	6,332
Accounts payable and accrued expenses	965	42,290	98	4,528
Long-term debt (including current maturities) . .	1,333	73,995	664	30,674
Finance lease liabilities	2,636	115,556	—	—
Other noncurrent liabilities	1	35	—	—
	<u>5,074</u>	<u>237,941</u>	<u>899</u>	<u>41,534</u>
Net foreign currency-denominated monetary assets (liabilities)	<u>US\$(3,316)</u>	<u>P(160,858)</u>	<u>US\$2,115</u>	<u>P 97,669</u>

The Group reported net foreign exchange gains (losses) amounting to P8,366, (P2,256) and (P7,298) in 2010, 2009 and 2008, respectively, with the translation of its foreign currency-denominated assets and liabilities. These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

	Peso to US Dollar
December 31, 2008	47.52
December 31, 2009	46.20
December 31, 2010	43.84

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The management of foreign currency risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various foreign currency exchange rate scenarios. Foreign exchange movements affect reported equity in the following ways:

- retained earnings arising from increases or decreases in unrealized and realized foreign exchange gains or losses;
- translation reserves arising from increases or decreases in foreign exchange gains or losses recognized directly as part of other comprehensive income; and
- hedging reserves arising from increases or decreases in foreign exchange gains or losses of the hedged item and the hedging instrument.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) and the Group's equity (due to translation of results and financial position of foreign operations) as of December 31, 2010 and 2009:

	₱1 Decrease in the US Dollar Exchange Rate		₱1 Increase in the US Dollar Exchange Rate	
	Effect on Income Before Income Tax	Effect on Equity	Effect on Income Before Income Tax	Effect on Equity
<u>2010</u>				
Cash and cash equivalents	₱(29,066)	₱(20,462)	₱ 29,066	₱20,462
Trade and other receivables	(7,634)	(5,438)	7,634	5,438
Noncurrent receivables	(29)	(23)	29	23
	<u>(36,729)</u>	<u>(25,923)</u>	<u>36,729</u>	<u>25,923</u>
Drafts and loans payable	2,592	74	(2,592)	(74)
Accounts payable and accrued expenses . .	12,905	289	(12,905)	(289)
Long-term debt (including current maturities)	16,873	940	(16,873)	(940)
Finance lease liabilities	2,636	—	(2,636)	—
Other noncurrent liabilities	1	1	(1)	(1)
	<u>35,007</u>	<u>1,304</u>	<u>(35,007)</u>	<u>(1,304)</u>
	<u>₱ (1,722)</u>	<u>₱(24,619)</u>	<u>₱ 1,722</u>	<u>₱24,619</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	₱1 Decrease in the US Dollar Exchange Rate		₱1 Increase in the US Dollar Exchange Rate	
	Effect on Income Before Income Tax	Effect on Equity	Effect on Income Before Income Tax	Effect on Equity
2009				
Cash and cash equivalents	₱(2,685)	₱(1,743)	₱2,685	₱1,743
Trade and other receivables	(7)	(93)	7	93
Noncurrent receivables	<u>(100)</u>	<u>(61)</u>	<u>100</u>	<u>61</u>
	<u>(2,792)</u>	<u>(1,897)</u>	<u>2,792</u>	<u>1,897</u>
Drafts and loans payable	69	109	(69)	(109)
Accounts payable and accrued expenses	8	95	(8)	(95)
Long-term debt (including current maturities) . .	<u>600</u>	<u>424</u>	<u>(600)</u>	<u>(424)</u>
	<u>677</u>	<u>628</u>	<u>(677)</u>	<u>(628)</u>
	<u>₱(2,115)</u>	<u>₱(1,269)</u>	<u>₱2,115</u>	<u>₱1,269</u>

Exposures to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nonetheless, the analysis above is considered to be representative of the Group's currency risk.

Commodity Price Risk

Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in commodity prices. The Group enters into various commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show marked-to-market losses; however, any loss in the marked-to-market position is offset by the resulting lower physical raw material cost.

The Parent Company enters into commodity derivative transactions on behalf of its subsidiaries and affiliates to reduce cost by optimizing purchasing synergies within the Group and managing inventory levels of common materials.

Commodity Swaps, Futures and Options. Commodity swaps, futures and options are used to manage the Group's exposures to volatility in prices of certain commodities such as fuel oil, crude oil, aluminum, soybean meal and wheat.

Commodity Forwards. The Group enters into forward purchases of various commodities. The prices of the commodity forwards are fixed either through direct agreement with suppliers or by reference to a relevant commodity price index.

Liquidity Risk

Liquidity risk pertains to the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group's objectives to manage its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Group constantly monitors and manages its liquidity position, liquidity gaps or surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted payments used for liquidity management as of December 31, 2010 and 2009.

<u>2010</u>	<u>Carrying Amount</u>	<u>Contractual Cash Flow</u>	<u>1 Year or Less</u>	<u>> 1 Year - 2 Years</u>	<u>>2 Years - 5 Years</u>	<u>Over 5 Years</u>
Financial Assets						
Cash and cash equivalents	P125,188	P125,188	P125,188	P —	P —	P —
Trade and other receivables — net	75,904	75,904	75,904	—	—	—
Derivative assets (included under "Prepaid expenses and other current assets" account in the consolidated statements of financial position)	249	249	249	—	—	—
Financial assets at FVPL (included under "Prepaid expenses and other current assets" account in the consolidated statements of financial position)	193	193	193	—	—	—
AFS financial assets	3,597	3,597	—	3,597	—	—
Noncurrent receivables and deposits — net (included under "Other noncurrent assets" account in the consolidated statements of financial position)	24,783	24,783	—	24,783	—	—
Financial Liabilities						
Drafts and loans payable	74,128	75,057	75,057	—	—	—
Accounts payable and accrued expenses (excluding current retirement liabilities and IRO)	69,198	69,198	69,198	—	—	—
Derivative liabilities (included under "Accounts payable and accrued expenses" account in the consolidated statements of financial position)	71	71	71	—	—	—
Long-term debt (including current maturities)	168,927	209,335	22,250	28,947	126,378	31,760
Finance lease liabilities (including current portion)	208,407	314,678	11,794	18,479	60,458	223,947
Other noncurrent liabilities (excluding noncurrent retirement liabilities, ARO and IRO)	16,168	16,168	—	16,168	—	—

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

<u>2009</u>	<u>Carrying Amount</u>	<u>Contractual Cash Flow</u>	<u>1 Year or Less</u>	<u>> 1 Year - 2 Years</u>	<u>> 2 Years - 5 Years</u>	<u>Over 5 Years</u>
Financial Assets						
Cash and cash equivalents	P209,411	P209,411	P209,411	P —	P —	P —
Trade and other receivables — net	49,082	49,082	49,082	—	—	—
Derivative assets (included under “Prepaid expenses and other current assets” account in the consolidated statements of financial position)	202	202	202	—	—	—
AFS financial assets	351	351	—	351	—	—
Noncurrent receivables and deposits — net (included under “Other noncurrent assets” account in the consolidated statements of financial position)	5,933	5,933	—	—	5,933	—
Financial Liabilities						
Drafts and loans payable	56,789	56,925	56,925	—	—	—
Accounts payable and accrued expenses (excluding current retirement liabilities)	30,708	30,708	30,708	—	—	—
Derivative liabilities (included under “Accounts payable and accrued expenses” account in the consolidated statements of financial position)	111	111	111	—	—	—
Long-term debt (including current maturities) . . .	72,962	89,747	4,836	5,318	75,526	4,067
Finance lease liabilities	30	33	14	19	—	—
Other noncurrent liabilities (excluding noncurrent retirement liabilities)	19,393	19,393	—	7,803	11,590	—

Credit Risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group’s trade receivables and investment securities. The Group manages its credit risk mainly through the application of transaction limits and close risk monitoring. It is the Group’s policy to enter into transactions with a wide diversity of creditworthy counterparties to mitigate any significant concentration of credit risk. The Group has regular internal control reviews to monitor the granting of credit and management of credit exposures.

Trade and Other Receivables

The Group’s exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group’s customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on the credit risk.

Goods are subject to retention of title clauses so that in the event of default, the Group would have a secured claim. Where appropriate, the Group obtains collateral or arranges master netting agreements.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the Group’s standard payment and delivery terms and conditions are offered. The Group ensures that sales on account are made to customers with appropriate credit history. The Group has detailed credit criteria and several layers of credit approval requirements before engaging a particular customer or counterparty. The Group’s review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer and are reviewed on a regular basis.

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Customers that fail to meet the Group's benchmark creditworthiness may transact with the Group only on a prepayment basis.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Investments

The Group recognizes provision for impairment losses based on specific and collective impairment tests, when objective evidence of impairment has been identified either on an individual account or on a portfolio level.

Financial information on the Group's maximum exposure to credit risk as of December 31, 2010 and 2009, without considering the effects of collaterals and other risk mitigation techniques, is presented below.

	<u>Note</u>	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	9	₱125,188	₱209,411
Trade and other receivables — net	10	75,904	49,082
Derivative assets	12	249	202
Financial assets at FVPL	12	193	—
AFS financial assets	14	3,597	351
Noncurrent receivables and deposits — net	20	24,783	5,933
		<u>₱229,914</u>	<u>₱264,979</u>

The credit risk for cash and cash equivalents, derivative assets, financial assets at FVPL and AFS financial assets is considered negligible, since the counterparties are reputable entities with high quality external credit ratings.

The Group's exposure to credit risk arises from default of counterparty. Generally, the maximum credit risk exposure of receivables is its carrying amount without considering collaterals or credit enhancements, if any. The Group has no significant concentration of credit risk since the Group deals with a large number of homogenous trade customers. The Group does not execute any credit guarantee in favor of any counterparty.

Financial and Other Risks Relating to Livestock

The Group is exposed to financial risks arising from the change in cost and supply of feed ingredients and the selling prices of chicken, hogs and cattle and related products, all of which are determined by constantly changing market forces of supply and demand, and other factors. The other factors include environmental regulations, weather conditions and livestock diseases for which the Group has little control. The mitigating factors are listed below.

- The Group is subject to risks affecting the food industry, generally, including risks posed by food spoilage and contamination. Specifically, the fresh meat industry is regulated by environmental, health and food safety organizations and regulatory sanctions. The Group has put into place systems to monitor food safety risks throughout all stages of manufacturing and processing to mitigate these risks. Furthermore, representatives from the government regulatory agencies are present at all times during the processing of dressed chicken in all dressing plants and issue certificates accordingly. The authorities, however, may impose additional regulatory requirements that may require significant capital investment at short notice.

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- The Group is subject to risks relating to its ability to maintain animal health status considering that it has no control over neighboring livestock farms. Livestock health problems could adversely impact production and consumer confidence. However, the Group monitors the health of its livestock on a daily basis and proper procedures are put in place.
- The livestock industry is exposed to risk associated with the supply and price of raw materials, mainly grain prices. Grain prices fluctuate depending on the harvest results. The shortage in the supply of grain will result in adverse fluctuation in the price of grain and will ultimately increase the Group's production cost. If necessary, the Group enters into forward contracts to secure the supply of raw materials at reasonable price.

Other Market Price Risk

The Group's market price risk arises from its investments carried at fair value (FVPL and AFS financial assets). The Group manages its risk arising from changes in market price by monitoring the changes in the market price of the investments.

Capital Management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its businesses and maximize shareholder value.

The Group manages its capital structure and makes adjustments, in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, pay-off existing debts, return capital to shareholders or issue new shares.

The Group defines capital as paid-in capital stock, additional paid-in capital and retained earnings, both appropriated and unappropriated. Other components of equity such as treasury stock and cumulative translation adjustments are excluded from capital for purposes of capital management.

The BOD has overall responsibility for monitoring capital in proportion to risk. Profiles for capital ratios are set in the light of changes in the Group's external environment and the risks underlying the Group's business, operation and industry.

The Group monitors capital on the basis of debt-to-equity ratio, which is calculated as total debt divided by total equity. Total debt is defined as total current liabilities and total noncurrent liabilities, while equity is total equity as shown in the consolidated statements of financial position.

There were no changes in the Group's approach to capital management during the year.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

42. Financial Assets and Financial Liabilities

The table below presents a comparison by category of carrying amounts and fair values of the Group's financial instruments as of December 31, 2010 and 2009:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Cash and cash equivalents	₱125,188	₱125,188	₱209,411	₱209,411
Trade and other receivables — net	75,904	75,904	49,082	49,082
Derivative assets (included under “Prepaid expenses and other current assets” account in the consolidated statements of financial position)	249	249	202	202
Financial assets at FVPL (included under “Prepaid expenses and other current assets” account in the consolidated statements of financial position)	193	193	—	—
AFS financial assets	3,597	3,597	351	351
Noncurrent receivables and deposits — net (included under “Other noncurrent assets” account in the consolidated statements of financial position)	24,783	24,783	5,933	5,933
Financial Liabilities				
Drafts and loans payable	74,128	74,128	56,789	56,789
Accounts payable and accrued expenses (excluding current retirement liabilities in 2010 and 2009 and IRO in 2010)	69,198	69,198	30,708	30,708
Derivative liabilities (included under “Accounts payable and accrued expenses” account in the consolidated statements of financial position)	71	71	111	111
Long-term debt (including current maturities)	168,927	182,030	72,962	77,773
Finance lease liabilities (including current portion)	208,407	208,407	30	30
Other noncurrent liabilities (excluding noncurrent retirement liabilities in 2010 and 2009 and ARO and IRO in 2010)	16,168	15,764	19,393	17,854

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents, Trade and Other Receivables and Noncurrent Receivables and Deposits. The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of long-term receivables, the fair value is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

Derivatives. The fair values of forward exchange contracts are calculated by reference to current forward exchange rates. In the case of freestanding currency and commodity derivatives, the fair values are determined based on quoted prices obtained from their respective active markets. Fair values for

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stand-alone derivative instruments that are not quoted from an active market and for embedded derivatives are based on valuation models used for similar instruments using both observable and non-observable inputs.

Financial Assets at FVPL and AFS Financial Assets. The fair values of publicly traded instruments and similar investments are based on quoted market prices in an active market. For debt instruments with no quoted market prices, a reasonable estimate of their fair values is calculated based on the expected cash flows from the instruments discounted using the applicable discount rates of comparable instruments quoted in active markets. Unquoted equity securities are carried at cost less impairment.

Drafts and Loans Payable and Accounts Payable and Accrued Expenses. The carrying amount of drafts and loans payable and accounts payable and accrued expenses approximates fair value due to the relatively short-term maturities of these financial instruments.

Long-term Debt, Finance Lease Liabilities and Other Noncurrent Liabilities. The fair value of interest-bearing fixed-rate loans is based on the discounted value of expected future cash flows using the applicable market rates for similar types of instruments as of reporting date. As of December 31, 2010 and 2009, discount rates used range from 1.3% to 5.7% and 4.3% to 8.0%, respectively. The carrying amounts of floating rate loans with quarterly interest rate repricing approximate their fair values.

Derivative Financial Instruments

The Group's derivative financial instruments according to the type of financial risk being managed and the details of freestanding and embedded derivative financial instruments that are categorized into those accounted for as hedges and those that are not designated as hedges are discussed below.

The Group enters into various currency and commodity derivative contracts to manage its exposure on foreign currency and commodity price risk. The portfolio is a mixture of instruments including forwards, swaps and options.

Derivative Instruments Accounted for as Hedges

Cash Flow Hedges

Commodity Options

In 2008, the Group has outstanding bought and sold options designated as hedge of forecasted purchases of fuel oil with a notional quantity of 12,000 metric tons. The call and put options were exercised at various calculation dates in 2009 with specified quantities on each calculation date. These option contracts were used to hedge the commodity price risk of the Group's commitments. There was no ineffective portion on these hedges. The amount charged to profit or loss in 2009 amounted to ₱159.

As of December 31, 2010 and 2009, the Group has no outstanding options designated as hedge on the purchase of commodity.

Other Derivative Instruments Not Designated as Hedges

The Group enters into certain derivatives as economic hedges of certain underlying exposures. These include freestanding and embedded derivatives found in host contracts, which are not designated as accounting hedges. Changes in fair value of these instruments are accounted for directly in profit or loss. Details are as follows:

Freestanding Derivatives

Freestanding derivatives consist of commodity and currency derivatives entered into by the Group.

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Currency Forwards

As of December 31, 2010, the Group has outstanding non-deliverable foreign currency forward contracts to hedge existing and anticipated US\$ denominated receivables. These forwards have an aggregate notional amount of US\$110 with various maturities in 2011. As of December 31, 2010, the net negative fair value of these currency forwards amounted to ₱8.

The Group has no outstanding currency forward contracts as of December 31, 2009.

Commodity Swaps

The Group has outstanding swap agreements covering its aluminum requirements, with various maturities in 2010 and 2011. Under the agreement, payment is made either by the Group or its counterparty for the difference between the agreed fixed price of aluminum and the price based on the relevant price index. The outstanding equivalent notional quantity covered by the commodity swaps as of December 31, 2010 and 2009 is 450 and 1,875 metric tons, respectively. As of December 31, 2010 and 2009, the positive fair value of these swaps amounted to ₱16 and ₱60, respectively.

Commodity Options

The Group has outstanding bought and sold options covering its wheat requirements with notional quantities as of December 31, 2010 and 2009 of 49,532 and 59,874 metric tons, respectively. These options can be exercised at various calculation dates in 2010 and 2011 with specified quantities on each calculation date. As of December 31, 2010 and 2009, the net positive (negative) fair value of these options amounted to ₱54 and (₱6), respectively.

Embedded Derivatives

The Group's embedded derivatives include currency derivatives (forwards and options) embedded in non-financial contracts.

Embedded Currency Forwards

As of December 31, 2010 and 2009, the total outstanding notional amount of currency forwards embedded in non-financial contracts amounted to US\$244 and US\$112, respectively. These non-financial contracts consist mainly of foreign currency- denominated purchase orders, sales agreements and capital expenditures. The embedded forwards are not clearly and closely related to their respective host contracts. As of December 31, 2010 and 2009, the net positive fair value of these embedded currency forwards amounted to ₱127 and ₱73, respectively.

Embedded Currency Options

As of December 31, 2010 and 2009, the total outstanding notional amount of currency options embedded in non-financial contracts amounted to US\$26 and US\$36, respectively. These non-financial contracts consist mainly of sales agreements. These embedded options are not clearly and closely related to their host contracts. As of December 31, 2010 and 2009, the net negative fair value of these embedded currency options amounted to ₱11 and ₱36, respectively.

For the years ended December 31, 2010, 2009 and 2008, the Group recognized marked-to-market gains (losses) from freestanding and embedded derivatives amounting to ₱660, ₱962 and (₱10,718), respectively.

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Fair Value Changes on Derivatives

The net movements in fair value of all derivative instruments for the years ended December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Balance at beginning of year	₱ 91	₱(2,162)
Net changes in fair value of derivatives:		
Designated as accounting hedges	—	77
Non-accounting hedges	660	914
	751	(1,171)
Less fair value of settled instruments	573	(1,262)
Balance at end of year	<u>₱178</u>	<u>₱ 91</u>

Fair Value Hierarchy

Financial assets and financial liabilities measured at fair value in the consolidated statements of financial position are categorized in accordance with the fair value hierarchy. This hierarchy groups financial assets and financial liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and financial liabilities.

The table below analyzes financial instruments carried at fair value, by valuation method as of December 31, 2010 and 2009. The different levels have been defined as follows:

- *Level 1:* quoted prices (unadjusted) in active markets for identical assets or liabilities;
- *Level 2:* inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- *Level 3:* inputs for the asset or liability that are not based on observable market data.

<u>2010</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Financial Assets			
Derivative assets	₱ 3	₱ 246	₱ 249
Financial assets at FVPL	193	—	193
AFS financial assets	2,477	1,120	3,597
Financial Liabilities			
Derivative liabilities	—	71	71
 <u>2009</u>	 <u>Level 1</u>	 <u>Level 2</u>	 <u>Total</u>
Financial Assets			
Derivative assets	₱ 65	₱137	₱202
AFS financial assets	239	112	351
Financial Liabilities			
Derivative liabilities	11	100	111

As of December 31, 2010 and 2009, the Group has no financial instruments valued based on Level 3. During the year, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

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The disclosure on fair value hierarchy is only presented for December 31, 2010 and 2009 as comparative information is not required in 2009, which was the first year of application of the amended PFRS 7.

43. Registration with the Board of Investments (BOI)

- SMPFC

SMFI

SMFI was registered with the BOI on a non-pioneer status as a New Producer of Animal Feeds for its Mariveles, Bataan plant and as a New Producer of Chicken (Dressed) for its Orion, Bataan farm in August 2006 and July 2007, respectively.

Under the terms of SMFI's BOI registration and subject to certain requirements as provided in the Omnibus Code of 1987, SMFI is entitled to incentives which included, among others, ITH for a period of four (4) years from January 2007 for Animal Feeds and from October 2007 for Dressed Chicken (can be extended to maximum of 8 years provided certain conditions are met).

SMFI's (formerly Monterey) Sumilao Hog Project (Sumilao Project) was registered with the BOI under Registration No. 2008-192, in accordance with the provisions of the Omnibus Investment Code of 1987 on a pioneer status as New Producer of Hogs on July 30, 2008. As a BOI-registrant, the Sumilao Project is entitled to incentives which included, among others, income tax holiday (ITH) for a period of six (6) years, extendable under certain conditions to eight (8) years, from February 2009 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration.

PF-Hormel

The existing registration of PF-Hormel with the BOI was made on May 18, 2006 in accordance with the provisions of the Omnibus Investments Code of 1987 as a new producer of processed meat products on a non-pioneer status. Under the terms of this new registration, PF-Hormel is entitled to certain tax incentives, including ITH for four years from July 2007, or from the actual start of commercial operations, whichever comes first, but in no case earlier than the date of registration.

PF-Hormel's new registered activity with the BOI commenced commercial operations in July 2007 and began to avail tax incentives since then.

- Petron

Isomerization and Gas Oil Hydrotreater Units

On January 7, 2004, the BOI approved Petron's application under RA 8479, otherwise known as the Downstream Oil Industry Deregulation Act (RA 8479), for new investments at its Bataan Refinery for an Isomerization Unit and a Gas Oil Hydrotreater ("Project"). The BOI is extending the following major incentives:

- a. ITH for five years without extension or bonus year from January 2005 for the Project and March 2005 for LVN Isomerization or actual start of commercial operations, whichever is earlier.
- b. Duty of three percent and VAT on imported capital equipment and accompanying spare parts.
- c. Tax credit on domestic capital equipment on locally fabricated capital equipment which is equivalent to the difference between the tariff rate and the three percent duty imposed on the imported counterpart.

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- d. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.
- e. Exemption from real property tax on production equipment or machinery.
- f. Exemption from contractor's tax.

Mixed Xylene, Benzene, Toluene (BTX) and Propylene Recovery Units

On October 20, 2005, Petron registered with the BOI under the Omnibus Investments Code of 1987 (Executive Order 226) as: (1) a non-pioneer, new export producer status of Mixed Xylene; (2) a pioneer, new export product status of Benzene and Toluene; and (3) a pioneer, new domestic producer status of Propylene. Under the terms of its registration, Petron is subject to certain requirements principally that of exporting at least 70% of the production of the mentioned petrochemical products every year except for the produced propylene.

As a registered enterprise, Petron is entitled to the following benefits on its production of petroleum products used as petrochemical feedstock:

- a. ITH: (1) for four years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Mixed Xylene subject to base figure of 120,460 metric tons per year representing Petron's highest attained production volume for the last three (3) years; (2) for six years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Benzene and Toluene; and (3) for six years from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Propylene.
- b. Tax credit equivalent to the national internal revenue taxes and duties paid on raw materials and supplies and semi-manufactured products used in producing its export product and forming parts thereof for ten years from start of commercial operations.
- c. Simplification of custom procedures.
- d. Access to Customs Bonded Manufacturing Warehouse (CBMW) subject to Custom rules and regulations provided firm exports at least 70% of production output.
- e. Exemption from wharfage dues, any export tax, duty, imposts and fees for a ten year period from date of registration.
- f. Importation of consigned equipment for a period of ten years from the date of registration subject to the posting of re-export bond.
- g. Exemption from taxes and duties on imported spare parts and consumable supplies for export producers with CBMW exporting at least 70% production.
- h. Petron may qualify to import capital equipment, spare parts, and accessories at zero duty from date of registration up to June 5, 2006 pursuant to Executive Order (EO) No. 313 and its Implementing Rules and Regulations.

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Fluidized Bed Catalytic Cracker (PetroFCC) Unit

On December 20, 2005, the BOI approved Petron's application under RA 8479 for new investment at its Bataan Refinery for the PetroFCC. Subject to Petron's compliance with the terms and conditions of registration, the BOI is extending the following major incentives:

- a. ITH for five years without extensions or bonus year from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to a rate of exemption computed based on the % share of product that are subject to retooling.
- b. Minimum duty of three percent and VAT on imported capital equipment and accompanying spare parts.
- c. Tax credit on domestic capital equipment shall be granted on locally fabricated capital equipment. This shall be equivalent to the difference between the tariff rate and the three percent (3%) duty imposed on the imported counterpart.
- d. Importation of consigned equipment for a period of five years from date of registration subject to posting of the appropriate re-export bond; provided that such consigned equipment shall be for the exclusive use of the registered activity.
- e. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.
- f. Exemption from real property tax on production equipment or machinery.
- g. Exemption from contractor's tax.

Grease Manufacturing Plant

In December 2005, the BOI approved Petron's application under RA 8479 as an Existing Industry Participant with New Investment in Modernization of the firm's Grease Manufacturing Plant in Pandacan, Manila. The BOI is extending the following major incentives:

- a. ITH for a period of five years without extension or bonus year from March 2006 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to base figure of 845 metric tons of grease product representing Petron's highest attained sales volume prior to rehabilitation.
- b. Minimum duty of three percent and VAT on imported capital equipment and accompanying spare parts.
- c. Tax credit on domestic capital equipment on locally fabricated capital equipment which is equivalent to the difference between the tariff rate and the three percent duty imposed on the imported counterpart.
- d. Importation of consigned equipment for a period of five years from date of registration subject to posting of the appropriate re-export bond; provided that such consigned equipment shall be for the exclusive use of the registered activity.
- e. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.
- f. Exemption from real property tax on production equipment or machinery.
- g. Exemption from contractor's tax.

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70 MW Coal-Fired Power Plant (Limap, Bataan)

On November 3, 2010, Petron registered with the BOI as new operator of a 70 MW Coal-Fired Power Plant on a pioneer status with non-pioneer incentives under the Omnibus Investments Code of 1987 (Executive Order No. 226). Subject to Petron's compliance with the terms and conditions of registration, the BOI is extending the following major incentives:

- a. ITH for four years from July 2012 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration limited to the revenue generated from the electricity sold to the grid.
- b. Importation of consigned equipment for a period of ten years from the date of registration subject to the posting of re-export bond.
- c. Zero percent (0%) duty from date of registration up to June 16, 2011 for imported capital equipment, spare parts and accessories.

Yearly certificates of entitlement have been timely obtained by Petron to support its ITH credits.

44. Events After the Reporting Date

a. Increase in BOC ownership

On January 13, 2011, SMPI acquired additional 7.16% of the outstanding capital stock of BOC, by way of a Deed of Sale of Shares with Assignment of Subscription Rights from Valiant Ventures and Development Holdings, Inc., consisting of: (i) 2,800,000 outstanding and issued common shares of stock and; (ii) the subscription rights to 5,237,265 common shares of stock for a total consideration of ₱876.

The said acquisition has been approved by SMPI's BOD in its meeting held on December 8, 2010.

b. Purchase of Manila North Harbour Port Inc.

On January 3, 2011, Petron entered into a Share Sale and Purchase Agreement with Harbour Centre Port Terminal Inc. for the purchase of 35% of Manila North Harbour Port Inc.'s outstanding and issued capital stock.

c. SMC Global issuance of bonds

On January 28, 2011, SMC Global carried out a US\$300, 7%, 5 year bond issue under Regulations of the U.S. Securities Act of 1933, as amended. SMC Global has filed an application for listing of the bond issue in the Singapore Exchange Securities Trading Limited and does not intend to register any securities subject of the proposed bond issue under the U.S. Securities Act and the Philippine Securities Regulation Code.

d. SMPFC

On January 20, 2011, the SEC favorably considered SMPFC's Registration Statement covering the registration of 15,000,000 preferred shares with a par value of ₱10.00 per share.

On January 26, 2011, the PSE approved, subject to certain conditions, the application of SMPFC to list up to 15,000,000 preferred shares with a par value of ₱10.00 per share to cover SMPFC's follow-on preferred shares offering at an offer price of ₱1,000.00 per share and with a dividend rate determined by management on the dividend rate setting date.

On February 10, 2011, the SEC issued the order for the registration of SMPFC's 15,000,000 preferred shares with a par value of ₱10.00 per share and released the Certificate of Permit to Offer Securities for Sale.

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On February 11, 2011, SMPFC's BOD approved the terms of the preferred shares offer.

SMPFC, through the underwriters and selling agents, offered 15,000,000 cumulative, non-voting, non-participating and non-convertible preferred shares with 5-year maturity at an offer price of ₱1,000.00 per share during the period February 14 to 25, 2011. The dividend rate was set at 8% per annum with dividend payment dates on March 3, June 3, September 3 and December 3 of each year calculated on a 30/360-day basis, as and if declared by SMPFC's BOD. Optional redemption of the preferred shares prior to 5th year from issuance date was provided under certain conditions (i.e., accounting, tax or change of control events). Unless the preferred shares are redeemed by SMPFC on its 5th year anniversary, the dividend rate shall be adjusted thereafter to the higher of the dividend rate of 8% or the ten-year PDST-F rate prevailing on the optional redemption date plus 3.33% per annum.

On March 3, 2011, SMPFC's 15,000,000 preferred shares with par value of ₱10.00 per share were listed with the PSE.

e. Top Frontier

On February 2, 2011, the BOD of Top Frontier declared cash dividends amounting to ₱139.50 per share or a total of ₱363 to preferred shareholders of record as of February 2, 2011. The cash dividend was paid on February 10, 2011.

45. Other Matters

a. 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.

• Deficiency Excise Tax

On April 12, 2004 and May 26, 2004, the Parent Company was assessed by the BIR for deficiency excise tax on one of its beer products. The Parent Company contested the assessments before the Court of Tax Appeals (CTA) (1st Division) under CTA case numbers 7052 and 7053. In the opinion of management and its legal counsel, the Parent Company has strong legal grounds to contest the assessments.

In relation to the aforesaid contested assessments, the Parent Company, on January 31, 2006, filed with the CTA (1st Division), under CTA case number 7405, a claim for refund of taxes paid in excess of what it believes to be the excise tax rate applicable to it. An independent Certified Public Accountant (CPA) commissioned by the CTA to conduct an examination, verification and audit to validate the documents supporting the claim for refund has submitted a report stating, among other things, that the claim is properly supported by the relevant documents.

The above assessment cases (CTA case numbers 7052 and 7053) and claim for refund (CTA case number 7405), which involve common questions of fact and law, had been consolidated and are now deemed submitted for decision by the CTA.

On November 27, 2007, the Parent Company filed with the CTA (3rd Division), under CTA case number 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. An independent CPA was likewise commissioned by the CTA in this case for the purpose of conducting an examination, verification and

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audit of the documents supporting the aforesaid claim. In a report recently submitted to the CTA, the independent CPA stated that the second claim is properly supported by the relevant documents.

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 numbers 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 March 14, 2011, 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, under CTA case number 7953, also in relation to the contested assessments. This case is now undergoing trial.

On January 7, 2011, the CTA under CTA case number 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 ₱926, representing erroneously, excessively and/or illegally collected and over paid excise taxes on “San Mig Light” during the period from December 1, 2005 up to July 31, 2007.

- Tax Credit Certificates Cases

In 1998, the BIR issued a deficiency excise tax assessment against Petron. The assessment relates to Petron’s use of ₱659 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 is contesting the BIR’s assessment before the CTA. In July 1999, the CTA ruled that, as a fuel supplier of Board of Investments-registered companies, Petron is a qualified transferee of the TCCs. Following an unfavorable ruling from the CTA En Banc, Petron filed an appeal to the Supreme Court. A Resolution was issued by the Supreme Court (1st Division) on September 13, 2010 denying with finality The Commissioner of Internal Revenue’s motion for reconsideration of the Decision dated July 28, 2010.

In November 1999, the BIR issued a ₱284 assessment against Petron for deficiency excise taxes for the years 1995 to 1997. The assessment results from the cancellation by the Philippine Department of Finance (“DOF”) of tax debit memos, the related TCCs and their assignment to Petron. Petron contested the assessment before the CTA. In August 2006, the CTA denied Petron’s petition, ordering it to pay the BIR ₱580 representing the ₱284 unpaid deficiency excise from 1995 to 1997, and 20% interest per annum computed from December 4, 1999. In July 2010, the Philippine Supreme Court (“SC”) nullified the assessment against Petron and declared Petron as a valid transferee of the TCCs. The BIR filed a motion for reconsideration, which remains pending.

In May 2002, the BIR issued a ₱254 assessment against Petron for deficiency excise taxes for the years 1995 to 1998. The assessment results from the cancellation by the DOF of tax debit memos, the related TCCs and their assignment to Petron. Petron contested the assessment before the CTA. In May 2007, the CTA second division denied Petron’s petition, ordering Petron to pay the BIR ₱601 representing Petron’s ₱254 unpaid deficiency excise taxes for the taxable years 1995 to 1998, and 25% late payment surcharge and 20% delinquency interest per annum computed from June 27, 2002. Petron appealed the decision to the CTA *en banc*, which ruled in favor of Petron, reversing the unfavorable decision of the CTA second division. The BIR is contesting the CTA *en banc* decision before the SC where the case is still pending as of March 14, 2011.

There are duplications in the TCCs subject of the three assessments described above. Excluding these duplications, the aggregate deficiency excise taxes, excluding interest and penalties, resulting from the cancellation of the subject TCCs amount to ₱911.

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- Pandacan Terminal Operations

In November 2001, the City of Manila enacted City Ordinance No. 8027 (“Ordinance 8027”) reclassifying the areas occupied by the oil terminals of Petron, Shell and Chevron from industrial to commercial. This reclassification made the operation of the oil terminals in Pandacan, Manila illegal. However, in June 2002, Petron, together with Shell and Chevron, entered into a Memorandum of Understanding (“MOU”) with the City of Manila and DOE, agreeing to scale down operations, recognizing that this was a sensible and practical solution to reduce the economic impact of Ordinance 8027. In December 2002, in reaction to the MOU, Social Justice Society (“SJS”) filed a petition with the SC against the Mayor of Manila asking that the latter be ordered to enforce Ordinance 8027. In April 2003, Petron filed a petition with the Regional Trial Court (“RTC”) to annul Ordinance 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, Mayor of Manila ceased implementation of Ordinance 8027.

The City of Manila subsequently issued the Comprehensive Land Use Plan and Zoning Ordinance (“Ordinance 8119”), which applied to the entire City of Manila. Ordinance 8119 allowed Petron (and other non-conforming establishments) a seven-year grace period to vacate. As a result of the passage of Ordinance 8119, which was thought to effectively repeal Ordinance 8027, in April 2007, the RTC dismissed the petition filed by Petron questioning Ordinance 8027.

However, on March 7, 2007, in the case filed by SJS, the SC rendered a decision (the “March 7 Decision”) directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, Petron, together with Shell and Chevron, filed motions with the SC seeking intervention and reconsideration of the March 7 Decision, on the ground that the SC failed to consider supervening events, notably (i) the passage of Ordinance 8119 which supersedes Ordinance 8027, as well as (ii) the RTC orders preventing the implementation of Ordinance 8027. Petron, Shell, and Chevron also noted the possible ill-effects on the entire country arising from the sudden closure of the oil terminals in Pandacan.

On February 13, 2008, the SC resolved to allow Petron, Shell and Chevron to intervene, but denied their motion for reconsideration. In its February 13 resolution (the “February 13 Resolution”), the Supreme Court also declared Ordinance 8027 valid, dissolved all existing injunctions against the implementation of the Ordinance 8027, and directed Petron, Shell and Chevron to submit their relocation plans to the RTC. Petron, Shell and Chevron have sought reconsideration of the February 13 Resolution. In compliance with the February 13 Resolution, Petron, Shell and Chevron have submitted their relocation plans to the RTC.

In May 2009, Manila City Mayor Alfredo Lim approved Ordinance No. 8187 (“Ordinance 8187”), which repealed Ordinance 8027 and Ordinance 8119, and permitted the continued operations of the oil terminals in Pandacan.

In June 2009, petitions were filed with the SC, seeking the nullification of Ordinance 8187 and enjoining its implementation. These petitions are still pending as of March 14, 2011.

- Oil Spill Incident in Guimaras

On August 11, 2006, M/T Solar I, a third party vessel contracted by Petron to transport approximately two million liters of industrial fuel oil, capsized 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 M/T 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 Philippine Department of Transportation and Communication 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, who are charterers.

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- **Bataan Realty Property Tax Cases**

Petron has three pending real property tax cases with the Province of Bataan, arising from three real property tax assessments. The first is for an assessment made by the Municipal Assessor of Limay, Bataan in 2006 for the amount of ₱86.4 covering Petron's isomerization and gas oil hydrotreater facilities which enjoy, among others, a five-year real property tax exemption under the Oil Deregulation Law per the Board of Investments Certificates of Registration. The second is for an assessment made also in 2006 by the Municipal Assessor of Limay for ₱17 relating to the leased foreshore area on which the pier of Petron's Refinery is located. In 2007, the Bataan Provincial Treasurer issued a Final Notice of Delinquent Real Property Tax requiring Petron to settle the amount of ₱2,168 allegedly in delinquent real property taxes as of September 30, 2007, based on a third assessment made by the Provincial Assessor covering a period of 13 years from 1994 to 2007. The third assessment cited Petron's non-declaration or under-declaration of machineries and equipment in the Refinery for real property tax purposes and its failure to pay the corresponding taxes for the said period.

Petron timely contested the assessments by filing appeals with the Local Board of Assessment Appeals ("LBAA"), and posted the necessary surety bonds to stop collection of the assessed amount.

However, with regard to the third assessment, notwithstanding the appeal to the LBAA and the posting of the surety bond, the Provincial Treasurer, acting on the basis of the Final Notice of Delinquent Real Property Tax relating to the third assessment, proceeded with the publication of the public auction of the assets of Petron, which was set for October 17, 2007. Due to the Provincial Treasurer's refusal to cancel the auction sale, Petron filed a complaint for injunction on October 8, 2007 before the RTC to stop the auction sale. A writ of injunction stopping the public auction until the final resolution of the case was issued by the RTC on November 5, 2007.

A motion to dismiss filed by the Provincial Treasurer on the ground of forum-shopping was denied by the RTC. However, a similar motion based on the same ground of forum shopping was filed by the Provincial Treasurer before the LBAA and the motion was granted by the LBAA in December 2007. On appeal by Petron, the Central Board of Assessment Appeals ("CBAA"), in August 2008, remanded the case to the LBAA for factual determination, effectively granting Petron's appeal and reversing the LBAA's dismissal of the case.

The RTC issued a Decision dated June 25, 2010 upholding Petron's position and declared null and void the demand on Petron for the payment of realty taxes in the amount of ₱1,731 made by the Provincial Assessor of Bataan and the levy of the properties of Petron. The Court issued a Writ of Prohibition permanently prohibiting, preventing and restraining the Provincial Treasurer of Bataan from conducting a public auction of the properties of Petron or selling the same by auction, negotiated sale, or any act of disposition pending the finality of the disposition by the LBAA or CBAA, as the case maybe, on the pending appeal made by Petron from the revised assessment of the Provincial Assessor of Bataan.

b. Top Frontier

On November 27, 2009, Top Frontier acquired 857,115,914 common shares of the issued and outstanding common shares of the Parent Company for a total of ₱64,284. To acquire an additional 327,000,000 Class "B" common shares of the Parent Company under the SPA with Q-Tech Alliance Holdings Inc. (Q-Tech), Top Frontier conducted a tender offer before such acquisition pursuant to the 35% threshold under the mandatory provisions of the Securities Regulation Code.

Under the tender offer, Top Frontier accepted a total of 49,629,119 Class "A" common shares and 31,773,965 Class "B" common shares tendered by the Parent Company's shareholders at the offer price of ₱75.00 per share, for a total consideration of ₱6,105. On April 13, 2010, Top Frontier acquired 327,000,000 Class "B" common shares of the Parent Company held by Q-Tech at the price of ₱66.00 per share. The

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tendered shares and the 327,000,000 Class “B” common shares were crossed in the PSE on April 13, 2010. As of December 31, 2010, Top Frontier had total shareholdings of 1,265,518,998 common shares of the Parent Company.

The SPA with Q-Tech also provides a grant of call option to Top Frontier for the purchase of 301,666,675 Class “B” common shares of the Parent Company at ₱70.00 per share. The call option may be exercised by Top Frontier until March 31, 2011 or such later date as may be mutually agreed upon by the parties in writing. On March 8, 2011, Top Frontier has notified Q-Tech of its intention to exercise the call option within the period specified in the SPA.

Top Frontier entered into an Option Agreement with 44 Corporations in 2009 wherein Top Frontier has exclusive right to acquire 476,722,639 Class “A” and 16,652,544 Class “B” common shares of the Parent Company at ₱75.00 per share for which Top Frontier paid an amount of US\$200 as advances. The call option may be exercised by Top Frontier until November 12, 2012. Any further extension of the term of the option period shall require the written consent and approval of both parties.

c. Commitments

The outstanding purchase commitments of the Group as of December 31, 2010 amounted to ₱237.

Amount authorized but not yet disbursed for capital projects as of December 31, 2010 is approximately ₱4,856.

d. Foreign Exchange Rates

The foreign exchange rates used in translating the US dollar accounts of foreign subsidiaries and associates to Philippine peso were closing rates of ₱43.84 in 2010 and ₱46.20 in 2009 for consolidated statements of financial position accounts; and average rates of ₱45.12, ₱47.64 and ₱44.47 in 2010, 2009 and 2008, respectively, for income and expense accounts.



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PRC-BOA Registration No. 0003
SEC Accreditation No. 0004-FR-2
BSP Accredited

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
San Miguel Corporation
No. 40 San Miguel Avenue
Mandaluyong City

We have audited the accompanying consolidated financial statements of San Miguel Corporation and Subsidiaries which comprise the consolidated statements of financial position as at December 31, 2009 and 2008, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2009, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Manabat Sanagustin & Co., CPAs, a Philippine partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of San Miguel Corporation and Subsidiaries as of December 31, 2009 and 2008, and its consolidated financial performance and its consolidated cash flows for each of the three years in the period ended December 31, 2009, in accordance with Philippine Financial Reporting Standards.

MANABAT SANAGUSTIN & CO., CPAs

JORGE MA. S. SANAGUSTIN

Partner

CPA License No. 0030399

SEC Accreditation No. 0026-AR-2

Tax Identification No. 124-282-616

BIR Accreditation No. 08-001987-7-2007

Issued July 10, 2007; Valid until July 9, 2010

PTR No. 2092726 MB

Issued January 7, 2010 at Makati City

April 14, 2010

Makati City, Metro Manila

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2009 AND 2008

		December 31	
	Note	2009	2008
		(In millions)	
ASSETS			
Current Assets			
Cash and cash equivalents	7,35,36	P209,411	P116,939
Trade and other receivables — net	4,8,35,36	49,082	50,814
Inventories	4,9	25,458	25,836
Current portion of biological assets — net	4,13	2,525	2,932
Prepaid expenses and other current assets	30,35,36	8,891	7,742
		295,367	204,263
Assets held for sale	6,10	2,746	—
Total Current Assets		298,113	204,263
Noncurrent Assets			
Investments and advances — net	4,10,35,36	39,356	32,253
Property, plant and equipment — net	4,11,27	65,919	68,313
Investment properties — net	4,12	1,867	1,838
Biological assets — net of current portion	4,13	1,847	1,814
Goodwill — net	4,10,14,27,33	6,408	5,201
Other intangible assets — net	4,14,27	3,630	3,812
Deferred tax assets	4,19	8,883	7,638
Other noncurrent assets — net	4, 10, 15, 27, 30, 35, 36	12,468	14,241
Total Noncurrent Assets		140,378	135,110
		P438,491	P339,373
LIABILITIES AND EQUITY			
Current Liabilities			
Drafts and loans payable	16,35,36	P 56,789	P 48,560
Accounts payable and accrued expenses	17,30,35,36	31,404	23,292
Income and other taxes payable	19	4,186	4,429
Dividends payable	31	573	1,563
Current maturities of long-term debt — net of debt issue costs	18,35,36	1,077	9,044
Total Current Liabilities		94,029	86,888
Noncurrent Liabilities			
Long-term debt — net of current maturities and debt issue costs	18,35,36	P 71,885	P 40,719
Deferred tax liabilities	19	12,037	17,851
Other noncurrent liabilities	29,30,35,36	19,602	25,691
Total Noncurrent Liabilities		103,524	84,261
Equity	20,31,34		
Equity Attributable to Equity Holders of the Parent Company			
Capital stock — common		16,150	16,112
Capital stock — preferred		4,852	—
Additional paid-in capital		99,085	31,183
Revaluation increment		18	18
Cumulative translation adjustments		5,845	4,837
Retained earnings:			
Appropriated		5,497	5,522
Unappropriated		151,911	96,298
Treasury stock		(69,541)	(4,053)
		213,817	149,917
Non-controlling Interests	2	27,121	18,307
Total Equity		240,938	168,224
		P438,491	P339,373

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
		(In millions, except per share data)		
SALES		P174,213	P168,041	P148,022
COST OF SALES	21	<u>124,295</u>	<u>124,072</u>	<u>110,062</u>
GROSS PROFIT		49,918	43,969	37,960
SELLING AND ADMINISTRATIVE EXPENSES	22	(30,249)	(29,151)	(26,333)
INTEREST EXPENSE AND OTHER FINANCING CHARGES	16, 18, 25	(7,926)	(6,032)	(7,117)
INTEREST INCOME	26	5,989	6,630	2,087
EQUITY IN NET EARNINGS (LOSSES) OF ASSOCIATES	6, 10	2,816	(1,132)	164
GAIN ON SALE OF INVESTMENTS AND PROPERTY AND EQUIPMENT	10, 11	50,630	8,746	2,224
OTHER INCOME (CHARGES) — Net	27	<u>(6,843)</u>	<u>(2,262)</u>	<u>3,614</u>
INCOME BEFORE INCOME TAX FROM CONTINUING OPERATIONS		64,335	20,768	12,599
INCOME TAX EXPENSE	19	<u>3,706</u>	<u>6,098</u>	<u>4,520</u>
INCOME FROM CONTINUING OPERATIONS		60,629	14,670	8,079
INCOME AFTER INCOME TAX FROM DISCONTINUED OPERATIONS	6	<u>—</u>	<u>5,413</u>	<u>272</u>
NET INCOME		<u><u>P 60,629</u></u>	<u><u>P 20,083</u></u>	<u><u>P 8,351</u></u>
Attributable to:				
Equity holders of the Parent Company		P 57,799	P 19,348	P 8,630
Non-controlling interests		<u>2,830</u>	<u>735</u>	<u>(279)</u>
		<u><u>P 60,629</u></u>	<u><u>P 20,083</u></u>	<u><u>P 8,351</u></u>
Earnings Per Share From Continuing Operations, attributable to equity holders of the Parent Company ...	32			
Basic		P 19.21	P 4.41	P 2.59
Diluted		<u><u>P 19.10</u></u>	<u><u>P 4.40</u></u>	<u><u>P 2.58</u></u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	<u>Note</u>	<u>2009</u>	<u>2008</u> (In millions)	<u>2007</u>
NET INCOME		<u>P60,629</u>	<u>P20,083</u>	<u>P 8,351</u>
EXCHANGE DIFFERENCES ON TRANSLATION OF FOREIGN OPERATIONS		521	689	(3,022)
SHARE IN COMPREHENSIVE GAIN (LOSS) OF ASSOCIATES	10	252	(19)	—
NET GAIN (LOSS) ON CASH FLOW HEDGES	36	222	(221)	(17)
INCOME TAX BENEFIT (EXPENSE)		(67)	66	6
NET GAIN (LOSS) ON AVAILABLE-FOR-SALE FINANCIAL ASSETS		(33)	(17)	190
INCOME TAX BENEFIT (EXPENSE)		<u>3</u>	<u>2</u>	<u>(19)</u>
OTHER COMPREHENSIVE INCOME (LOSS) — NET OF TAX		<u>898</u>	<u>500</u>	<u>(2,862)</u>
TOTAL COMPREHENSIVE INCOME — NET OF TAX		<u><u>P61,527</u></u>	<u><u>P20,583</u></u>	<u><u>P 5,489</u></u>
Comprehensive Income Attributable to:				
Equity holders of the Parent Company		P58,807	P19,314	P 8,887
Non-controlling interests.		<u>2,720</u>	<u>1,269</u>	<u>(3,398)</u>
		<u><u>P61,527</u></u>	<u><u>P20,583</u></u>	<u><u>P 5,489</u></u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

Equity Attributable to Equity Holders of the Parent Company

Equity Attributable to Equity Holders of the Parent Company

Note	Cumulative Translation Adjustments										Non-Controlling Interests	Total Equity				
	Capital Stock		Additional Paid-in Capital	Revaluation Increment	Translation Reserve			Hedging Reserve		Fair Value Reserve (In millions)			Retained Earnings		Treasury Stock	Total
	Common	Preferred			Translation Reserve	Hedging Reserve	Translation Reserve	Appropriated	Unappropriated							
As of January 1, 2007	P16,067	P—	P30,211	P18	P4,567	P 9	P 1	—	—	—	P6,036	P76,637	P(4,053)	P129,493	P21,604	P151,097
Foreign currency translation differences	—	—	—	—	95	—	—	—	—	—	—	—	—	95	(3,117)	(3,022)
Effective portion of changes in fair value of cash flow hedges, net of tax	—	—	—	—	—	(9)	—	—	—	—	—	—	—	—	(2)	(11)
Net change in fair value of available-for-sale financial assets, net of tax	—	—	—	—	—	—	171	—	—	—	—	—	—	171	—	171
Other comprehensive income (loss)	—	—	—	—	—	—	171	—	—	—	—	—	—	257	(3,119)	(2,862)
Net income for the year	—	—	—	—	—	—	—	—	—	—	—	8,630	—	8,630	(279)	8,351
Total comprehensive income (loss) for the year	—	—	—	—	95	(9)	171	—	—	—	—	8,630	—	8,887	(3,398)	5,489
Issuances of capital stock	42	—	461	—	—	—	—	—	—	—	—	—	—	503	—	503
Stock options	—	—	258	—	—	—	—	—	—	—	—	—	—	258	—	258
Addition to non-controlling interests	—	—	—	—	—	—	—	—	—	—	—	—	—	—	2,061	2,061
Appropriations — net	—	—	—	—	—	—	—	(2)	—	—	—	2	—	—	—	—
Non-controlling interest associated with discontinued operations	6	—	—	—	—	—	—	—	—	—	—	—	—	—	(8,824)	(8,824)
Cash dividends	31	—	—	—	—	—	—	—	—	—	—	(4,414)	—	(4,414)	(114)	(4,528)
Amounts recognized directly in equity relating to assets held for sale	6	16,109	30,930	18	4,662	—	172	—	—	—	6,034	80,855	(4,053)	134,727	11,329	146,056
As of December 31, 2007	P16,109	P—	P30,930	P18	P4,699	P—	P172	—	—	—	P6,034	P80,855	P(4,053)	P134,764	P11,329	P146,093

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007

	Note	2009	2008 (In millions)	2007
CASH FLOWS FROM OPERATING ACTIVITIES				
Income before income tax from continuing operations		P 64,335	P 20,768	P 12,599
Income (loss) before income tax from discontinued operations	6	—	(19)	2,681
Gain (loss) from disposal of discontinued operations	6	—	5,425	(1,235)
Income before income tax		<u>64,335</u>	<u>26,174</u>	<u>14,045</u>
Adjustments for:				
Depreciation, amortization and others — net	5	14,724	9,303	10,236
Interest expense and financing charges	6, 25	7,926	6,032	10,101
Interest income		(5,989)	(6,630)	(2,404)
Equity in net losses (earnings) of associates	10	(2,816)	1,132	(246)
Loss (gain) from disposal of discontinued operations	6	—	(5,425)	1,235
Gain on sale of investments and property and equipment		<u>(50,630)</u>	<u>(8,746)</u>	<u>(2,219)</u>
Operating income before working capital changes		<u>27,550</u>	<u>21,840</u>	<u>30,748</u>
Changes in noncash current assets, certain current liabilities and others	33	<u>(1,195)</u>	<u>(1,291)</u>	<u>15,192</u>
Cash generated from operations		<u>26,355</u>	<u>20,549</u>	<u>45,940</u>
Interest paid		<u>(6,348)</u>	<u>(5,665)</u>	<u>(9,449)</u>
Income taxes paid		<u>(6,651)</u>	<u>(7,835)</u>	<u>(6,201)</u>
Net cash flows provided by operating activities		<u>13,356</u>	<u>7,049</u>	<u>30,290</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Acquisitions of subsidiaries, net of cash and cash equivalents acquired	33	(1,494)	—	—
Additions to investments and advances		(5,771)	(6,667)	—
Additions to property, plant and equipment	11	(6,249)	(6,437)	(9,310)
Increase in other noncurrent assets and others		(950)	(16,010)	(14,820)
Payments by (advances to) related parties		P 3,243	P 31,708	P (35,721)
Proceeds from sale of investments and property and equipment		55,127	13,663	6,269
Proceeds from disposal of discontinued operations, net of cash and cash equivalents disposed of	6	—	9,083	90,684
Interest received		5,249	6,558	2,374
Dividends received		—	—	59
Net cash flows provided by investing activities		<u>49,155</u>	<u>31,898</u>	<u>39,535</u>
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from:				
Short-term borrowings		691,093	608,756	345,789
Long-term borrowings		67,786	64	84,398
Payments of:				
Short-term borrowings		(683,569)	(605,088)	(337,512)
Long-term borrowings		(44,657)	(13,336)	(88,342)
Cash dividends paid	31	(3,301)	(4,463)	(3,228)
Proceeds from issuance of capital stock	20	7,087	3	503
Dividends paid to non-controlling shareholders		(2,192)	(393)	(123)
Increase in non-controlling interests		315	592	—
Net cash flows provided by (used in) financing activities		<u>32,562</u>	<u>(13,865)</u>	<u>1,485</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS				
CASH EQUIVALENTS		(2,601)	(1,424)	(1,016)
NET INCREASE IN CASH AND CASH EQUIVALENTS		92,472	23,658	70,294
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		116,939	93,281	24,280
CASH AND CASH EQUIVALENTS ASSOCIATED TO ASSETS HELD FOR SALE		—	—	(1,293)
CASH AND CASH EQUIVALENTS AT END OF YEAR	7	<u>P 209,411</u>	<u>P 116,939</u>	<u>P 93,281</u>

See Notes to the Consolidated Financial Statements.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Millions, Except Per Share Data)

1. Reporting Entity

San Miguel Corporation (SMC or “Parent Company”) was incorporated in the Philippines. The consolidated financial statements as at and for the year ended December 31, 2009 comprise the financial statements of the Parent Company and its Subsidiaries (collectively referred to as the “Group”) and the Group’s interest in associates and jointly controlled entities. The Parent Company is a public company under Section 17.2 of the Securities Regulation Code and its shares are listed on the Philippine Stock Exchange (PSE). The Group is primarily engaged in the production, processing and marketing of beverage, food and packaging products. The Group is also engaged in the management and development of real estate properties. The Parent Company is authorized to invest corporate funds and/or engage in the power generation/transmission, water and other utilities, mining and infrastructure business. The registered office address of the Parent Company is No. 40 San Miguel Avenue, Mandaluyong City.

The consolidated financial statements as at and for the year ended December 31, 2009 were authorized for issue by the Board of Directors (BOD) on April 14, 2010.

2. Basis of Preparation

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis, except for the following:

- derivative financial instruments are measured at fair value;
- available-for-sale (AFS) financial assets are measured at fair value;
- defined benefit asset is measured as the net total of the plan assets, less unrecognized actuarial gains and the present value of the defined benefit obligation; and
- agricultural produce are measured at 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 Parent Company’s functional currency. All values are rounded to the nearest million (₱000,000), except when otherwise indicated.

Statement of Compliance

The consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards (PAS) and Philippine Interpretations from International Financial Reporting Interpretations Committee (IFRIC), issued by the Financial Reporting Standards Council (FRSC).

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Basis of Consolidation

The consolidated financial statements include the accounts of the Parent Company and its Subsidiaries. The major subsidiaries include the following:

	<u>Percentage of Ownership</u>	<u>Country of Incorporation</u>
Beverage Business:		
San Miguel Brewery Inc. (SMB) ^(a, e) and subsidiary, Iconic Beverages, Inc. (IBI)	51.00	Philippines
San Miguel Brewing International Ltd. (SMBIL) and subsidiaries [including San Miguel Brewery Hong Kong Limited (SMBHK), PT Delta Djakarta Tbk (PT-Delta), San Miguel Bada (Baoding) Utility Co. Ltd. (SMBB), San Miguel (Baoding) Brewery Co. Ltd., San Miguel Brewery Vietnam Ltd. (SMBV) and San Miguel Beer (Thailand) Ltd. (SMHT)]	100.00	British Virgin Islands (BVI)
Ginebra San Miguel, Inc. (GSMI) and subsidiaries [including Distileria Bago, Inc. and Ginebra San Miguel International, Ltd. (GSMIL)]	79.53	Philippines
San Miguel Beverages, Inc. (SMBI) ^(c)	100.00	Philippines
San Miguel (Thailand) Co. Ltd.	100.00	Thailand
San Miguel (Guangdong) Foods & Beverages Co. Ltd.	100.00	China
San Miguel (Vietnam) Co. Ltd.	100.00	Vietnam
PT San Miguel Marketing Indonesia	100.00	Indonesia
San Miguel (Malaysia) Sdn. Bhd.	100.00	Malaysia
Food Business:		
San Miguel Foods and Beverage International Limited (SMFBIL) and subsidiaries [including PT San Miguel Indonesia Foods & Beverages (PTSMIFB) and San Miguel Pure Foods Investment (BVI) Limited (SMPFI) and subsidiary, San Miguel Pure Foods (Vn) Co. Ltd. (SMPFVN)]	100.00	BVI
Star Dari, Inc. (SDI)	100.00	Philippines
San Miguel Pure Foods Company, Inc. (SMPFC) and subsidiaries [including San Miguel Foods, Inc. (SMFI), San Miguel Mills, Inc. (SMMI), The Purefoods-Hormel Company, Inc., Magnolia Inc. (Magnolia), San Miguel Super Coffeemix Co., Inc. (SMSCCI), Monterey Foods Corporation (MFC) ^(f) , RealSnacks Mfg. Corporation (RealSnacks) ^(b, d) , P.T. San Miguel Pure Foods Indonesia (PTSMPFI) ^(b) and San Miguel Pure Foods International, Limited (SMPFIL) ^(d)]	99.92	Philippines
Packaging Business:		
San Miguel Yamamura Packaging Corporation (SMYPC) ^(e, k) and subsidiary, San Miguel Yamamura Fuso Molds Corporation (SYFMC) ^(h)	65.00	Philippines
San Miguel Yamamura Packaging International Limited (SMYPIL) ^(e, l) and subsidiaries [including San Miguel Yamamura Phu Tho Packaging Co. Ltd. ^(m) , Zhaoqing San Miguel Yamamura Glass Co., Ltd. ⁽ⁿ⁾ , Foshan San Miguel Yamamura Packaging Co. Ltd. ^(o) , PT San Miguel Sampoerna Packaging Industries Ltd., San Miguel Yamamura Packaging & Printing Sdn. Bhd. ^(p) , San Miguel Yamamura Woven Products Sdn. Bhd. ^(q) , Packaging Research Centre Sdn. Bhd., San Miguel Plastic Films Sdn. Bhd. and JHK Investments Pty Ltd. (JHK Investments) ^(u)]	65.00	BVI
Mindanao Corrugated Fibreboard, Inc. (Mincorr) ^(b)	100.00	Philippines

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	<u>Percentage of Ownership</u>	<u>Country of Incorporation</u>
San Miguel Paper Packaging Corporation (SMPPC) ^(b, x)	100.00	Philippines
San Miguel Yamamura Asia Corporation (SMYAC)	60.00	Philippines
Real Estate Business:		
San Miguel Properties, Inc. (SMPI) and subsidiaries ^(b)	99.68	Philippines
Brewery Properties Inc. (BPI) ⁽ⁱ⁾ and subsidiary, Brewery Landholdings, Inc. (BLI)	100.00	Philippines
Others:		
SMC Stock Transfer Service Corporation	100.00	Philippines
ArchEn Technologies, Inc.	100.00	Philippines
SMITS, Inc. ^(b)	100.00	Philippines
SM Bulk Water Company Inc. (SMBW) and subsidiary, Kaliwa Water Development Corp. (Kaliwa) ^(d, v)	100.00	Philippines
Anchor Insurance Brokerage Corporation (AIBC)	58.33	Philippines
Pacific Central Properties, Inc.	100.00	Philippines
Philippine Breweries Corporation (PBC)	99.52	Philippines
San Miguel Holdings Corp. (SMHC) ^(r) and subsidiaries ^(b) including Rapid Thoroughfares Inc. (Rapid)	100.00	Philippines
Seaside Industrial Estate, Inc. ^(b)	100.00	Philippines
Navotas Ridge Realty Corp. (NRRC) ^(b, d)	100.00	Philippines
SMC Shipping and Lighterage Corporation (SMCSLC)	70.00	Philippines
Vega Telecom, Inc. (Vega) ^(s)	100.00	Philippines
Challenger Aero Air Corp.	100.00	Philippines
San Miguel Distribution Co., Inc. (SMDCI) ^(g)	100.00	Philippines
San Miguel Kuok Food Security, Inc. (SMKFSI) ^(d, j)	100.00	Philippines
Strategic Power Devt. Corp. (SPDC) ^(t)	100.00	Philippines
Panasia Energy Holdings Inc. (Panasia)	100.00	Philippines
Northlink Toll Management, Inc. (Northlink) ^(w)	60.00	Philippines

^(a) This was formerly the Domestic Beer Division of the Parent Company and was incorporated on July 26, 2007 (Note 10).

^(b) The financial statements of these subsidiaries were audited by other auditors.

^(c) Consolidated effective January 10, 2007.

^(d) Not yet operating as of December 31, 2009.

^(e) The Parent Company's percentage of ownership was 100% in 2007.

^(f) Consolidated to SMPFC effective January 1, 2007.

^(g) Consolidated effective June 18, 2007.

^(h) Consolidated to SMYPC effective January 2008. As of December 31, 2007, SYFMC was 60% owned by the Parent Company.

⁽ⁱ⁾ Consolidated effective December 16, 2008.

^(j) Consolidated effective September 5, 2008.

^(k) Formerly San Miguel Packaging Specialists, Inc. (SMPSI).

^(l) Formerly San Miguel Packaging International Limited (SMPIL).

^(m) Formerly San Miguel Phu Tho Packaging Co. Ltd.

⁽ⁿ⁾ Formerly Zhaoqing San Miguel Glass Co. Ltd.

^(o) Formerly Foshan San Miguel Packaging Co. Ltd.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
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- ^(p) Formerly San Miguel Packaging & Printing Sdn. Bhd.
- ^(q) Formerly San Miguel Woven Products Sdn. Bhd.
- ^(r) Formerly San Miguel Logistics Asia Corporation.
- ^(s) Formerly SM View Realty Corp.
- ^(t) Formerly Big Bucks Realty Corp.
- ^(u) Consolidated to SMYPIL effective December 17, 2009. JHK Investments was renamed “San Miguel Yamamura Knox Pty. Ltd.” in February 2010.
- ^(v) Consolidated effective November 6, 2009.
- ^(w) Incorporated on December 15, 2009.
- ^(x) Formerly San Miguel Rengo Packaging Corporation (SMRPC).

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefit from its activities. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account. The financial statements of the subsidiaries are included in the consolidated financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The consolidated financial statements are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the consolidated financial statements.

Non-controlling interests represent the portion of profit or loss and net assets not held by the Group and are presented in the consolidated statements of financial position, separately from equity attributable to equity holders of the Parent Company.

Non-controlling interests represent the interests not held by the Group in GSMI, SMPFC, SMYAC, SMPI, PBC, SMCSLC, AIBC, PT-Delta, SMHT, SMBHK, SMBB, SMBV, PTSMIFB, SMPFI, PTSMPFI, SMB, SMYPIL and SMYPC in 2009 and 2008 and also Mincorr and SMPPC in 2008.

3. Significant Accounting Policies

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

Adoption of New or Revised Standards, Amendments to Standards and Interpretations

The FRSC approved the adoption of new or revised standards, amendments to standards, and interpretations as part of PFRS. Accordingly, the Group changed its accounting policies in the following areas:

Adopted effective 2009

- PFRS 8, *Operating Segments*, introduces the “management approach” to segment reporting.

Starting January 1, 2009, the Group determined and presented operating segments based on the information internally provided to the BOD. Previously, operating segments were determined and presented in accordance with PAS 14, *Segment Reporting*. The new accounting policy in respect of segment operating disclosures is presented as follows:

- Comparative segment information has been re-presented in conformity with the transitional requirements of such standard. Since the change in accounting policy only impacts presentation and disclosure aspects, there is no impact on basic and diluted earnings per share (EPS).

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- An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. An operating segment's operating results are reviewed regularly by the BOD to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.
- Segment results that are reported to the BOD include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly of corporate assets (primarily the Parent Company's headquarters), certain head office expenses, and deferred tax assets and liabilities.
- Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment, and intangible assets other than goodwill.
- Revised PAS 1, *Presentation of Financial Statements* (2007), introduces the term total comprehensive income, which represents changes in equity during a period other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income may be presented in either a single statement of comprehensive income (effectively combining both the statement of income and all non-owner changes in equity in a single statement), or in a statement of income and a separate statement of comprehensive income.

The Group applied Revised PAS 1, which became effective as of January 1, 2009. The Group presented all non-owner changes in equity in the consolidated statements of comprehensive income and consolidated statements of changes in equity.

Comparative information has been re-presented to be also in conformity with the revised standard. Since the change in accounting policy only impacts presentation aspects, there is no impact on basic and diluted EPS.

- Revised PAS 23, *Borrowing Costs*, removes the option to charge to expense borrowing costs and requires an entity to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

Prior to this revised standard, the Group already capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

- Amendments to PFRS 7, *Financial Instruments: Disclosures — Improving Disclosures about Financial Instruments*, require disclosures relating to fair value measurements using a three-level fair value hierarchy that: reflects the significance of the inputs used in measuring fair values; provides more direction on the form of quantitative disclosures about fair value measurements; and requires information to be disclosed in a tabular format unless another format is more appropriate. In addition, the amendments clarify and enhance the existing requirements for the disclosure of liquidity risk.

The said new required disclosures have been included in Note 36 to the consolidated financial statements. As allowed by the amendments, in the first year of application, comparative information is not required to be disclosed.

- *Embedded Derivatives* — Amendments to Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives* and PAS 39, *Financial Instruments: Recognition and Measurement*, clarify that on reclassification of a financial asset out of the "at fair value through profit or loss" category, all embedded derivatives have to be assessed and, if necessary, separately accounted for in the consolidated financial statements. The amendments are effective for annual periods ending on or after June 30, 2008.

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- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*, addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. The interpretation takes effect for annual periods beginning on or after July 1, 2008.
- Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*, applies to all entities using net investment hedging for investments in foreign operations and clarifies that net investment hedging can be applied only when the net assets of the foreign operation are included in the financial statements of the entity. The requirements in the interpretation do not apply to other forms of hedge accounting under PAS 39 and cannot be applied by analogy. IFRIC 16 provides guidance on the following issues: a) nature of the hedged risk and the amount of the hedged item for which a hedging relationship may be designated; b) where the hedging instrument can be held and assessing hedge effectiveness; and c) disposal of a foreign operation. The interpretation is effective for annual periods beginning on or after October 1, 2008.
- Philippine Interpretation IFRIC 18, *Transfers of Assets from Customers*, provides additional guidance on the accounting for the contributed property, plant and equipment by “access providers” (i.e., by the entity receiving the contribution) from customers. The interpretation clarifies: the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services; the recognition of revenue; and the accounting for transfers of cash from customers. The interpretation is effective for all transfers on or after July 1, 2009.
- Amendments to PAS 32, *Financial Instruments: Presentation* and PAS 1, *Presentation of Financial Statements — Puttable Financial Instruments and Obligations Arising on Liquidation*, became effective for financial years beginning on or after January 1, 2009. The standards have been amended to require puttable instruments, and instruments that impose on the entity an obligation to deliver to another party a *pro rata* share of the net assets of the entity only on liquidation, to be classified as equity if certain conditions are met.
- Amendments to PFRS 2, *Share-based Payment — Vesting Conditions and Cancellations*, became effective for financial years beginning on or after January 1, 2009. The standards have been amended: to clarify the definition of vesting conditions (which are service conditions and performance conditions only); introduce the concept of non-vesting conditions; require non-vesting conditions to be reflected in grant-date fair value; and provide the accounting treatment for non-vesting conditions and cancellations.
- Amendments to PAS 27, *Consolidated and Separate Financial Statements — Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, became effective for financial years beginning on or after January 1, 2009. The amendments to PAS 27 remove the definition of “cost method” currently set out in PAS 27, and instead require all dividend from a subsidiary, jointly controlled entity or associate to be recognized as income in the separate financial statements of the investor when the right to receive the dividend is established.
- *Improvements to PFRS 2008* — various standards (except as related to PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*), discusses 35 amendments and is divided into two parts: a) Part I includes 24 amendments that result in accounting changes for presentation, recognition or measurement purposes; and b) Part II includes 11 terminology or editorial amendments that the International Accounting Standards Board expects to have either no or only minimal effects on accounting. These improvements are effective for annual periods beginning on or after January 1, 2009.
- *Improvements to PFRS 2009* — Amendment to PAS 18, *Revenue, Determining whether an entity is acting as a principal or as an agent*. The appendix accompanying PAS 18 is amended to specify that

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an entity acts as a principal when it is exposed to the significant risks and rewards associated with the sale of goods or rendering of services. The amendments also include in the appendix to PAS 18 a number of indicators for consideration in assessing whether an entity is acting as a principal or as an agent. As this is an amendment to an appendix, there is no related effective date and therefore is applicable immediately.

The adoption of these foregoing new or revised standards, amendments to standards and Philippine Interpretations of IFRIC did not have a material effect on the consolidated financial statements. Additional disclosures required by the revised standards and improvements were included in the consolidated financial statements, where applicable.

New or Revised Standards, Amendments to Standards and Interpretations Not Yet Adopted

The Group will adopt the following new or revised standards, amendments to standards and interpretations in the respective effective dates:

- Revised PFRS 3, *Business Combinations* (2008), effective for annual periods beginning on or after July 1, 2009, incorporates the following changes that are likely to be relevant to the Group's operations:
 - The definition of a business has been broadened, which is likely to result in more acquisitions being treated as business combinations.
 - Contingent consideration will be measured at fair value, with subsequent changes therein recognized in profit or loss.
 - Transaction costs, other than share and debt issue costs, will be expensed as incurred.
 - Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognized in profit or loss.
 - Any non-controlling interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

Revised PFRS 3, which becomes mandatory for the 2010 consolidated financial statements, will be applied prospectively.

- Revised PAS 27, *Consolidated and Separate Financial Statements* (2008), effective for annual periods beginning on or after July 1, 2009, requires accounting for changes in ownership interests by the Parent Company in a subsidiary, while maintaining control, to be recognized as an equity transaction. When the Parent Company loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognized in consolidated statements of income. Revised PAS 27 will become mandatory for the 2010 consolidated financial statements.
- Amendments to PAS 39, *Financial Instruments: Recognition and Measurement — Eligible Hedged Items*, provide for the following: a) new application guidance to clarify the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedge relationship; and b) additional application guidance on qualifying items, assessing hedge effectiveness, and designation of financial items as hedged items. The amendments are effective for annual periods beginning on or after July 1, 2009. Amendments to PAS 39 will become mandatory for the 2010 consolidated financial statements.
- Philippine Interpretation IFRIC 17, *Distributions of Non-cash Assets to Owners*, provides guidance on the accounting for non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners. It also applies to distributions in which the owners may elect to receive either the non-cash

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asset or a cash alternative. The liability for the dividend payable is measured at the fair value of the assets to be distributed. The interpretation is effective for annual periods beginning on or after July 1, 2009.

- *Improvements to PFRS 2008* — Amendments to PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, specify that if an entity is committed to a plan to sell a subsidiary, then it would classify all of that subsidiary's assets and liabilities as held for sale when the held for sale criteria in paragraphs 6 to 8 of PFRS 5 are met. This applies regardless of the entity retaining an interest (other than control) in the subsidiary. Disclosures for discontinued operations are required by the parent when a subsidiary meets the definition of a discontinued operation. The amendments are effective for annual periods beginning on or after July 1, 2009.
- Amendments to PFRS 2, *Share-based Payment: Group Cash-settled Share-based Payment Transactions*, clarify the scope of PFRS 2, that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, and regardless of whether the transaction is equity-settled or cash-settled; and the interaction of PFRS 2 and other standards, that in PFRS 2, a "group" has the same meaning as in PAS 27, *Consolidated and Separate Financial Statements*, that is, it includes only a parent and its subsidiaries. The amendments are effective for annual periods beginning on or after January 1, 2010.
- *Improvements to PFRS 2009*, include 15 amendments to 12 standards. Some of these amendments may have significant implications for current practice, in particular the amendments to PAS 17, *Leases*, may affect the classification of leases of land and buildings, particularly in jurisdictions in which such leases often are for a long period of time. The improvements are generally effective for annual periods beginning on or after January 1, 2010.
- Amendment to PAS 32, *Financial Instruments: Presentation — Classification of Rights Issues*, permits rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants *pro rata* to all of its existing owners of the same class of its own non-derivative equity instruments. The amendment is applicable for annual periods beginning on or after February 1, 2010.
- Philippine Interpretation IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*, addresses issues in respect of the accounting by the debtor in a debt for equity swap transaction. It clarifies that equity instruments issued to a creditor to extinguish all or part of a financial liability in a debt for equity swap are consideration paid in accordance with PAS 39 paragraph 41. The interpretation is applicable for annual periods beginning on or after July 1, 2010.
- Revised PAS 24, *Related Party Disclosures* (2009), amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. The revised standard is effective for annual periods beginning on or after January 1, 2011.
- *Prepayments of a Minimum Funding Requirement (Amendments to Philippine Interpretation IFRIC 14: PAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction)*. These amendments remove unintended consequences arising from the treatment of prepayments where there is a minimum funding requirement and result in prepayments of contributions in certain circumstances being recognized as an asset rather than an expense. The amendments are effective for annual periods beginning on or after January 1, 2011.
- Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*, applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. It provides guidance on the recognition of revenue among real estate

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developers for sales of units, such as apartments or houses, 'off plan'; i.e., before construction is completed. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of PAS 11, *Construction Contracts*, or PAS 18, *Revenue*, and the timing of revenue recognition. The interpretation is effective for annual periods beginning on or after January 1, 2012.

- PFRS 9, *Financial Instruments*, is the first standard issued as part of a wider project to replace PAS 39. PFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and contractual cash flow characteristics of the financial asset. The guidance in PAS 39 on impairment of financial assets and hedge accounting continues to apply. The new standard is effective for annual periods beginning on or after January 1, 2013.

The Group will assess the impact of the new or revised standards, amendments to standards and interpretations on the consolidated financial statements upon adoption.

Financial Assets and Financial Liabilities

Date of Recognition. The Group recognizes a financial asset or a financial liability in the consolidated statements of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at fair value of the consideration given (in case of an asset) or received (in case of a liability). The initial measurement of financial instruments, except for those designated at fair value through profit and loss (FVPL), includes transaction costs.

The Group classifies its financial assets in the following categories: held-to-maturity (HTM) investments, AFS financial assets, FVPL financial assets and loans and receivables. The Group classifies its financial liabilities as either FVPL financial liabilities or other liabilities. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

Determination of Fair Value. The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there is no significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Day 1 Profit. Where the transaction price in a non-active market is different from the fair value of the other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a Day 1 profit) in the consolidated statements of income unless it qualifies for recognition as some other type of asset. In cases where use is made of data which are not observable, the difference between the transaction price and model value is only recognized in the consolidated statements of

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income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the ‘Day 1’ profit amount.

Financial Assets

Financial Assets at FVPL. Financial assets at FVPL include financial assets held for trading, financial assets designated upon initial recognition as at FVPL and those classified under this category through the fair value option. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Financial assets may be designated by management at initial recognition as at FVPL or reclassified under this category through the fair value option, when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis; or
- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group carries financial assets at FVPL using their fair values. Fair value changes and realized gains and losses are recognized in the consolidated statements of income. Fair value changes from derivatives accounted for as part of an effective accounting hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. Any interest earned shall be recognized as part of “Interest income” in the consolidated statements of income. Any dividend income from equity securities classified as FVPL shall be recognized in the consolidated statements of income when the right of collection has been established.

The Group’s derivative assets are classified under this category (Note 36).

The carrying values of financial assets under this category amounted to ₱202 and ₱191 as of December 31, 2009 and 2008, respectively (Note 36).

Loans and Receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables shall be recognized as part of “Interest income” in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of “Interest income” in the consolidated statements of income. Gains or losses are recognized in the consolidated statements of income when loans and receivables are derecognized or impaired, as well as through the amortization process.

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

The Group's cash and cash equivalents, trade and other receivables and noncurrent receivables and deposits are included in this category (Notes 7, 8 and 15).

The combined carrying values of financial assets under this category amounted to ₱264,426 and ₱175,192 as of December 31, 2009 and 2008, respectively (Note 36).

HTM Investments. HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and classified as AFS financial assets. After initial measurement, these investments are measured at amortized cost using the effective interest rate method, less impairment in value. Any interest earned on the HTM investments shall be recognized as part of "Interest income" in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" in the consolidated statements of income. Gains or losses are recognized in the consolidated statements of income when the HTM investments are derecognized or impaired, as well as through the amortization process.

As of December 31, 2009 and 2008, the Group has no investments accounted for under this category.

AFS Financial Assets. AFS financial assets are non-derivative financial assets that are either designated in this category or not classified under any of the other financial asset categories. Subsequent to initial recognition, AFS financial assets are carried at fair value in the consolidated statements of financial position. The effective yield component of AFS debt securities is reported as part of "Interest income" in the consolidated statements of income. Any interest earned on AFS debt securities shall be recognized as part of "Interest income" in the consolidated statements of income on an accrual basis. Dividends earned on holding AFS equity securities are recognized as "Dividend income" when the right of collection has been established. Any unrealized gains or losses for the period arising from the fair valuation of AFS financial assets are reported as part of other comprehensive income, while the accumulated unrealized gains or losses are reported as a separate component of the Group's equity. When individual AFS financial assets are either derecognized or impaired, the related accumulated unrealized gains or losses previously reported in equity are transferred to and recognized in the consolidated statements of income.

AFS financial assets also include unquoted equity instruments with fair values which cannot be reliably determined. These instruments are carried at cost less impairment in value, if any.

The Group's investments in equity securities included under "Investments and advances" account are classified under this category (Note 10).

The carrying values of financial assets under this category amounted to ₱351 and ₱590 as of December 31, 2009 and 2008, respectively (Note 36).

Financial Liabilities

Financial Liabilities at FVPL. Financial liabilities are classified under this category through the fair value option. Derivative instruments (including embedded derivatives) with negative fair values, except those covered by hedge accounting relationships, are also classified under this category.

The Group carries financial liabilities at FVPL using their fair values and reports fair value changes in the consolidated statements of income. Fair value changes from derivatives accounted for as part of an

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effective accounting hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. Any interest expense incurred shall be recognized as part of “Interest expense” in the consolidated statements of income.

The Group’s derivative liabilities are classified under this category (Note 17).

The carrying values of financial liabilities under this category amounted to ₱111 and ₱2,353 as of December 31, 2009 and 2008, respectively (Notes 17 and 36).

Other Financial Liabilities. This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability.

Included in this category are the Group’s liabilities arising from its trade or borrowings such as drafts and loans payable, accounts payable and accrued expenses, long-term debt and other noncurrent liabilities (Notes 16, 17, 18 and 36).

The combined carrying values of financial liabilities under this category amounted to ₱179,882 and ₱144,222 as of December 31, 2009 and 2008, respectively (Note 36).

Debt Issue Costs

Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest rate method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are charged against current operations.

Derivative Financial Instruments and Hedging

Freestanding Derivatives

For the purpose of hedge accounting, hedges are classified as either: a) fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk); b) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment; or c) hedges of a net investment in foreign operations.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an on-going basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Fair Value Hedge. Derivatives classified as fair value hedges are carried at fair value with corresponding change in fair value recognized in the consolidated statements of income. The carrying amount of the hedged asset or liability is also adjusted for changes in fair value attributable to the hedged item and the gain or loss associated with that remeasurement is also recognized in the consolidated statements of income.

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When the hedge ceases to be highly effective, hedge accounting is discontinued and the adjustment to the carrying amount of a hedged financial instrument is amortized immediately.

The Group discontinues fair value hedge accounting if the hedging instrument expires, is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation.

As of December 31, 2009 and 2008, the Group has no outstanding derivatives accounted for as fair value hedges.

Cash Flow Hedge. Changes in the fair value of a hedging instrument that qualifies as a highly effective cash flow hedge are recognized in other comprehensive income and presented under the “Hedging reserve” account in equity. The ineffective portion is immediately recognized in the consolidated statements of income.

If the hedged cash flow results in the recognition of an asset or a liability, all gains and losses previously recognized directly in equity are transferred from equity and included in the initial measurement of the cost or carrying value of the asset or liability. Otherwise, for all other cash flow hedges, gains and losses initially recognized in equity are transferred from equity to profit or loss in the same period or periods during which the hedged forecasted transaction or recognized asset or liability affect the consolidated statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been reported directly in equity is retained in equity until the forecasted transaction occurs. When the forecasted transaction is no longer expected to occur, any net cumulative gain or loss previously reported in equity is recognized in the consolidated statements of income.

As of December 31, 2009, the Group has no outstanding derivative accounted for as cash flow hedge. As of December 31, 2008, the Group has outstanding commodity options accounted for as cash flow hedge amounting to ₱208.

Net Investment Hedge. As of December 31, 2009 and 2008, the Group has no hedge of a net investment in a foreign operation.

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

Embedded Derivatives

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at FVPL. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Derecognition of Financial Assets and Financial Liabilities

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

- the rights to receive cash flows from the asset expired;

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

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to pay.

Financial Liabilities. A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statements of income.

Impairment of Financial Assets

The Group assesses at reporting date whether a financial asset or group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Assets Carried at Amortized Cost. For assets carried at amortized cost such as loans and receivables, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets pooled according to their credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment for specific impairment purposes may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset’s original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

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The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The impairment loss for the period shall be recognized in the consolidated statements of income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statements of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets. If an AFS financial asset is impaired, an amount comprising the difference between the cost (net of any principal payment and amortization) and its current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statements of income, is transferred from equity to the consolidated statements of income. Reversals in respect of equity instruments classified as AFS financial assets are not recognized in profit or loss. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statements of income.

In the case of an unquoted equity instrument or of a derivative asset linked to and must be settled by delivery of an unquoted equity instrument, for which its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows from the asset discounted using its historical effective rate of return on the asset.

Classification of Financial Instruments Between Debt and Equity

From the perspective of the issuer, a financial instrument is classified as debt instrument if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity; or
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or
- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statements of financial position.

Inventories

Finished goods, goods in process and materials and supplies are valued at the lower of cost and net realizable value.

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Costs incurred in bringing each inventory to its present location and conditions are accounted for as follows:

- Finished goods and goods in process . . . — at cost which includes direct materials and labor and a proportion of manufacturing overhead costs based on normal operating capacity but excluding borrowing costs; cost of goods in process includes unrealized gain (loss) on fair valuation of agricultural produce; costs are determined using the moving-average method;
- Materials and supplies — at cost using the moving-average method.

Net realizable value of finished goods and goods in process is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

Net realizable value of materials and supplies is the current replacement cost.

Containers (i.e., returnable bottles and shells) are stated at deposit values less any impairment in value. The excess of the acquisition cost of the containers over their deposit value is presented under deferred containers included under “Other noncurrent assets” account in the consolidated statements of financial position and is amortized over the estimated useful lives of two to ten years. Amortization of deferred containers is included under “Selling and administrative expenses” account in the consolidated statements of income.

Biological Assets and Agricultural Produce

The Group’s biological assets include breeding, growing poultry livestock, hogs and cattle and goods in process which are grouped according to their physical state, transformation capacity (breeding, growing or laying), as well as their particular stage in the production process.

Growing hogs, cattle and poultry livestock and goods in process are carried at accumulated cost while breeding stocks are carried at accumulated cost net of amortization and any impairment in value. The costs and expenses incurred up to the start of the productive stage are accumulated and amortized over the estimated productive lives of the breeding stocks. The Group uses this method of valuation since fair value cannot be measured reliably. The Group’s biological assets have no active market and no active market for similar assets prior to point of harvest are available in the Philippine poultry and hog industries. Further, the existing sector benchmarks are determined to be irrelevant and the estimates (i.e., revenues due to highly volatile prices, input costs, efficiency values, production) necessary to compute for the present value of expected net cash flows comprise a wide range of data which will not result to a reliable basis for determining the fair value.

The carrying values of the biological assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

The Group’s agricultural produce, which consists of grown broilers and marketable hogs and cattle harvested from the Group’s biological assets, are measured at their fair value less estimated costs to sell at the point of harvest. The fair value of grown broilers is based on the quoted prices for harvested mature grown broilers in the market at the time of harvest. For marketable hogs and cattle, the fair value is based on the quoted prices in the market at any given time.

The Group in general, does not carry any inventory of agricultural produce at any given time as these are either sold as live broilers, hogs and cattle or transferred to the different poultry or meat processing plants and immediately transformed into processed or dressed chicken and carcass.

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Amortization is computed using straight-line method over the following estimated productive lives of breeding stocks:

	<u>Number of Years</u>
Hogs — sow	3 years or 6 births, whichever is shorter
Hogs — boar	2.5 - 3 years
Cattle	2.5 - 3 years
Poultry breeding stock	40 - 44 weeks

Investments in Shares of Stock of Associates

The Group's investments in shares of stock of associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity.

Under the equity method, the investment in an associate is carried in the consolidated statements of financial position at cost plus post-acquisition changes in the Group's share in net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associate. The consolidated statements of income include the Group's share of the total recognized earnings and losses of the associate on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. Adjustments to the carrying amount may also be necessary for changes in the Group's proportionate interest in the associate arising from changes in the associate's other comprehensive income. The Group's share of those changes is recognized in other comprehensive income. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

An investment in an associate is accounted for using the equity method from the date when it becomes an associate. Upon acquisition of the investment, any difference between the cost of the investment and the investor's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with PFRS 3, *Business Combinations*. Consequently:

- a. goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. Instead, the entire amount of the investment in an associate is tested for impairment as a single asset when there is objective evidence that the investment in an associate may be impaired.
- b. any excess of the Group's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group discontinues applying the equity method when its investment in an associate is reduced to zero. Additional losses are provided only to the extent that the Group has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the Group has guaranteed or otherwise committed. If the associate subsequently reports profits, the Group resumes applying the equity method only after its share of the profits equals the share of net losses not recognized during the period the equity method was suspended.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The financial statements of the associates are prepared for the same reporting period as the Parent Company. The accounting policies of the associates conform to those used by the Group for like transactions and events in similar circumstances.

Interest in Joint Venture

The Group recognizes its interest in joint venture using proportionate consolidation. The Group combines its share in each of the assets, liabilities, income and expenses of the joint venture with similar items, line by line, in its consolidated financial statements. The financial statements of the joint venture are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The joint venture is proportionately consolidated until the date when the Group ceases to have joint control over the joint venture.

Property, Plant and Equipment

Property, plant and equipment, except land, are stated at cost less accumulated depreciation and amortization and any accumulated impairment in value. Such cost includes the cost of replacing part of the property, plant and equipment at the time that cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its construction cost or purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation and interest incurred during the construction period on funds borrowed to finance the construction of the projects. Expenditures incurred after the asset has been put into operation, such as repairs, maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. Major repairs are capitalized as part of property, plant and equipment only when it is probable that future economic benefits associated with the items will flow to the Group and the cost of the items can be measured reliably.

Construction in progress represents structures under construction and is stated at cost. This includes the costs of construction and other direct costs. Borrowing costs that are directly attributable to the construction of plant and equipment are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are ready for use.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

	<u>Number of Years</u>
Land improvements	5 - 50
Buildings and improvements	5 - 50
Machinery and equipment	3 - 40
Transportation equipment.	5 - 7
Tools and small equipment	2 - 5
Office equipment, furniture and fixtures	2 - 6
Molds	2 - 5
Leasehold improvements	5 - 50
	or term of the lease, whichever is shorter

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The remaining useful lives, residual values, depreciation and amortization method are reviewed and adjusted, if appropriate, periodically to ensure that such periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation and amortization are credited or charged to current operations.

An item of property, plant and equipment is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its use or disposal. Any gain or loss arising on the retirement and disposal of an item of property, plant and equipment (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statements of income in the period of retirement or disposal.

Investment Properties

Investment properties consist of properties held to earn rentals and/or for capital appreciation. Investment properties, except for land, are measured at cost including transaction costs less accumulated depreciation and amortization and any accumulated impairment in value. The carrying amount includes the cost of replacing part of an existing investment property at the time the cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property. Land is stated at cost less any impairment in value.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

	<u>Number of Years</u>
Land improvements	5 - 50
Buildings and improvements	5 - 50
Machinery and equipment	3 - 40
Tools and small equipment	2 - 5

The residual values, useful lives and method of depreciation and amortization of the assets are reviewed and adjusted, if appropriate, at each financial year-end.

Investment property is derecognized either when it has been disposed of or when it is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains and losses on the retirement and disposal of investment property are recognized in the consolidated statements of income in the period of retirement or disposal.

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

For a transfer from investment property to owner-occupied property or inventories, the cost of property for subsequent accounting is its carrying value at the date of change in use. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

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Business Combinations

Business combinations are accounted for using the purchase method of accounting. The cost of acquisition is the aggregate of the fair values, at the date of exchange of assets given, liabilities incurred or assumed and equity instruments issued by the acquirer, in exchange for control over the net assets of the acquired company, plus any directly attributable costs. The identifiable assets, liabilities and contingent liabilities that satisfy certain recognition criteria have to be measured initially at their fair values at acquisition date, irrespective of the extent of any non-controlling interests.

Transfers of assets between commonly controlled entities are accounted for under historical cost accounting.

When a business combination involves more than one exchange transaction (occurs in stages), each exchange transaction is treated separately by the Group, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of goodwill associated with that transaction. Any adjustment to fair values relating to the previously held interest is a revaluation and is accounted for as such.

When subsidiaries are sold, the difference between the selling price and the net assets plus goodwill is recognized in the consolidated statements of income.

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Subsequently, goodwill is measured at cost less any accumulated impairment in value. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than an operating segment or determined in accordance with PFRS 8, *Operating Segments*.

Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss with respect to goodwill is not reversed.

When the Group acquires a business, embedded derivatives separated from the host contract by the acquiree are not reassessed on acquisition unless the business combination results in a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

Negative goodwill which is not in excess of the fair values of acquired identifiable nonmonetary assets of subsidiaries and associates is charged directly to income.

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Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition. Subsequently, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is charged against profits in the year in which the expenditure is incurred. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method used for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income in the expense category consistent with the function of the intangible asset.

Amortization is computed using the straight-line method over the following estimated useful lives of other intangible assets with finite lives:

	<u>Number of Years</u>
Computer software	2 - 8
Franchise	13 - 20
Leasehold rights	20 or term of the lease, whichever is shorter
Land use rights	25 - 50 or term of the lease, whichever is shorter

The Group assessed the useful life of the trademarks and brand names to be indefinite because based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate cash inflows for the Group.

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

Gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statements of income when the asset is derecognized.

Impairment of Non-financial Assets

The carrying values of investments and advances, property, plant and equipment, investment properties, containers, biological assets, other intangible assets with definite useful lives and idle assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists, and if the carrying value exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of fair value less costs to sell or value in use. The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. In assessing value in use, the estimated future cash flows are discounted to their present

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value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses of continuing operations are recognized in the consolidated statements of income in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in consolidated statements of income. After such a reversal, the depreciation and amortization charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Provisions

Provisions are recognized when the Group has: a) a present obligation (legal or constructive) as a result of past event; b) it is probable (i.e., more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and c) a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the receipt of the reimbursement is virtually certain. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

Share Capital

Common Shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

Preferred Shares

Preferred shares are classified as equity if it is non-redeemable, or redeemable only at the Parent Company's option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity upon approval by the Parent Company's BOD.

Preferred shares are classified as a liability if it is redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as interest expense in the consolidated statements of income as accrued.

Treasury Shares

Own equity instruments which are reacquired are carried at cost and are deducted from equity. No gain or loss is recognized on the purchase, sale, issue or cancellation of the Parent Company's own equity instruments. When the shares are retired, the capital stock account is reduced by its par value and the excess of cost over par value upon retirement is debited to additional paid-in capital to the extent of the specific or

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average additional paid-in capital when the shares were issued and to retained earnings for the remaining balance.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the amount of the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Sales. Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably, which is normally upon delivery.

Agricultural Produce. Revenue from initial recognition of agricultural produce is measured at fair value less estimated costs to sell at the point of harvest. Fair value is based on the relevant market price at point of harvest.

Interest. Revenue is recognized as the interest accrues, taking into account the effective yield on the asset.

Dividend. Revenue is recognized when the Group's right as a shareholder to receive the payment is established.

Gain or Loss on Sale of Investments in Shares of Stock. Gain or loss is recognized if the Group disposes of its investment in a subsidiary or associate. Gain or loss is computed as the difference between the proceeds of the disposed investment and its carrying amount, including the carrying amount of goodwill, if any.

Rent. Revenue from investment properties is recognized on a straight-line basis over the term of the lease. Rent income is included as part of other income.

Cost and Expense Recognition

Costs and expenses are recognized upon receipt of goods, utilization of services or at the date they are incurred.

Share-based Transactions

The cost of Long-term Incentive Plan for Stock Options (LTIP) is measured by reference to the option fair value at the date when the options are granted. The fair value is determined using Black-Scholes option pricing model. In valuing LTIP transactions, any performance conditions are not taken into account, other than conditions linked to the price of the shares of the Parent Company. The cost of Employee Stock Purchase Plan (ESPP) is measured by reference to the market price at the time of the grant less subscription price.

The cost of share-based transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date when the relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognized for share-based transactions, at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Parent Company's best estimate of the number of equity instruments that will ultimately vest. Where the terms of a share-based award are modified, as a minimum, an expense is recognized as if the terms had not been modified. In addition, an expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

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Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as Lessee. Finance leases which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased property, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are reflected in the consolidated statements of income.

Leased asset is depreciated over its estimated useful life. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases which do not transfer to the Group substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term. Associated costs such as maintenance and insurance are expensed as incurred.

Group as Lessor. Leases where the Group does not transfer substantially all the risks and benefits of ownership of the assets are classified as operating leases. Rent income from operating leases is recognized as income on a straight-line basis over the lease term. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rent income. Contingent rents are recognized as income in the period in which they are earned.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized.

Research and Development Costs

Research costs are expensed as incurred. Development costs incurred on an individual project are carried forward when their future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortized in line with the expected future sales from the related project.

The carrying value of development costs is reviewed for impairment annually when the related asset is not yet in use. Otherwise, this is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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Retirement Costs

The Parent Company and majority of its subsidiaries have separate funded, noncontributory retirement plans, administered by the respective trustees, covering their respective permanent employees. Retirement costs are actuarially determined using the projected unit credit method. This method reflects service rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement cost includes current service cost, interest cost, expected return on plan assets, amortization of unrecognized past service costs, recognition of actuarial gains and losses, effect of asset limit and effect of any curtailments or settlements. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to the plan, past service cost is recognized immediately as an expense. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceed the greater of 10% of the present value of the defined benefit obligation or the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The transitional liability as of January 1, 2005, the date of adoption of PAS 19, *Employee Benefits*, is recognized as an expense over five years from date of adoption.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not recognized, reduced by past service costs not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate is negative, the resulting asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan.

If the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan, net actuarial losses of the current period and past service costs of the current period are recognized immediately to the extent that they exceed any reduction in the present value of those economic benefits. If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service costs of the current period are recognized immediately. Similarly, net actuarial gains of the current period after the deduction of past service costs of the current period exceeding any increase in the present value of the economic benefits stated above are recognized immediately if the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan. If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service costs of the current period are recognized immediately.

Foreign Currency Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is the Parent Company's functional currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated at the functional currency rate of exchange at reporting date. All differences are taken to the consolidated statements of income. Nonmonetary items that are measured in terms of historical cost in foreign currency are translated using the exchange rates as at the dates of the initial transactions. Nonmonetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value was determined.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Foreign currency gains and losses are reported on a net basis.

The functional currency of the Group's foreign operations is United States (US) dollar. As at the reporting date, the assets and liabilities of these subsidiaries are translated into the presentation currency of the Parent Company at the rate of exchange ruling at the reporting date and their income and expense accounts are translated at the quarterly weighted average exchange rates for the year. The resulting translation differences are recognized in other comprehensive income and presented under the "Translation reserve" account in equity. On disposal of a foreign subsidiary, the accumulated exchange differences are recognized in the consolidated statements of income as a component of the gain or loss on disposal.

Taxes

Current Tax. Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at reporting date.

Deferred Tax. Deferred income tax is provided using the balance sheet liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- with respect to taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits — Minimum Corporate Income Tax (MCIT) and unused tax losses — Net Operating Loss Carry Over (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- with respect to deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

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Current tax and deferred tax are recognized in the consolidated statements of income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value Added Tax (VAT). Revenues, expenses and assets are recognized net of the amount of VAT, except:

- where the tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables that are stated with the amount of tax included.

The net amount of tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated statements of financial position.

Assets Held for Sale

Noncurrent assets or disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and expected to be completed within one year from classification and the asset is available for immediate sale in its present condition.

Assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell.

Discontinued Operations

A discontinued operation is a component of the Group's business that represents a separate major line of business that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative consolidated statements of income are re-presented as if the operation had been discontinued from the start of the comparative period and show the results of discontinued operation separate from the results of continuing operation.

Related Parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities. Transactions between related parties are on an arm's length basis in a manner similar to transactions with non-related parties.

Basic and Diluted Earnings Per Common Share (EPS)

Basic EPS is computed by dividing the net income for the period attributable to equity holders of the Parent Company, net of dividends on preferred shares, by the weighted average number of issued and outstanding common shares during the period, with retroactive adjustment for any stock dividends declared.

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Diluted EPS is computed in the same manner, adjusted for the effects of the shares issuable to employees and executives under the Parent Company's ESPP and LTIP, respectively, which are assumed to be exercised at the date of grant.

Where the effect of the assumed conversion of shares issuable to employees and executives under the Parent Company's stock purchase and option plans would be anti-dilutive, diluted EPS is not presented.

Operating Segments

The Group's operating segments are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets. Financial information on operating segments is presented in Note 5 to the consolidated financial statements.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

Events After the Reporting Date

Post year-end events that provide additional information about the Group's consolidated financial position at reporting date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the consolidated financial statements when material.

4. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the Group's consolidated financial statements in accordance with PFRS requires management to make judgments, estimates and assumptions that affect amounts reported in the consolidated financial statements at the reporting date. However, uncertainty about these estimates and assumptions could result in outcome that could require a material adjustment to the carrying amount of the affected asset or liability in the future.

Judgments

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

Operating Leases. The Group has entered into various lease agreements as a lessee. The Group has determined that the lessor retains all significant risks and rewards of ownership of these properties which are leased out under operating lease arrangements.

Rent expense charged to operations amounted to ₱2,120, ₱1,796 and ₱1,450 in 2009, 2008 and 2007, respectively (Notes 21 and 22).

Contingencies. The Group currently has several tax assessments, legal and administrative claims. The Group's estimate of the probable costs for the resolution of these assessments and claims has been developed in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these matters and is based on an analysis of potential results. The Group currently does not believe that these tax assessments, legal and administrative claims will have a material adverse effect on its consolidated financial position and consolidated financial performance. It is possible, however, that

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

future financial performance could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings. No accruals were made in relation to these proceedings (Note 38).

Estimates

The key estimates and assumptions used in the consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from such estimates.

Allowance for Impairment Losses on Trade and Other Receivables. Provisions are made for specific and groups of accounts, where objective evidence of impairment exists. The Group evaluates these accounts on the basis of factors that affect the collectibility of the accounts. These factors include, but are not limited to, the length of the Group's relationship with the customers and counterparties, the customers' current credit status based on third party credit reports and known market forces, average age of accounts, collection experience, and historical loss experience. The amount and timing of recorded expenses for any period would differ if the Group made different judgments or utilized different methodologies. An increase in allowance for impairment losses would increase the recorded selling and administrative expenses and decrease current assets.

The allowance for impairment losses amounted to ₱2,729 and ₱2,884 as of December 31, 2009 and 2008, respectively. The carrying values of trade and other receivables amounted to ₱49,082 and ₱50,814 as of December 31, 2009 and 2008, respectively (Note 8).

Allowance for Inventory Losses. The Group provides allowance for inventory losses whenever net realizable value becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made of the amount the inventories are expected to be realized. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after reporting date to the extent that such events confirm conditions existing at reporting date. The allowance account is reviewed periodically to reflect the accurate valuation in the financial records.

The allowance for inventory losses amounted to ₱1,149 and ₱901 as of December 31, 2009 and 2008, respectively. The carrying values of inventories amounted to ₱25,458 and ₱25,836 as of December 31, 2009 and 2008, respectively (Note 9).

Estimated Useful Lives of Investment Properties, Containers and Property, Plant and Equipment. The Group estimates the useful lives of investment properties, containers and property, plant and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of investment properties, containers and property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

In addition, estimation of the useful lives of investment properties, containers and property, plant and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of investment properties, containers and property, plant and equipment would increase recorded cost of sales and selling and administrative expenses and decrease noncurrent assets.

Accumulated depreciation and amortization of investment properties and property, plant and equipment amounted to ₱56,714 and ₱52,965 as of December 31, 2009 and 2008, respectively. Property, plant and

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equipment, net of accumulated depreciation and amortization amounted to ₱73,892 and ₱72,873 as of December 31, 2009 and 2008, respectively (Note 11). Investment properties, net of accumulated depreciation amounted to ₱2,263 and ₱2,253 as of December 31, 2009 and 2008, respectively (Note 12). Deferred containers net of accumulated amortization amounted to ₱4,446 and ₱3,708 as of December 31, 2009 and 2008, respectively (Note 15).

Estimated Useful Lives of Intangible Assets. The useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Intangible assets are regarded to have an indefinite useful life when, based on analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group.

Intangible assets with finite useful lives amounted to ₱1,491 and ₱1,561 as of December 31, 2009 and 2008, respectively (Note 14).

Impairment of Goodwill and Trademarks and Brand Names with Indefinite Lives. The Group determines whether goodwill, trademarks and brand names are impaired at least annually. This requires the estimation of the value in use of the cash-generating units to which the goodwill is allocated and the value in use of the trademarks and brand names. Estimating value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and from the trademarks and brand names and to choose a suitable discount rate to calculate the present value of those cash flows.

The carrying values of goodwill as of December 31, 2009 and 2008 amounted to ₱6,408 and ₱5,201, respectively (Note 14).

The carrying values of trademarks and brand names amounted to ₱2,139 and ₱2,251 as of December 31, 2009 and 2008, respectively (Note 14).

Purchase Price Allocation in Business Combinations. Purchase method requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair market values of the acquiree's identifiable assets and liabilities at acquisition date. It also requires the acquirer to recognize goodwill. The Group's acquisitions have resulted in goodwill and trademarks and brand names with indefinite lives.

The total carrying values of goodwill and trademarks and brand names with indefinite useful lives arising from business combinations as of December 31, 2009 and 2008 amounted to ₱8,547 and ₱7,452, respectively (Note 14).

Realizability of Deferred Tax Assets. The Group reviews its deferred tax assets at each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Group's assessment on the recognition of deferred tax assets on deductible temporary difference and carryforward benefits of MCIT and NOLCO is based on the projected taxable income in the following periods.

Deferred tax assets amounted to ₱8,883 and ₱7,638 as of December 31, 2009 and 2008, respectively (Note 19).

Impairment of Non-financial Assets. PFRS requires that an impairment review be performed on investments and advances, property, plant and equipment, investment properties, containers, biological assets, other intangible assets with definite useful lives and idle assets when events or changes in circumstances indicate that the carrying value may not be recoverable. Determining the recoverable amount of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable amounts and any resulting impairment loss could have a material adverse impact on the financial performance.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Accumulated impairment losses of property, plant and equipment and investment properties amounted to ₱8,369 and ₱4,975 as of December 31, 2009 and 2008, respectively. The aggregate amount of investments and advances, property, plant and equipment, investment properties, biological assets, other intangible assets with definite useful lives, containers, and idle assets, amounted to ₱117,686 and ₱112,484 as of December 31, 2009 and 2008, respectively (Notes 10, 11, 12, 13, 14 and 15).

Present Value of Defined Benefit Obligation. The present value of the retirement obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. These assumptions are described in Note 30 to the consolidated financial statements and include discount rate, expected return on plan assets and salary increase rate. Actual results that differ from the assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The assumption of the expected return on plan assets is determined on a uniform basis, taking into consideration the long-term historical returns, asset allocation and future estimates of long-term investment returns.

The Group determines the appropriate discount rate at the end of each year. It is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Group considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid. The terms to maturity of these bonds should approximate the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions.

While it is believed that the Group's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Group's retirement obligations.

The Group has a net cumulative unrecognized actuarial gain (loss) amounting to ₱3,271 and (₱268) as of December 31, 2009 and 2008, respectively (Note 30).

Fair Value of Agricultural Produce. The Group determines the fair value of its agricultural produce based on most recent market transaction price provided that there has been no significant change in economic circumstances between the date of transactions and reporting date. Costs to sell are estimated based on most recent transaction and is deducted from the fair value in order to measure the fair value of agricultural produce at point of harvest.

Unrealized gain (loss) on fair value adjustments included in the cost of inventories as of December 31, 2009 and 2008 amounted to ₱63 and (₱2), respectively (Note 9).

Financial Assets and Financial Liabilities. The Group carries certain financial assets and financial liabilities at fair value, which requires extensive use of accounting estimates and judgments. Significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates). The amount of changes in fair value would differ if the Group utilized different valuation methodologies and assumptions. Any change in the fair value of these financial assets and financial liabilities would affect profit and loss and equity.

Fair value of financial assets and financial liabilities are discussed in Note 36.

Asset Retirement Obligation. Determining asset retirement obligation requires estimation of the cost of dismantling property and equipment and other costs of restoring the leased properties to their original condition. The Group determined that there are no significant asset retirement obligations as of December 31, 2009 and 2008.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. Segment Information

Operating Segments

The reporting format of the Group's operating segments is determined by the Group's risks and rates of return which are affected predominantly by differences in the products and services produced. The operating businesses are organized and managed separately according to the nature of the products produced and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The Group has three reportable segments, namely, beverage, food and packaging.

The beverage segment produces and markets alcoholic and nonalcoholic beverages.

The food segment includes, among others, poultry, feeds production and selling, livestock farming, processing and selling of basic meat products, processing and marketing of refrigerated and canned meat products, manufacturing and marketing of flour product, premixes and flour-based products, dairy-based products, breadfill, desserts, cooking oil, importation and marketing coffee and coffee-related products and processed meats.

The packaging segment is involved in the production and marketing of the following packaging products, among others, glass containers, glass molds, polyethylene terephthalate (PET) bottles and preforms, PET recycling, plastic closures, corrugated cartons, woven polypropylene/kraft sacks and paperboard, pallets, flexible packaging, plastic crates, plastic floorings, plastic films, plastic trays, plastic pails and tubs, crate and plastic pallet leasing, metal closures and two-piece aluminum cans, woven products, industrial laminates and radiant barriers. It is also involved in PET bottle filling graphics design, packaging research and testing, packaging development and consultation, contract packaging and trading.

Segment Assets and Liabilities

Segment assets include all operating assets used by a segment and consist principally of operating cash, receivables, inventories and property, plant and equipment, net of allowances and impairment. Segment liabilities include all operating liabilities and consist principally of accounts payable, wages, taxes currently payable and accrued liabilities. Segment assets and liabilities do not include deferred income taxes.

Inter-segment Transactions

Segment revenues, expenses and performance include sales and purchases between operating segments. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transfers are eliminated in consolidation.

Major Customer

The Group does not have a single external customer from which sales revenue generated amounted to 10% or more of the total revenue of the Group.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Operating Segments

Financial information about reportable segments follow:

	For the Years Ended December 31, 2009, 2008 and 2007											
	Continuing Operations						Discontinued Operations (Note 6)			Total Operations		
	Beverage		Food		Packaging		Others		Eliminations		Total	
	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007
Sales												
External sales	P82,735	P78,599	P69,334	P77,220	P73,830	P63,516	P14,258	P15,612	P15,172	P —	P174,213	P168,041
Inter-segment sales	1,067	—	425	15	50	10	5,413	4,246	3,605	—	—	—
Total sales	P83,802	P78,599	P69,759	P77,235	P73,880	P63,526	P19,671	P19,858	P18,777	P —	P174,213	P168,041
Result												
Segment result	P14,035	P14,556	P11,359	P 4,559	P 865	P 2,341	P 1,562	P 1,315	P 146	P12,769	P14,818	P 11,627
Interest expense and financing charges										P (7926)	(6,032)	(7,117)
Interest income										5,989	6,630	2,087
Equity in net earnings (losses) of associates										2,816	(1,132)	164
Gain (loss) on sale of investments and property and equipment										50,630	8,746	2,224
Other income (charges) — net										(6,843)	(2,262)	3,614
Income tax benefit (expense)										(3,706)	(6,098)	(4,520)
Gain (loss) from discontinued operations										—	—	—
Net income										P 60,629	P 14,670	P 8,079
Attributable to:												
Equity holders of the Parent Company										P 57,799	P 13,935	P 8,160
Non-controlling interest										2,830	735	(81)
Net income										P 60,629	P 14,670	P 8,079

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

For the Years Ended December 31, 2009, 2008 and 2007

	Beverage			Food			Packaging			Others			Eliminations			Consolidated		
	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007	2009	2008	2007
Other Information																		
Segment assets	P76,816	P100,242	P76,617	P43,126	P711,122	P63,300	P33,689	P33,021	P34,787	P315,548	P241,782	P210,355	P(91,069)	P(154,247)	P(115,834)	P378,110	P291,920	P269,225
Investments in and advances to associates . . .	—	—	—	—	—	—	—	—	—	39,005	31,663	220	—	—	—	39,005	31,663	220
Goodwill, trademarks and brand names										8,547	7,452	7,310				8,547	7,452	7,310
Other assets										1,200	700	6,381				1,200	700	6,381
Assets held for sale										2,746	—	—				2,746	—	—
Deferred tax assets										8,883	7,638	4,973				8,883	7,638	4,973
Consolidated total assets																P438,491	P339,373	P288,109
Segment liabilities	P 9,722	P 26,443	P22,438	P23,337	P24,095	P16,767	P 7,714	P 7,659	P16,178	P 96,547	P146,348	P 84,594	P(87,690)	P(155,935)	P(119,603)	P 49,630	P 48,610	P 20,374
Drafts and loans payable										56,789	48,560	44,231				56,789	48,560	44,231
Long-term debt and redeemable preferred shares										72,962	49,763	55,834				72,962	49,763	55,834
Income and other taxes payable										4,186	4,429	3,327				4,186	4,429	3,327
Dividends payable and others										1,949	1,936	5,529				1,949	1,936	5,529
Deferred tax liabilities										12,037	17,851	12,721				12,037	17,851	12,721
Consolidated total liabilities																P197,553	P171,149	P142,016
Capital expenditures	P 1,399	P 3,471	P 4,851	P 781	P 215	P 1,065	P 1,010	P 1,354	P 2,550	P 3,059	P 1,397	P 844	P —	P —	P —	P 6,249	P 6,437	P 9,310
Depreciation and amortization of property, plant and equipment	2,415	2,251	2,372	940	868	2,260	1,533	1,491	1,144	366	323	304	—	—	—	5,254	4,933	6,080
Noncash items other than depreciation and amortization of property, plant and equipment	763	795	1,037	1,167	966	806	172	(81)	103	2,612	2,368	466	—	—	—	4,714	4,048	2,412
Loss on impairment of goodwill, property, plant and equipment, and other noncurrent assets	3,705	—	1,461	54	—	—	695	—	283	302	322	—	—	—	—	4,756	322	1,744

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. Discontinued Operations and Assets Held for Sale

a. Bank of Commerce (BOC) (Note 10)

On February 15, 2010, SMPI's BOD authorized the divestment of SMPI's 31.23% interest in BOC. The carrying amount of the investment as of December 31, 2009 of ₱2,746 representing 16,396,689 common shares is presented as "Assets held-for-sale" in the consolidated statements of financial position.

b. Agribusiness Division of the Parent Company

In 2008, the Parent Company ceased the operations of its Agribusiness Division, in particular the operations of its Iligan Coconut Oil Mill.

c. San Miguel Australia Holdings Ltd. (SMAH)

On November 8, 2007, the Parent Company through San Miguel Beverages (L) Pte. Ltd. signed a definitive agreement to sell its SMAH shares including its premium Tasmanian brewer, J. Boag, to Lion Nathan Australia Pty. Ltd., an Australian alcoholic beverages company, for which enterprise value amounted to Australian Dollar (A\$)325.

The closing audit was completed on January 2, 2008 and the Parent Company received A\$277 as payment of purchase price, net of adjustments. The Group recognized a gain of ₱5,425, net of deferred income tax in 2008.

d. San Miguel Foods Australia Holdings Pty. Ltd. (SMFAH)

On November 8, 2007, the Parent Company through San Miguel Foods (L) Pte. Limited reached an agreement with Kirin Holdings (Australia) Pty. Ltd. to sell its Australian dairy and juice business, SMFAH, for a purchase price of A\$752 (net of external debt and shareholder loans) subject to adjustments at completion of closing audit. The sale also includes National Foods Limited's shares in Berri Ltd., King's Creameries (S) Pte. and Lactos Pty. Ltd.

On December 27, 2007, the Parent Company received A\$2,090 representing payment of the purchase price and settlement of shareholder loans.

Based on the results of the closing audit on April 30, 2008, an adjustment in the purchase price of A\$28 was received by the Parent Company five (5) business days after completion of the closing audit. The loss realized from the sale amounted to ₱513, net of ₱1,922 net income of SMFAH in 2007.

e. Coca-Cola Bottlers Philippines, Inc. (CCBPI)

On February 22, 2007, the Parent Company and Coca-Cola South Asia Holdings, Inc. (CCSAHI) executed a Deed of Sale of Shares of Stock covering the Parent Company's 65% equity in CCBPI consisting of 766,121 common shares and 172,942 Class "A" preferred shares for US\$590. The payments to the Parent Company are scheduled on various dates over a five-year period subject to fulfillment of specific conditions attached to each and every payment due. Receivable from CCSAHI amounting to ₱4,620 and ₱4,752 as of December 31, 2009 and 2008, respectively are presented as part of "Noncurrent receivables and deposits" under "Other noncurrent assets" account (Note 15).

On August 23, 2007, the closing audit for the sale transaction was completed and the selling price was adjusted to US\$520. The gain realized from the sale amounted to ₱824, net of ₱376 net loss of CCBPI (from January 1 to February 22, 2007).

The adjustment in selling price from US\$590 to US\$520 (net of the assigned receivables amounting to US\$17) is a result of a compromise agreement between the Parent Company and CCSAHI.

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As required by PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, the financial performance of Agribusiness in 2008 and 2007, SMFAH and SMAH in 2007 and CCBPI for the period ended February 22, 2007, were presented as a separate item under “Income After Income Tax from Discontinued Operations” in the consolidated statements of income.

The results of discontinued operations are presented below:

	<u>Note</u>	<u>2008</u>	<u>2007</u>
Net sales		P 181	P 93,948
Cost of sales		<u>168</u>	<u>59,568</u>
Gross profit		13	34,380
Selling and administrative expenses		(23)	(28,858)
Interest expense and financing charges	25	—	(2,984)
Interest income	26	—	317
Equity in net earnings of associates		—	82
Gain on sale of investments and property, plant and equipment		—	(5)
Other charges — net		<u>(9)</u>	<u>(251)</u>
Income (loss) before income tax		(19)	2,681
Income tax expense (benefit)	19	<u>(7)</u>	<u>1,174</u>
Income (loss) from discontinued operations		(12)	1,507
Gain (loss) on sale from disposal of investment — net of tax of P2,921 and P4,596 in 2008 and 2007, respectively	19	<u>5,425</u>	<u>(1,235)</u>
Net income from discontinued operations		<u>P5,413</u>	<u>P 272</u>
Attributable to:			
Equity holders of the Parent Company	32	P5,413	P 470
Non-controlling interests		<u>—</u>	<u>(198)</u>
		<u>P5,413</u>	<u>P 272</u>

Basic and diluted earnings per share from discontinued operations, attributable to equity holders of the Parent Company, are presented in Note 32.

Cash flows provided by discontinued operations are presented below:

	<u>2008</u>	<u>2007</u>
Net cash flows provided by operating activities	P1,312	P 4,173
Net cash flows provided by investing activities	7,786	97,762
Net cash flows used in financing activities	<u>—</u>	<u>(11,221)</u>
Net cash flows provided by discontinued operations	<u>P9,098</u>	<u>P 90,714</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
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The effect of disposal on the consolidated financial position follows:

	<u>2008</u>
Assets held for sale	P 5,324
Liabilities directly associated with assets held for sale	(3,642)
Amounts recognized directly in equity relating to assets held for sale	<u>(37)</u>
Net assets disposed of	<u>P 1,645</u>
Cash consideration received	<u>P 9,083</u>

7. Cash and Cash Equivalents

Cash and cash equivalents consist of:

	<u>2009</u>	<u>2008</u>
Cash in banks and on hand	P 25,926	P 8,220
Short-term investments	<u>183,485</u>	<u>108,719</u>
	<u>P209,411</u>	<u>P116,939</u>

Cash in banks earns interest at the respective bank deposit rates. Short-term investments are made for varying periods of up to three months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term investment rates.

8. Trade and Other Receivables

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Trade		P17,188	P18,668
Amounts owed by related parties	28	3,170	6,491
Non-trade	29, 34	<u>31,453</u>	<u>28,539</u>
		51,811	53,698
Less allowance for impairment losses		<u>2,729</u>	<u>2,884</u>
		<u>P49,082</u>	<u>P50,814</u>

Trade receivables are non-interest bearing and are generally on a 30 to 45-day term.

The movements in the allowance for impairment losses are as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	P2,884	P2,541
Charges for the year	398	604
Amounts written off	(257)	(283)
Reversals and others	<u>(296)</u>	<u>22</u>
Balance at end of year	<u>P2,729</u>	<u>P2,884</u>

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As at December 31, 2009 and 2008 the aging of receivables is as follows:

<u>2009</u>	<u>Total</u>	<u>Trade</u>	<u>Owed by Related Parties</u>	<u>Non-Trade</u>
Current	₱43,988	₱11,142	₱3,170	₱29,676
Past due				
Less than 30 days	2,609	2,334	—	275
30-60 days	789	613	—	176
61-90 days	804	729	—	75
Over 90 days	3,621	2,370	—	1,251
	<u>₱51,811</u>	<u>₱17,188</u>	<u>₱3,170</u>	<u>₱31,453</u>
<u>2008</u>	<u>Total</u>	<u>Trade</u>	<u>Owed by Related Parties</u>	<u>Non-Trade</u>
Current	₱44,831	₱11,610	₱6,491	₱26,730
Past due				
Less than 30 days	3,633	3,245	—	388
30-60 days	1,078	814	—	264
61-90 days	629	437	—	192
Over 90 days	3,527	2,562	—	965
	<u>₱53,698</u>	<u>₱18,668</u>	<u>₱6,491</u>	<u>₱28,539</u>

The Parent Company has outstanding advances to San Miguel Corporation Retirement Plan (SMCRP) amounting to ₱2,785 and ₱6,323 (Note 28) as of December 31, 2009 and 2008, respectively, subject to interest of 6.5% per annum. Interest pertaining to the said advances amounted to ₱639, ₱2,310 and ₱1,148 for the years ended December 31, 2009, 2008 and 2007, respectively (Note 26).

SMCRP used the proceeds of the advances mainly for the purchase of the Parent Company's common shares. Such investment accounts for more than 46% of the total plan assets as of December 31, 2008.

On December 27, 2007, SMCRP entered into a Stock Purchase Agreement (the Agreement) with a third party (Buyer) for the sale of the SMC common shares (857,115,914 shares). The contract provides among others, that the shares be sold at an agreed price, payable on or before December 31, 2008, extendible for additional three months up to March 31, 2009, subject to interest.

Under the terms of the Agreement, all rights to, interests and title in and ownership of the shares shall remain with SMCRP provided that upon receipt of the agreed downpayment, the voting rights shall be transferred to the Buyer. All dividends and other benefits, except for stock dividends, declared by the Parent Company in relation to the shares shall accrue fully to SMCRP. All stock dividends declared by the Parent Company in relation to the shares shall accrue to SMCRP and the Buyer proportionately based on the consideration paid by the Buyer.

On November 25, 2008, SMCRP and the Buyer through amendments to the Agreement, agreed to extend the maturity of the contract up to December 31, 2009, subject to a partial payment. Upon remittance of the partial payment, interest at 7% per annum shall accrue on the remaining balance of the contract.

On November 27, 2009, the Buyer paid the remaining balance of the contract.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

9. Inventories

Inventories at net realizable value consist of:

	<u>2009</u>	<u>2008</u>
Finished goods and goods in process	P 8,547	P 8,073
Materials and supplies	15,355	16,392
Containers	<u>1,556</u>	<u>1,371</u>
	<u>P25,458</u>	<u>P25,836</u>

The cost of finished goods and goods in process amounted to P8,877 and P8,257 as of December 31, 2009 and 2008, respectively.

The cost of materials and supplies as of December 31, 2009 and 2008 amounted to P15,879 and P16,733, respectively.

Containers at deposit value amounted to P1,851 and P1,747 as of December 31, 2009 and 2008, respectively.

Finished goods and goods in process include net unrealized gain of P63 and net unrealized loss of P2 on fair valuation of agricultural produce as of December 31, 2009 and 2008, respectively (Note 4). The fair value of agricultural produce less costs to sell, which formed part of finished goods inventory, amounted to P287 and P557 as of December 31, 2009 and 2008, respectively, with corresponding cost at point of harvest amounting to P224 and P559, respectively.

10. Investments and Advances

Investments in Shares of Stock of Subsidiaries

The following are the developments relating to the Parent Company's investments in shares of stock of subsidiaries in 2009 and 2008:

a. SMB

On July 24, 2007, the stockholders of the Parent Company, during the annual stockholders' meeting, approved the transfer of the Parent Company's domestic beer business assets (excluding land and brands) to a wholly-owned subsidiary of the Parent Company, in exchange for shares of stock. The transfer of such assets to a wholly-owned subsidiary is pursuant to the listing with the PSE and the public offering of the shares of SMB.

On July 26, 2007, the Parent Company incorporated SMB, a wholly-owned subsidiary with an initial authorized capital stock of P100 and paid-up capital of P6.25. Pursuant to the stockholders approval obtained on July 24, 2007, the Parent Company's domestic beer business net assets as of June 30, 2007, excluding land, brands and certain payables were transferred to SMB in exchange for additional shares of stock effective October 1, 2007.

On September 27, 2007, the Securities and Exchange Commission (SEC) approved the transfer of the domestic beer business net assets to SMB and the increase in SMB's authorized capital stock from P100 to P25,000.

Shares totaling 15,308,416,960, were issued to the Parent Company pursuant to such transfer under a tax-free asset-for-share agreement, as confirmed by the Bureau of Internal Revenue (BIR) in its certification No. SN-300-2007.

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As a standard condition of the SEC for approval of applications for increase in authorized capital stock, where the payment for the shares issued pursuant to such increase is made in the form of motor vehicles and receivables, 2,557,573,242 common shares that were issued by SMB to the Parent Company in exchange for motor vehicles and receivables, out of the 15,308,416,960 common shares issued by SMB, are being held in escrow by the SEC pending the transfer of ownership of those motor vehicles in the name of SMB and proof of collection of receivables.

On November 5, 2008, SMB submitted to the SEC the required documentation for the transfer of ownership of motor vehicles and proof of collection of receivables. This is still being reviewed by the SEC as of April 14, 2010.

On May 12, 2008, SMB listed its shares in the PSE pursuant to its listing application approved on March 26, 2008. SMB sold 77,052,000 shares to the public by way of a primary offer, and the Parent Company sold to the public 809,050,000 shares of its existing shares in SMB (including shares to cover for over-allotments) by way of a secondary offer, pursuant to a registration statement rendered effective by the SEC on April 28, 2008. The total shares offered represents 5.75% stake in SMB. The Group recognized a net gain of ₱5,650 from the transaction.

On February 20, 2009, the Parent Company signed a share purchase agreement for the acquisition by Kirin Holdings Company, Limited (“Kirin”), of a 43.2499% stake in SMB. Under the terms of the agreement, purchase price of the shares amounted to ₱8.841 per share, implying a total acquisition price at ₱58,924. Further to the agreement, the Parent Company, Kirin and SMB negotiated exclusively for SMB’s purchase of shares in Parent Company’s overseas beer business.

On April 30 and May 22, 2009, the Parent Company sold its 2,185,402,491 and 4,479,621,199 common shares, respectively, representing 43.2499% stake in SMB to Kirin at ₱8.841 per share for a total purchase price of ₱58,924. The Group recognized a net gain of ₱50,537 from the sale.

b. SMBIL

On August 17, 2009, the Parent Company assigned its international trademarks, trade dress, know-how, copyrights, patents and other intellectual property rights (“International IP Rights”) used in connection with the international beer business of the Parent Company and its international subsidiaries valued at US\$31.5 to SMIL. Common shares totaling 2,863,636 were issued to the Parent Company under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-233-2009.

On December 18, 2009, SMB’s BOD approved the purchase of the international beer and malt-based beverages business of the Parent Company through the purchase of the shares of San Miguel Holdings Ltd. (SMHL) in SMBIL, comprising 100% of the issued and outstanding capital stock of SMBIL (SMBIL Shares), with an enterprise value of US\$300. The BOD of the Parent Company likewise approved the sale of its international beer and malt-based beverage business to SMB, through the sale by SMHL, its wholly-owned subsidiary, of the SMBIL Shares to SMB, on the same day. On the same date, the Parent Company, SMB and SMHL entered into a Share Purchase Agreement (SPA) for the SMBIL Shares.

On December 21, 2009, SMIL’s BOD approved the assignment of International IP Rights to SMHL valued at US\$31.5 in exchange for 286,363 SMHL common shares. The assignment was also approved by SMHL’s BOD on the same date.

Also on the same date, SMHL’s BOD approved the assignment of International IP Rights to SMBIL valued at US\$31.5 in exchange for 2,863,636 SMBIL shares. The assignment was also approved by SMBIL’s BOD on the same date.

On January 28, 2010, SMB entered into a US\$300 unsecured loan facility agreement. Proceeds of the loan were used to finance SMB’s acquisition of SMBIL Shares. The sale was completed on January 29, 2010,

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with SMB acquiring the SMBIL Shares for a purchase price of US\$302, after adjustments in accordance with the terms of the SPA.

c. IBI

On December 8, 2008, the BOD of the Parent Company approved the transfer of its domestic beer and malt-based beverages brands, including related trademarks, copyrights, patents and other intellectual property rights and know-how (“Domestic IP Rights”) to a wholly-owned subsidiary, in exchange for shares of stock.

On December 16, 2008, the Parent Company formed IBI, a wholly-owned subsidiary, with an authorized capital stock of ₱1. IBI was incorporated primarily to engage in the manufacturing, buying, selling (on wholesale) and dealing in alcoholic and non-alcoholic beverages and to own, purchase, license and/or acquire such trademarks and other intellectual property rights necessary for the furtherance of its business. On the same date, the BOD and stockholders of IBI approved the increase in its authorized capital stock from ₱1 to ₱10,000 divided into 100,005,000 shares at ₱100.00 par value per share. To fund such increase, the Parent Company and IBI executed a Deed of Assignment of Domestic Intellectual Rights dated December 16, 2008 as supplemented for the transfer of the Domestic IP Rights in exchange for common shares in IBI.

On January 27, 2009, the Parent Company’s BOD approved the sale of its Domestic IP Rights to SMB, through the sale of all its interests in IBI. On the same date, the BOD of SMB approved the purchase of the IP Rights through the purchase of all of the Parent Company’s interests in IBI after the completion of such transfer by the Parent Company of the IP Rights to IBI.

On February 27, 2009, the SEC approved the increase in the authorized capital stock of IBI. With such approval, the SEC likewise approved the transfer of the Domestic IP Rights by the Parent Company to IBI in exchange for 100,000,000 shares in IBI. The said shares were issued to the Parent Company under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-405-2008.

On April 29, 2009, the Parent Company sold its 100% interest in IBI to SMB for a total purchase price of ₱32,000. Following such sale, IBI became a wholly-owned subsidiary of SMB.

d. BPI

On December 8, 2008, the BOD of the Parent Company approved the transfer of certain parcels of land used in the domestic beer operations to a wholly-owned subsidiary, in exchange for shares of stock.

On December 16, 2008, the Parent Company formed BPI, a wholly-owned subsidiary, with an authorized capital stock of ₱1. BPI was incorporated primarily to own, use, improve, develop, sell, exchange, lease and hold investment or otherwise, real estate of all kinds, including buildings and other structures.

On January 27, 2009, the BOD of the Parent Company approved the sale of certain parcels of land used in the domestic beer operations, partly to BLI, a wholly-owned subsidiary of San Miguel Brewery Inc. Retirement Plan (SMBRP) at ₱239, and the rest to SMB, through the sale of all its interests in BPI, the company to which the rest of such parcels of land will be transferred at the purchase price of ₱6,829, corresponding to the appraised value of the land transferred by the Parent Company to BPI.

On the same date, SMB’s BOD likewise approved the purchase of all of SMC’s interests in BPI after: (i) SMC has transferred certain parcels of land used in the domestic beer operations to BPI in exchange for common shares; and (ii) SMBRP has transferred its shares in BLI to BPI in exchange for preferred shares. The acquisition will be financed using part of the proceeds of the bond offering of SMB.

The sale by the Parent Company of its interests in BPI to SMB will be implemented after obtaining all the required approvals from the appropriate regulatory agencies.

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On January 28, 2009, the BOD of BPI approved the increase in the par value of its common shares from ₱100.00 to ₱350.00 per share and the increase in its authorized capital stock from ₱1 divided into 10,000 shares with a par value of ₱100.00 per share to ₱800 divided into 2,400,000 preferred shares and 1,600,000 common shares with a par value of ₱100.00 and ₱350.00 per share, respectively. To fund the increase in BPI's authorized capital stock, SMC transferred certain parcels of land used in the domestic beer business of SMB to BPI in exchange for 1,592,281 common shares, out of its existing unissued capital stock and the increase in its authorized capital stock, and SMBRP transferred its 2,389,494 common shares (with a par value of ₱100.00 per share) in BLI as payment for its subscription to 2,389,494 preferred shares of BPI (with a par value of ₱100.00 per share).

On February 25, 2009, the Parent Company sold certain parcels of land to BLI for a total consideration of ₱239 and recognized a gain of ₱232.

On September 10, 2009, the SEC approved the increase in the par value of BPI's common shares and the increase in its authorized capital stock. With such approval, the transfer of: (i) the certain parcels of land (used in the domestic beer business of SMB) of the Parent Company to BPI in exchange for additional common shares from the existing unissued authorized capital stock of BPI and increase in authorized capital stock; and (ii) the common shares of SMBRP in BLI to BPI as payment for SMBRP's subscription to BPI preferred shares were also approved by the SEC. The transfer was under a tax-free asset-for-share agreement, as confirmed by the BIR in its certification No. SN-121-2009. Following the approval, BLI became a subsidiary of BPI.

BLI and BPI started commercial operations on February 25, 2009 and September 10, 2009, respectively.

e. Packaging Businesses

On April 12, 2007, the BOD approved the sale of up to 40% of the Parent Company's interests in its domestic packaging businesses under SMPSI and in its regional packaging businesses under SMPIL.

On April 27, 2007, the Parent Company executed the SMPSI Stock Purchase Agreement (SMPSI SPA) with Nihon Yamamura Glass Co., Ltd. (NYG), a leading Japanese manufacturer of glass and plastics packaging, for the sale of the Parent Company's 35% stake in its domestic packaging businesses, subject to the completion of the closing terms and conditions under the SMPSI SPA. On the same date, the Parent Company and its wholly-owned foreign subsidiary, SMHL, also executed the SMPIL Stock Purchase Agreement (SMPIL SPA) with NYG for the sale of SMHL's 35% stake in its regional packaging businesses, subject to the completion of the closing terms and conditions under the SMPIL SPA.

On November 16, 2007, the Parent Company and NYG entered into the SMPSI Shareholder's Agreement and, together with SMHL, also entered into the SMPIL Shareholder's Agreement, in compliance with the requirements of the SMPSI SPA and the SMPIL SPA. The shareholders' agreements provide the terms and conditions that govern the relationship among the Parent Company, SMHL and NYG as shareholders.

Also on the same date, the authorized capital stock of SMPIL was increased from US\$0.001 to US\$100. And pursuant to a written resolution of the BOD of SMPIL dated November 23, 2007, SMPIL approved, among others, the conversion of SMHL's shareholder advances in the amount of US\$64.3 into 64,281,176 fully paid shares in SMPIL.

On December 18, 2007, the Parent Company entered into several deeds of assignment with SMPSI for the following assignments by the Parent Company in favor of SMPSI: (i) its receivables of ₱187.5 as full payment of the Parent Company's incorporation subscription payables; (ii) its receivables of ₱6,083 as full payment of the Parent Company's additional subscription of 5,294,180 SMPSI shares; (iii) effective January 1, 2008, its 60% equity in SYFMC with an aggregate book value of ₱68 as full payment of the Parent Company's additional subscription of 58,977 SMPSI shares; and (iv) certain fixed assets with an aggregate

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carrying value of ₱123 as full payment of the Parent Company's additional subscription of 106,627 SMPSI shares, subject to the approval by the SEC of SMPSI's applications for confirmation of valuation in respect of the issuances of shares from its existing unissued capital stock and the increase in its authorized capital stock.

On January 21, 2008, the SEC approved the increase in the authorized capital stock of SMPSI from ₱10,000 divided into 10,000,000 shares to ₱11,000 divided into 11,000,000 shares with the same par value of ₱1,000 each and the valuation of the assets assigned by the Parent Company in favor of SMPSI as consideration for the issuance by SMPSI of shares from its existing unissued capital stock.

On January 30, 2008, effective on the closing of the SMPSI SPA on January 31, 2008, the Parent Company and NYG entered into a deed of assignment of shares of stock pursuant to which the Parent Company assigned, transferred and ceded all its rights, interest and/or title over the Parent Company's 3,756,501 shares in SMPSI for ₱4,317. On the same date, and effective on the closing of the SMPIL SPA on January 31, 2008, SMHL and NYG entered into a deed of assignment of shares of stock pursuant to which SMHL assigned, transferred and ceded all its rights, interest and/or title over SMHL's 20,726,119 shares in SMPIL for US\$21.

Also on January 30, 2008, effective on the closing of the SMPSI SPA on January 31, 2008, SMPSI and NYG entered into a deed of assignment of shares pursuant to which NYG assigned its 20% stake in SYFMC with an aggregate book value of ₱23 as full payment for its subscription of 19,659 SMPSI shares. On March 14, 2008, the SEC approved the valuation of NYG's shares in SYFMC. The relevant Certificate of Approval of Valuation was amended on April 23, 2008 to rectify the typographical error in the corporate name of SMPSI from "San Miguel Packaging Specialist, Inc." to "San Miguel Packaging Specialists, Inc."

On the closing of the SMPSI SPA and the SMPIL SPA both on January 31, 2008, the Parent Company and SMHL received ₱3,691 and US\$17, respectively, from NYG. The Group recognized a gain of ₱154 from the sale of 35% interest in SMPSI and SMPIL.

In connection with the sale, SMPSI changed its corporate name to "San Miguel Yamamura Packaging Corporation" as approved by the SEC on June 4, 2008. In addition, the BOD of SMPIL likewise approved the change in the corporate name of SMPIL to "San Miguel Yamamura Packaging International Limited" on January 3, 2008, and such change became effective on June 11, 2008.

f. JHK Investments

On December 3, 2009, SMYPIL's BOD approved the increase in the authorized capital stock of SMYPIL from US\$100 to US\$120. The proposed increase in capital stock would cover the additional capital to be issued by SMYPIL to finance the acquisition of JHK Investments and its subsidiaries.

On December 14, 2009, an amendment to the Articles of Association increasing SMYPIL's authorized capital from US\$100 to US\$120 was filed with the Registrar of Corporate Affairs of BVI.

Subsequently, while maintaining their respective ownership interests, SMHL and NYG made additional investments in SMYPIL amounting to US\$23.6 and US\$12.7, respectively.

On December 17, 2009, the Parent Company through its offshore subsidiary, SMYPIL, acquired from James Huntly Knox 60,705,521 shares in JHK Investments, the parent company of the Cospak Group, for up to a maximum amount of Australian Dollar A\$34.65 (US\$31.64). SMYPIL paid A\$24.74 (US\$22.59) for the shares. The balance of the purchase price in the amount of A\$9.91 (US\$9.05) will be paid by SMYPIL through an earn-out scheme based on the attainment by JHK Investments of an agreed Earnings Before Interests, Taxes, Depreciation and Amortization (EBITDA) for the period ended December 31, 2009 and for the six months period ending June 30, 2010.

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On the same date, SMYPIL also subscribed to an additional 12,269,939 shares in JHK Investments for A\$5 (US\$4.57).

SMYPIL owns an aggregate of 65% of the outstanding shares of JHK Investments.

In February 2010, JHK Investments was renamed “San Miguel Yamamura Knox Pty. Ltd.”

The following summarizes the major classes of consideration transferred, and the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

Cash	US\$27.16
Contingent consideration	9.05
	<u>US\$36.21</u>

Contingent Consideration

As disclosed above, the contingent consideration will be paid through an earn-out scheme based on the attainment by JHK Investments of an agreed EBITDA for certain periods. As of the date of acquisition, the SMYPIL believes that it is probable that JHK Investments will achieve the agreed EBITDA.

Identifiable assets acquired and liabilities assumed as a result of acquisition are disclosed in Note 33.

g. SMPPC and Mincorr

On April 17, 2009, the Parent Company acquired Rengo Co. Ltd.’s 30% and 20% stake in SMPPC (then SMRPC) and Mincorr, respectively, for a total purchase price of ₱250. Subsequently, on April 29, 2009, the Parent Company acquired all the interests of Macondray Fibreboard Corporation in Mincorr for ₱27.1.

The acquisitions of the said interests by the Parent Company resulted in SMPPC and Mincorr becoming wholly-owned subsidiaries of the Parent Company in 2009.

SMRPC was renamed “San Miguel Paper Packaging Corporation”, as approved by the SEC on September 3, 2009.

h. Highbreed Livestock Corporation (HLC)

In April 2009, MFC, a majority-owned subsidiary of SMPFC, acquired the subscription rights of certain individuals in HLC, a Philippine company engaged in livestock farming, processing, selling meat products (mainly pork and beef) and leasing of properties. As such, HLC became a subsidiary of MFC and was consolidated into SMPFC through MFC. On June 22, 2009, the respective BOD and stockholders of MFC and HLC approved the merger of HLC into MFC, with MFC as the surviving corporation. The consideration of the assignment of the subscription, net of the effect of the merger, amounted to ₱6.25. The SEC approved the merger on October 22, 2009. The BIR confirmed the tax-free merger of HLC into MFC in its certification No. S40-052-2009.

i. SMFI

On May 1, 2009, the Parent Company ceased the operations of Centralized Key Accounts Group and transferred its receivables, inventories and fixed assets to SMFI for a total consideration of ₱2,353.

j. SMMI

Pursuant to the Deed of Assignment executed by SMFI and SMMI in 2005 transferring certain assets and liabilities of SMFI’s Flour Division at historical book value of ₱1,646 in exchange for SMMI’s shares to be

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effective January 1, 2006, and the SEC's approval of such transfer and SMMI's increase in its authorized capital stock on March 27, 2007, SMMI issued to SMFI 16,454,816 of its common shares on April 10, 2007 in exchange for the transfer of said assets and liabilities. SMFI subsequently declared as property dividend its shares in SMMI in favor of the Parent Company.

In January 2008, the Parent Company executed a Deed of Assignment assigning its 16,454,816 shares in SMMI to SMPFC effective December 28, 2007. Following the Parent Company's transfer of its interest, SMFI became a wholly-owned subsidiary of SMPFC.

As of April 14, 2010, the declaration of the SMFI's shares in SMMI as property dividend in favor of the Parent Company is still pending issuance of a certificate of filing of property dividend declaration by SEC.

k. RealSnacks

As of December 31, 2009, RealSnacks has not yet started commercial operations.

l. SMPI

In 2009, SMPI executed the Deed of Absolute Sale completing the purchase of all the interests of certain individuals in Maison 17 Properties, Inc. (MPI) for a total purchase price of ₱311, including related taxes. SMPI fully paid the balance of the purchase price for the acquisition of shares of stock of MPI amounting to ₱157 (net of ₱154 advanced in 2008). As a result, MPI became a wholly-owned subsidiary of SMPI.

In 2009, SMPI acquired certain parcels of land at Boracay Island, Barangay Yapak, Malay, Aklan, with a total area of about 35,515 square meters, for a total consideration of ₱269.

In January 2009, SMPI acquired certain parcels of land located in Cauayan, Isabela (the Cauayan Property) for a total consideration of ₱128. The Cauayan Property has a total lot area of about 80,346 square meters.

Certain subsidiaries of SMPI acquired several parcels of land located in Metro Manila in 2009 and in Palawan in 2008 for a total consideration of ₱324 and ₱91, respectively.

m. Panasia

On September 11, 2009, the Power Sector Assets and Liabilities Management Corporation (PSALM) issued the Notice of Award to San Miguel Energy Corporation (SMEC) as the winning buyer of the 620 MW Limay Combined Cycle Power Plant (the "Limay Power Plant"). SMEC and PSALM entered into the Asset Purchase Agreement and Land Lease Agreement (collectively, the "Limay Agreements") with Effective Date of September 18, 2009.

On November 3, 2009, as part of the corporate restructuring of the Parent Company's power and energy business cluster, Panasia became a direct wholly-owned subsidiary of the Parent Company as a result of SMEC's sale of its 100% equity ownership interest in Panasia in favor of the Parent Company for ₱2.5. On November 13, 2009, SMEC and Panasia entered into an Assignment Agreement with Assumption of Obligations, wherein Panasia assumed all the rights and obligations of SMEC under the Limay Agreements subject to the written consent of PSALM to such assignment. PSALM's consent to the assignment was secured by SMEC and Panasia, as set out in the Amendment, Accession and Assumption Agreement executed by the parties on January 11, 2010.

On January 18, 2010, the physical possession of the Limay Power Plant was turned over and transferred to Panasia. Panasia started operations of the Limay Power Plant on February 16, 2010.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

n. Kaliwa

On November 6, 2009, the Parent Company's wholly-owned subsidiary SMBW, incorporated Kaliwa with an authorized capital stock of ₱1. Kaliwa's primary purpose is to construct, maintain, and operate dams, reservoirs, conduits, aqueducts, tunnels, conveyance water lines, hydropower stations, water treatment plants, water mains, pipes, pumping stations, storage facilities, off-take facilities, machineries, equipment, facilities and other waterworks necessary or required for the storage, treatment and supply of potable water in areas such as, but not limited to, the Kaliwa River Basin; to develop physical infrastructure and other amenities such as roads, water supply, drainage systems and sewerage facilities; and to purchase, acquire or lease property, machinery, equipment and operating facilities for the pursuit of the aforesaid objectives. Kaliwa has not yet started commercial operations as of April 14, 2010.

o. SPDC

Following the December 15, 2009 bidding conducted by PSALM for the Appointment of the IPP Administrator for the Contracted Capacity of the 345 MW San Roque Multi-Purpose Hydroelectric Power Plant located at Barangay San Roque, San Miguel, Pangasinan (the "San Roque Power Plant"), PSALM issued on December 28, 2009 the Notice of Award to SPDC as the winning bidder thereof. As of January 26, 2010, SPDC assumed the administration of the Contracted Capacity of the San Roque Power Plant in accordance with the provisions of the IPP Administration Agreement for the Contracted Capacity of the San Roque Power Plant with Execution Date of December 29, 2009.

On February 11, 2010, SPDC's BOD approved the following: (i) subscription by the Parent Company and Global 5000 Investment Inc. (Global) of 1,500 and 6,000 shares, respectively, of SPDC's remaining unissued capital stock; and (ii) increase in the authorized capital stock of SPDC from ₱1 divided into 10,000 shares with par value of ₱100.00 per share to ₱100 divided into 1,000,000 shares with par value of ₱100.00 per share, with the Parent Company and Global subscribing to 396,000 and 594,000 shares of SPDC, respectively, out of the increase in the authorized capital stock, at ₱100.00 per share. The aforementioned increase in the authorized capital stock of SPDC was likewise approved by the stockholders of SPDC in a meeting held on the same date. The application for the increase in authorized capital stock of SPDC is yet to be filed with the SEC as of April 14, 2010.

On March 15, 2010, the Parent Company and Global executed the Subscription Agreement setting forth their aforementioned subscription of the remaining unissued capital stock of SPDC. On March 19, 2010, the Parent Company paid in full its remaining unpaid subscription to the 2,495 common shares of stock in SPDC amounting to ₱0.1875.

With the new subscription, Global owns an aggregate of 60% equity ownership interest in SPDC, while the Parent Company retains an aggregate of 40% equity ownership interest in SPDC.

p. Northlink

Northlink was incorporated on December 15, 2009, with an authorized capital stock of ₱1 divided into 1,000,000 shares with the par value of ₱1.00 per share. Northlink is a joint venture company formed by the Parent Company and Star Tollway Corporation (STC), under a 60-40 equity arrangement. The Parent Company and STC have subscribed to 149,997 and 99,998 shares of stock of Northlink, respectively.

q. SMI

On November 1, 2008, GSMI entered into an Asset Purchase Agreement with SMI for the purchase of SMI's assets at net book value totaling ₱1,039, subject to adjustments as may be warranted by circumstances transpiring prior to closing date and which affect the value of the assets. Twenty-five percent (25%) of the purchase price was settled upon execution of the agreement, and thereafter the remaining balance shall be

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

payable in six (6) equal monthly installments. On December 8, 2008, GSMI also entered into a service agreement with SMBI whereby the latter rendered various services to GSMI related to the production, promotion, sale and distribution of non-alcoholic beverages products as well as the operation of beverage assets. In consideration of the services rendered by SMBI, GSMI paid a monthly service fee in the amount of ₱21. The term of the agreement is for six (6) months commencing on November 1, 2008 and expired on April 30, 2009.

On December 31, 2008, the closing date of the transaction, the purchase price was adjusted to ₱1,117.

r. SMDCi

On December 31, 2009, SMDCi ceased its commercial operations.

s. SMKFSI

On July 3, 2008, the Parent Company, the Kuok Group and the Philippine government, acting through several agencies, signed a Memorandum of Understanding on the Philippine Food Security Program (MOU) for the development and cultivation of up to one (1) million hectares of land for the purpose of producing basic food staples. Under the MOU, the Philippine government will identify and make available for cultivation or food production suitable tracts of land under its control, possession or ownership. In turn, the Parent Company and Kuok Group will, after conducting an evaluation and review of the suitability of the identified tracts of land, provide financing, technical support and management for agricultural crop production determined to be suitable for the identified areas, which will include, but will not be limited to, irrigation, access roads, post-harvest investments, and ready market for the agricultural produce.

On September 2008, SMKFSI was incorporated with the primary purpose to develop a sustainable food security program for the Philippines by harnessing idle lands of the government and private parties for the production of rice, corn, cassava, banana and other commercial agricultural products. The Parent Company intends to use SMKFSI as the corporate vehicle for the implementation of the project described in the MOU.

SMKFSI is currently undertaking site suitability assessments, feasibility studies and planning activities for prospective project areas in the Philippines. Land use arrangements are being worked out with the concerned government agencies.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Investments in Shares of Stock of Associates and Advances to Associates and Other Investments

Investments in shares of stock and advances to associates and other investments consist of:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Investments in associates — at equity:			
Acquisition cost			
Balance at beginning of year		P32,826	P 232
Additions		6,794	32,594
Transferred to assets held for sale	6	(3,159)	—
		<u>36,461</u>	<u>32,826</u>
Accumulated equity in net earnings (losses):			
Balance at beginning of year		(1,163)	(12)
Equity in net earnings (losses) during the year		2,816	(1,132)
Share in comprehensive gains (losses)		252	(19)
Impairment loss and others	27	(178)	—
Dividends		(752)	—
Accumulated equity on investments transferred to assets held for sale	6	413	—
Balance at end of year		<u>1,388</u>	<u>(1,163)</u>
		37,849	31,663
Advances		1,156	—
AFS financial assets	35, 36	351	590
		<u>P39,356</u>	<u>P32,253</u>

The carrying values of investments in shares of stock of associates are as follows:

	<u>Country of Incorporation</u>	<u>2009</u>		<u>2008</u>	
		<u>Percentage of Ownership</u>	<u>Amount</u>	<u>Percentage of Ownership</u>	<u>Amount</u>
Manila Electric Company (Meralco)	Philippines	27.00	P32,029	27.00	P30,971
BOC	Philippines	31.23	—	30.00	465
Northpine Land, Inc.	Philippines	20.00	237	20.00	227
SMEC	Philippines	40.00	294	—	—
Liberty Telecoms Holdings, Inc. (LTHI) . .	Philippines	32.70	3,714	—	—
Private Infra Dev Corporation (PIDC)	Philippines	35.00	1,575	—	—
			<u>P37,849</u>		<u>P31,663</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Following are the unaudited condensed and combined financial information of the associates:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets	₱100,853	₱ 93,633	₱1,678
Current liabilities	140,332	131,582	889
Noncurrent assets	297,501	172,880	8,079
Noncurrent liabilities	182,838	82,829	2,808
Revenue	194,795	198,577	735
Net income (loss)	8,262	(3,493)	515

a. Meralco

On October 27, 2008, the Parent Company entered into a sale and purchase agreement with the Government Service Insurance System (GSIS) to acquire the latter's 300,963,189 shares in Meralco for a total consideration of ₱27,087 plus an additional fixed term interest of ₱3,758. On November 10, 2008, the Parent Company paid ₱5,417 representing downpayment for said shares with the balance payable in three (3) years. The current portion of the Parent Company's outstanding payable as of December 31, 2009 amounted to ₱6,527 (included under "Accounts payable and accrued expenses" account). The noncurrent portion of ₱18,148 and ₱25,428 as of December 31, 2009 and 2008, respectively, is reported as part of "Other noncurrent liabilities" account.

The fair value of the Parent Company's investment in Meralco amounted to ₱61,396 and ₱16,553 as of December 31, 2009 and 2008, respectively.

b. BOC

In October 2007, SMPI and SMCRP entered into a subscription agreement pursuant to which SMPI and SMCRP agreed to subscribe, subject to certain terms and conditions, to 10,000,000 unissued and unsubscribed common shares of BOC with an aggregate par value of ₱1,000 (₱100.00 per share) for ₱2,000 (₱200.00 per share), equivalent to 34% of the total outstanding capital stock of BOC, with SMPI and SMCRP holding 30% and 4% equity ownership interest, respectively.

In April 2008, SMPI and SMCRP paid the balance of its payable to BOC for its subscription amounting to ₱1,500, of which ₱1,249 and ₱251 were paid by SMPI and SMCRP, respectively.

In May 2008, SMPI and SMCRP entered into a subscription agreement with BOC for a total of 10,000,000 additional shares in BOC, wherein SMPI subscribed to an additional 3,001,779 shares, from the increase in the authorized capital stock of BOC with an aggregate par value of ₱300 (₱100.00 per share) for ₱600 (₱200.00 per share) to maintain its 30% stake in BOC, while SMCRP increased its holdings in BOC to 21%. As of December 31, 2008, SMPI has made an advance payment of ₱150 which is presented as part of noncurrent receivables and deposits under "Other noncurrent assets" account (Note 15).

Pursuant to the second subscription agreement for a total consideration of ₱600, SMPI appropriately applied the advance payment as of December 31, 2008 and fully paid the remaining subscription payable in April 2009 amounting to ₱150 and ₱450, respectively. On July 2, 2009, SMPI exercised its pre-emptive right and subscribed an additional 4,001,197 shares (equivalent to 30% ownership interest) for ₱694. Such subscription was fully settled on August 8, 2009. On August 14, 2009, SMPI subscribed to portion of unexercised pre-emptive rights of certain stockholders acquiring additional 4% interest (equivalent to 596,898 shares) in BOC for ₱104 thereby increasing equity ownership interest from 30% to 34% starting September 30, 2009. On October 1, 2009, SMPI acquired additional 50,000 shares from existing stockholder of BOC with a selling price of US\$4.68 per share or about US\$0.234 (equivalent to ₱11). Also in the same month, the remaining unexercised pre-emptive rights were exercised by other existing stockholders thus,

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

decreasing equity ownership interest from 34% to 31.23%. As of December 31, 2009, SMPI fully paid all of its subscriptions payable to BOC.

BOC is required to meet certain ratios under Bangko Sentral ng Pilipinas (BSP) regulations to manage the risks inherent in the banking business. As of December 31, 2009 and 2008, BOC has complied with the statutory and regulatory capital requirements which were computed based on the regulatory accounting policies that differ from PFRS in some aspects.

Certain accounting policies applied by BOC in the preparation of its financial statements are not in accordance with PFRS. In computing for the equity in net earnings (losses) and comprehensive income (losses) of BOC, SMPI made adjustments to the 2009 and 2008 audited financial statements of BOC to conform BOC's accounting policies with PFRS and make them consistent with the Group's accounting policies. The adjustments made by SMPI relate to the correction of: (a) inadequate reserves on non-performing assets, investment properties and financial assets; and (b) deferral of losses on sale of non-performing loans.

Based on the adjusted account balances of BOC as of December 31, 2009, management determined that the carrying amount of the investment is not fully recoverable thus, an impairment loss on the investment amounting to ₱163 was recognized and is included in "Other income (charges)" account (Note 27). No impairment loss on the investment was recognized in 2008.

On February 15, 2010, SMPI's BOD authorized the divestment of SMPI's 31.23% interest in BOC. The carrying amount of the investment as of December 31, 2009 amounted to ₱2,746, representing 16,396,689 common shares (Note 6).

c. SMEC

As a result of the bidding conducted by PSALM on August 28, 2009 for the Appointment of the IPP Administrator for the Contracted Capacity of the Sual 2x500 MW Coal Fired Power Station ("Sual Power Plant"), SMEC was declared the winning bidder thereof as set out in the Notice of Award issued by PSALM on September 1, 2009. As of November 6, 2009, SMEC assumed the administration of the Contracted Capacity of the Sual Power Plant in accordance with the provisions of the IPP Administration Agreement for the Contracted Capacity of the Sual Power Plant with Execution Date of September 8, 2009.

On October 26, 2009, SMEC's BOD approved the following: (i) subscription by the Parent Company and Global of 15,000 and 60,000 shares, respectively, of SMEC's remaining unissued capital stock; and (ii) increase in the authorized capital stock of SMEC from ₱10 divided into 100,000 shares with par value of ₱100.00 per share to ₱300 divided into 3,000,000 shares with par value of ₱100.00 per share, with the Parent Company and Global subscribing to 1,160,000 and 1,740,000 shares of SMEC, respectively, out of the increase in the authorized capital stock, at ₱100.00 per share. The aforementioned increase in the authorized capital stock of SMEC was likewise approved by the stockholders of SMEC in a meeting held on the same date. The application for the increase in authorized capital stock of SMEC is yet to be filed with the SEC as of April 14, 2010.

The Parent Company, on November 16, 2009, and Global, on November 17, 2009, executed the Subscription Agreement setting forth their aforementioned subscription of the remaining unissued capital stock of SMEC. On November 26, 2009, the Parent Company paid in full its remaining unpaid subscription to the 24,995 common shares of stock in SMEC amounting to ₱1.835.

With the new subscription, Global owns an aggregate of 60% equity ownership interest in SMEC, while the Parent Company retains an aggregate of 40% equity ownership interest in SMEC.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

d. LTHI

On July 8, 2009, Vega, a wholly-owned subsidiary of the Parent Company, acquired 579,111,669 common shares (approximately 32.7% of the outstanding capital stock) of LTHI from LTHI's existing stockholders for a total consideration of ₱2,041.

On July 21, 2009, Vega entered into a subscription agreement with LTHI for the subscription of 587,951,737 voting, nonredeemable and participating preferred shares of LTHI at an issue price of ₱3.00 per share or approximately ₱1,764. As of December 31, 2009, Vega paid ₱735 as deposit for the subscription.

On January 5, 2010, Vega paid ₱588 as additional deposit for the subscription of LTHI's preferred shares.

The preferred shares will be issued from the increase in the authorized capital stock of LTHI. The application for the increase in the authorized capital stock of LTHI was approved by the SEC on January 18, 2010.

On April 8, 2010, Vega paid the remaining subscription payable on LTHI's preferred shares amounting to ₱441.

The fair value of the Group's capital stock investment in LTHI amounted to ₱1,564 as of December 31, 2009.

e. PIDC

On September 11, 2009, Rapid, a wholly-owned subsidiary of the Parent Company, acquired 35% stake in PIDC, a consortium of construction companies behind the Tarlac-Pangasinan-La Union Expressway Project. Rapid subscribed to 1,575,000 common shares of PIDC amounting to ₱1,575 and paid a portion of the subscription price amounting to ₱561 on September 11, 2009.

f. KSA Realty Corporation (KSA)

On December 14, 2007, the Parent Company through SMPI entered into a Share Purchase Agreement to sell its 354,862 common shares (equivalent to 29.38% ownership) in KSA with carrying amount equivalent to its acquisition cost plus accumulated equity in net earnings of ₱468 to Shang Properties, Inc. for a total consideration of ₱1,812. The Group recognized a gain of ₱1,182, net of capital gains tax of ₱162. The transaction was completed on January 14, 2008.

g. NutriAsia Pacific San Miguel Holdings Ltd. (NSMH)

In April 2007, the Parent Company, through San Miguel Foods Asia Limited (SMFAL), entered into a Share Purchase Agreement with Well Grounded Limited for the sale of SMFAL's 42.22% equity and other interest in NSMH for US\$150. NSMH is the holding company of Nutri Asia Pacific Limited, which in turn is the parent company of Del Monte Pacific Ltd. The amount of US\$130 was received on April 25, 2007 as partial payment for the transaction. The balance of US\$20 shall be subject to interest of 7.2% per annum. The principal amount and all interest accrued were paid on April 24, 2009. The Group recognized a gain from the said transaction amounting to US\$46 (₱2,149).

h. Thai San Miguel Liquor Co. Ltd. (TSML) and Thai Ginebra Trading Co. Ltd. (TGT)

On August 27, 2008 and September 11, 2008, GSMI incorporated Global Beverage Holdings, Limited (GBHL) and Siam Holdings Limited (SHL), respectively, as wholly-owned subsidiaries. GSMI subscribed to 1,000 shares of GBHL at par value of US\$1.00 per share for a total subscription value of US\$0.001 (₱0.05) and 1,000 shares of SHL at par value of US\$1.00 per share for a total subscription value of US\$0.001 (₱0.05).

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Both entities are established as holding companies for the acquisition of additional investment in TSML and TGT, both a joint venture by GSMI with Thai Life Group of Companies.

On October 14, 2008, GSMI, through SHL, acquired 24,500 shares representing 49% ownership of the outstanding shares of Siam Wine and Liquor Limited (SWL), a limited company organized under the laws of Thailand, for Thailand Baht THB2 (₱3). On the same date, SWL acquired 1,000,000 shares representing 10% ownership of the outstanding capital stock of TSML for THB106.48 (₱148). SHL's share on the share purchase is THB52.2 (₱72) for 490,000 shares at THB108.68 per share representing 4.9% ownership. Accordingly, GSMI group's share in TSML increased from 40% to 44.9%.

On October 14, 2008, GSMI advanced a total amount of US\$3 (₱147) to GBHL. On October 10, 2008, GBHL ("Lender") entered into a loan agreement with SWL ("Borrower") for the same amount, to finance the latter's working capital requirements and purchase of additional shares in TSML and TGT.

On March 6, 2009, the BOD of TSML approved the increase in the capital stock of TSML from THB1,000 to THB1,250. On the same date, GSMIL, a wholly-owned subsidiary of GSMI, subscribed to 40% of the said increase for a total subscription price of THB100 (₱134.6) to maintain its 40% stake in TSML. On March 9, 2009, GSMIL remitted to TSML THB60 (₱81.5), representing 60% of the subscription price as deposit for future stock subscription.

On March 6, 2009, SWL subscribed to 10% of the increase in capital stock of TSML for a total of THB25 (₱33.6) to retain its 10% stake in TSML. On March 9, 2009, SWL remitted to TSML THB15 (₱20.2) representing 60% of the subscription as deposit for future stock subscription. With the subscriptions of GSMIL and SWL in TSML, the GSMI group's interest in TSML remained at 44.9%.

On December 11, 2009, GSMIL and SWL remitted to TSML THB40 (₱57.3) and THB10 (₱14.2), respectively, representing 40% of the subscription in the increase in the capital stock of TSML on March 6, 2009. The payment made by SWL was financed by the proceeds of the loan agreement dated December 11, 2009 entered into by SHL and SWL in the amount of THB10 (₱14.2).

On February 25, 2010, GSMIL acquired additional shares to retain the 40% ownership of the outstanding shares of TSML for THB40 (₱56). On the same date, SHL ("Lender") entered into a loan agreement with SWL ("Borrower") for THB10 to purchase additional shares in TSML.

Presented below is the Group's share in the assets, liabilities, income and expenses of the joint venture as of and for the years ended December 31, 2009, 2008 and 2007 of TSML which is included in the Group's consolidated financial statements:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets	₱556	₱459	₱323
Noncurrent assets	896	911	843
Current liabilities	409	288	86
Noncurrent liabilities	416	526	526
Revenue	474	402	—
Cost of sales	397	398	—
Operating expenses	136	70	34
Other income	1	1	1
Net loss	58	65	33

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Group's share in the cash flows of TSML for the years ended December 31, 2009, 2008 and 2007 are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net cash flows provided by (used in) operating activities	₱ (69)	₱ 88	₱ (62)
Net cash flows provided by (used in) investing activities	17	(70)	(483)
Net cash flows provided by (used in) financing activities	(111)	(20)	536

On October 14, 2008, SWL acquired 5,000 shares representing 10% ownership of the outstanding capital stock of TGT for THB0.5 (₱0.7). SHL's share on the share purchase is THB0.2 (₱0.3) for 2,450 shares at THB100.00 per share representing 4.9% ownership. Accordingly, the GSMI group's share in TGT increased from 40% to 44.9%.

Presented below is the Group's share in the assets, liabilities, income and expenses of the joint venture as of and for the years ended December 31, 2009 and 2008 of TGT which is included in the Group's consolidated financial statements:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets.	₱102	₱142	₱ 3
Noncurrent assets	30	44	1
Current liabilities	237	219	2
Noncurrent liabilities	16	29	—
Revenue.	228	153	—
Cost of sales	206	121	—
Operating expenses.	80	92	2
Other income	2	1	—
Net loss	56	59	2

The Group's share in the cash flows of TGT for the periods ended December 31, 2009 and 2008 is as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net cash flows provided by (used in) operating activities	₱ 1	₱ 18	₱ (7)
Net cash flows provided by (used in) investing activities.	14	(43)	(1)
Net cash flows provided by (used in) financing activities	(13)	29	—

TSML and TGT both started commercial operations in March 2008.

i. SMPI Advances

In 2009, SMPI provided US dollar-denominated non-interest bearing cash advances to Primeria Comercio Holdings, Inc. (PCHI), a future investee of SMPI, amounting to US\$17 (₱794) as of December 31, 2009. These advances will be applied against future subscriptions of SMPI to the shares of stock of PCHI.

In June 2009, SMPI entered into a Joint Venture Agreement (JVA) with certain individuals and corporations (collectively referred to as Co-Venturer) to transfer title of the properties and develop and later operate the properties into a mixed commercial and residential estate. On July 28, 2009, as part of the terms of the JVA, Integrated Geosolutions Inc. (IGI) was incorporated with an authorized capital stock of ₱1,000 divided into 1,000,000,000 common shares with a par value of ₱1.00 per share. On the same date, the Co-Venturer subscribed to 600,000,000 common shares of IGI for ₱600.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Pursuant to the terms and conditions of the JVA, SMPI made cash advances in favor of the Co-Venturer amounting to ₱311 as of December 31, 2009. Under a Deed of Assignment, such advances will be applied as payment for SMPI's subscription to sufficient number of IGI shares of stock to give SMPI a 51% ownership interest, pending its execution.

On October 31, 2007, SMPI entered into a JVA with the GSIS to establish a Joint Venture Corporation (JVC). The JVC will hold ownership to the real property owned by GSIS, develop the property into a first class high-rise service apartment and manage and operate the same. The JVC will have an authorized capital stock of ₱600 divided into 600,000,000 shares with a par value of ₱1.00 per share. The parties agreed to an equal equity participation wherein the real estate property owned by GSIS is valued at ₱300 while SMPI has committed to contribute ₱300 to the JVC. On October 23, 2008, SMPI-GSIS JVC was incorporated.

Under the JVA, SMPI grants GSIS the option to sell to SMPI all the shares of stock of the JVC issued in the name of GSIS and its nominees under certain terms and conditions. As of December 31, 2009, SMPI has made unsecured non-interest bearing cash advances to the JVC amounting to ₱51. The JVC has not yet started commercial operations as of April 14, 2010. SMPI is yet to complete its subscription to the JVC's shares of stock with the assignment of its investment in MPI as part of the consideration.

j. Philippine Nutrition Technologies, Inc. (PNTI)

In 2007, SMPFC provided full allowance for the impairment in value of its investment in PNTI, a joint venture between SMPFC and the Great Wall Group of Taiwan. Application with the SEC for the dissolution of PNTI, through shortening of its corporate term, which was approved by the BOD and stockholders of PNTI in August 2005, will be filed by SMPFC following the receipt on February 4, 2010 of the tax clearance from the BIR and the completion of other SEC requirements necessary for such filing.

k. AFS financial assets pertain to various investments in shares of stock carried at fair value.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. Property, Plant and Equipment

Property, plant and equipment consist of:

	Land and Land Improvements	Buildings and Improvements	Machinery and Equipment	Transportation Equipment	Tools and Small Equipment	Office Equipment, Furniture and Fixtures	Molds	Leasehold Improvements	Construction in Progress	Total
Cost:										
December 31, 2007	P 8,881	P21,214	P68,696	P2,701	P1,932	P2,451	P395	P825	P 7,461	P114,556
Additions	350	1,234	5,143	406	115	97	140	24	(1,072)	6,437
Disposals/reclassifications	(187)	(50)	(7)	(226)	(282)	(4)	(17)	(9)	(1,623)	(2,405)
Currency translation adjustments	145	1,575	3,513	39	89	62	9	—	613	6,045
December 31, 2008	9,189	23,973	77,345	2,920	1,854	2,606	527	840	5,379	124,633
Additions	424	897	2,766	729	210	126	144	115	838	6,249
Disposals/reclassifications	977	(245)	(781)	(349)	315	(190)	(17)	(35)	(513)	(838)
Currency translation adjustments	37	(219)	(439)	5	(25)	—	3	1	(30)	(667)
December 31, 2009	10,627	24,406	78,891	3,305	2,354	2,542	657	921	5,674	129,377
Accumulated depreciation and amortization:										
December 31, 2007	1,074	5,279	33,977	1,888	1,559	2,005	288	309	—	46,379
Additions	90	663	3,511	231	121	169	108	40	—	4,933
Disposals/reclassifications	(124)	(97)	(704)	(122)	(249)	(57)	1	(15)	—	(1,367)
Currency translation adjustments	14	354	1,292	30	79	40	6	—	—	1,815
December 31, 2008	1,054	6,199	38,076	2,027	1,510	2,157	403	334	—	51,760
Additions	83	721	3,696	226	139	182	161	46	—	5,254
Disposals/reclassifications	7	(132)	(732)	(270)	42	(166)	(55)	(9)	—	(1,315)
Currency translation adjustments	10	(57)	(156)	4	(23)	5	2	1	—	(214)
December 31, 2009	1,154	6,731	40,884	1,987	1,668	2,178	511	372	—	55,485
Accumulated impairment losses:										
December 31, 2007	P —	P 918	P 2,884	P 1	P 11	P 6	P 2	P —	P —	P 3,822
Disposals/reclassifications	—	—	(46)	—	(3)	8	—	—	—	(41)
Currency translation adjustments	—	172	604	—	2	1	—	—	—	779
December 31, 2008	—	1,090	3,442	1	10	15	2	—	—	4,560
Additions for the year	208	1,571	1,852	6	3	6	—	—	—	3,646
Disposals/reclassifications	—	(280)	210	—	—	(1)	—	—	—	(71)
Currency translation adjustments	—	(68)	(94)	(1)	—	—	1	—	—	(162)
December 31, 2009	208	2,313	5,410	6	13	20	3	—	—	7,973
Net book value:										
December 31, 2008	P 8,135	P16,684	P35,827	P 892	P 334	P 434	P122	P506	P 5,379	P 68,313
December 31, 2009	P 9,265	P15,362	P32,597	P1,312	P 673	P 344	P143	P549	P 5,674	P 65,919

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Depreciation, amortization and impairment losses charged to operations amounted to ₱8,900, ₱4,933 and ₱7,824 in 2009, 2008 and 2007, respectively. Of the said amounts, ₱1,659 in 2007 was presented as part of discontinued operations and ₱1,461 was presented as part of loss on impairment of property, plant and equipment and idle assets under “Other income (charges)” account in 2007 (Notes 6, 23 and 27). These amounts include annual amortizations of capitalized interest amounting to ₱2, ₱2 and ₱23 in 2009, 2008 and 2007, respectively. No interest was capitalized in 2009 and 2008.

In 2008, the Group, through SMPI, sold its parcel of land, including improvements located along Aurora Boulevard, Quezon City for a total consideration of ₱1,616. The gain recognized by the Group relating to the sale amounting to ₱1,562, is presented as part of “Gain on sale of investments and property and equipment”.

Land and land improvements include a 144-hectare property in Bukidnon, acquired by SMFI in 2002, which later became the subject of a petition for revocation of conversion order filed by MAPALAD, a group of Sumilao farmers, with the Department of Agrarian Reform (DAR), and appealed to the Office of the President (OP). Total acquisition and development costs included in the account as of December 31, 2008 amounted to ₱37.

To settle the land dispute, a Memorandum of Agreement (MOA) was executed between SMFI, MAPALAD, OP and DAR on March 29, 2008. The MOA provided for the release of a 50-hectare portion of the property to qualified farmer-beneficiaries, and the transfer of additional 94 hectares outside of the property to be negotiated with other Sumilao landowners. Under the MOA, SMFI shall retain ownership and title to the remaining portion of the property for the completion and pursuit of the hog farm expansion. Implementation of the MOA provisions is ongoing.

The cost of farm improvements, buildings, machinery and equipment and construction in progress incurred for Monterey’s hog farm expansion project situated in Sumilao amounted to ₱676 and ₱481 in 2009 and 2008, respectively.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

12. Investment Properties

The movements in investment properties, including the effects of currency translation adjustments are as follows:

	<u>Land and Improvements</u>	<u>Buildings and Improvements</u>	<u>Machinery and Equipment</u>	<u>Tools and Small Equipment</u>	<u>Total</u>
Cost:					
December 31, 2007	P1,591	P537	P 633	P 9	P2,770
Additions/reclassifications	59	64	380	—	503
Disposals	(12)	(15)	—	—	(27)
Currency translation adjustments	<u>127</u>	<u>85</u>	<u>—</u>	<u>—</u>	<u>212</u>
December 31, 2008	1,765	671	1,013	9	3,458
Additions/reclassifications	71	7	—	—	78
Disposals	(2)	(38)	—	—	(40)
Currency translation adjustments	<u>7</u>	<u>(11)</u>	<u>—</u>	<u>—</u>	<u>(4)</u>
December 31, 2009	<u>1,841</u>	<u>629</u>	<u>1,013</u>	<u>9</u>	<u>3,492</u>
Accumulated depreciation:					
December 31, 2007	56	143	541	9	749
Additions	7	13	7	—	27
Disposals/reclassifications	23	33	353	—	409
Currency translation adjustments	<u>(13)</u>	<u>33</u>	<u>—</u>	<u>—</u>	<u>20</u>
December 31, 2008	73	222	901	9	1,205
Additions	8	11	15	—	34
Disposals/reclassifications	—	(7)	—	—	(7)
Currency translation adjustments	<u>—</u>	<u>(3)</u>	<u>—</u>	<u>—</u>	<u>(3)</u>
December 31, 2009	<u>81</u>	<u>223</u>	<u>916</u>	<u>9</u>	<u>1,229</u>
Accumulated impairment losses:					
December 31, 2007	335	38	—	—	373
Additions	5	—	—	—	5
Disposals	—	(13)	—	—	(13)
Currency translation adjustments	<u>2</u>	<u>48</u>	<u>—</u>	<u>—</u>	<u>50</u>
December 31, 2008	342	73	—	—	415
Additions	3	—	—	—	3
Disposals	—	(24)	—	—	(24)
Currency translation adjustments	<u>4</u>	<u>(2)</u>	<u>—</u>	<u>—</u>	<u>2</u>
December 31, 2009	<u>349</u>	<u>47</u>	<u>—</u>	<u>—</u>	<u>396</u>
Net book value:					
December 31, 2008	<u>P1,350</u>	<u>P376</u>	<u>P 112</u>	<u>P—</u>	<u>P1,838</u>
December 31, 2009	<u>P1,411</u>	<u>P359</u>	<u>P 97</u>	<u>P—</u>	<u>P1,867</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The fair value of investment properties as of December 31, 2009 and 2008 amounted to ₱2,886 and ₱2,758, respectively, which were determined based on valuations performed by independent appraisers.

13. Biological Assets

This account consists of poultry, hogs and cattle as follows:

	<u>2009</u>	<u>2008</u>
Current:		
Growing stocks	₱2,309	₱2,707
Goods in process	<u>216</u>	<u>225</u>
Total Current	2,525	2,932
Noncurrent breeding stocks — net.	<u>1,847</u>	<u>1,814</u>
	<u>₱4,372</u>	<u>₱4,746</u>

The amortization of breeding stocks charged to operations amounted to ₱909 in 2009, ₱863 in 2008 and ₱754 in 2007.

Growing stocks pertain to growing broilers, hogs and cattle and goods in process pertain to hatching eggs and carcass.

The movements in biological assets, including the effects of foreign exchange adjustments are as follows:

	<u>2009</u>	<u>2008</u>
Gross:		
Balance at beginning of year	₱ 6,767	₱ 5,054
Increase (decrease) due to:		
Purchases	13,391	14,608
Production	11,147	33,540
Mortality	(492)	(31)
Sales	(7,535)	(2,745)
Harvest	(15,957)	(43,593)
Currency translation adjustments	<u>(21)</u>	<u>(66)</u>
Balance at end of year	<u>7,300</u>	<u>6,767</u>
Accumulated amortization:		
Balance at beginning of year	2,021	1,411
Additions	909	863
Disposals and others	<u>(2)</u>	<u>(253)</u>
Balance at end of year	<u>2,928</u>	<u>2,021</u>
Net book value	<u>₱ 4,372</u>	<u>₱ 4,746</u>

The Group harvested approximately 348.1 million kgs. and 322.9 million kgs. of grown broilers, in 2009 and 2008, respectively, and 784,689 and 674,458 heads of marketable hogs and cattle, in 2009 and 2008, respectively.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

14. Goodwill and Other Intangible Assets

The movements in goodwill, including effects of currency translation adjustments are as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Balance at beginning of year		P5,201	P5,348
Additions		1,296	—
Impairment	27	(33)	(322)
Currency translation adjustments		(56)	175
Balance at end of year		<u>P6,408</u>	<u>P5,201</u>

The movements in other intangible assets, including the effects of currency translation adjustments are as follows:

	<u>Note</u>	<u>Trademarks and Brand Names</u>	<u>Others</u>	<u>Total</u>
Cost:				
December 31, 2007		P1,962	P2,027	P3,989
Additions		78	73	151
Disposals and reclassifications		—	241	241
Currency translation adjustments		<u>211</u>	<u>273</u>	<u>484</u>
December 31, 2008		2,251	2,614	4,865
Additions		—	92	92
Disposals and reclassifications		—	118	118
Currency translation adjustments		<u>21</u>	<u>(49)</u>	<u>(28)</u>
December 31, 2009		<u>2,272</u>	<u>2,775</u>	<u>5,047</u>
Accumulated amortization and impairment losses:				
December 31, 2007		—	787	787
Additions		—	92	92
Disposals and reclassifications		—	102	102
Currency translation adjustments		<u>—</u>	<u>72</u>	<u>72</u>
December 31, 2008		—	1,053	1,053
Additions	27	133	131	264
Disposals and reclassifications		—	119	119
Currency translation adjustments		<u>—</u>	<u>(19)</u>	<u>(19)</u>
December 31, 2009		<u>133</u>	<u>1,284</u>	<u>1,417</u>
Net book value:				
December 31, 2008		<u>P2,251</u>	<u>P1,561</u>	<u>P3,812</u>
December 31, 2009		<u>P2,139</u>	<u>P1,491</u>	<u>P3,630</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Goodwill acquired through business combinations and trademarks and brand names with indefinite lives have been allocated to individual cash-generating units, which are also reportable segments, for impairment testing as follows:

	2009		2008	
	Goodwill	Trademarks and Brand Names	Goodwill	Trademarks and Brand Names
Beverage	P1,265	P1,906	P1,311	P2,012
Food	2,943	233	2,950	239
Packaging	2,139	—	879	—
Others	61	—	61	—
Total	<u>P6,408</u>	<u>P2,139</u>	<u>P5,201</u>	<u>P2,251</u>

The recoverable amount of goodwill has been determined based on a valuation using cash flow projections covering a five-year period based on long range plans approved by management. Cash flows beyond the five year period are extrapolated using a constant growth rate determined per individual cash-generating unit. This growth rate is consistent with the long-term average growth rate for the industry. The discount rate applied to after tax cash flow projections ranged from 6% to 14% in December 31, 2009 and 2008. The discount rates also impute the risk of the cash-generating units compared to the respective risk of the overall market and equity risk premium.

Management believes that any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause its carrying amount to exceed its recoverable amount.

The calculations of value in use are most sensitive to the following assumptions:

Gross Margins. Gross margins are based on average values achieved in the period immediately before the budget period. These are increased over the budget period for anticipated efficiency improvements. Values assigned to key assumptions reflect past experience, except for efficiency improvement.

Discount Rates. The Group uses the weighted average cost of capital as the discount rates, which reflect management's estimate of the risk specific to each unit. This is the benchmark used by management to assess operating performance and to evaluate future investments proposals.

Raw Material Price Inflation. Forecast consumer price are obtained from indices during the budget period from which raw materials are purchased. Value assigned to key assumption is consistent with external sources of information.

Impairment loss on goodwill amounting to P33 and P322 was recognized and is included in "Other income (charges)" account in 2009 and 2008, respectively (Note 27). No impairment loss on goodwill was recognized in 2007.

15. Other Noncurrent Assets

	Note	2009	2008
Noncurrent receivables and deposits — net	6, 10, 29, 34, 35, 36	P 5,933	P 7,439
Deferred containers — net	4	4,446	3,708
Others	30, 35, 36	2,089	3,094
		<u>P12,468</u>	<u>P14,241</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Noncurrent receivables and deposits include advances to Meralco and SMEC amounting to ₱68 and ₱2, respectively as of December 31, 2009 (Note 28).

Idle assets included under “Others” amounted to ₱235 and ₱65 as of December 31, 2009 and 2008, respectively (Note 27).

As of December 31, 2009, the Group has no derivative assets included under “Other noncurrent assets”. Derivative assets included under “Others” amounted to ₱1 as of December 31, 2008 (Notes 35 and 36).

16. Drafts and Loans Payable

This account consists of:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Parent Company			
Peso-denominated		₱34,331	₱22,700
Foreign currency-denominated		3,188	6,605
Subsidiaries			
Peso-denominated		16,125	16,783
Foreign currency-denominated		3,145	2,472
	35, 36	<u>₱56,789</u>	<u>₱48,560</u>

Drafts and loans payable mainly represent unsecured peso and foreign currency-denominated amounts payable to local and foreign banks. Interest rates for peso-denominated loans range from 3.10% to 6.79% and 7.25% to 9.75% in 2009 and 2008, respectively. Interest rates for foreign currency-denominated loans range from 1.32% to 12.08% and 2.69% to 15.77% in 2009 and 2008, respectively.

17. Accounts Payable and Accrued Expenses

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Trade	35, 36	₱ 8,791	₱ 9,061
Non-trade	35, 36	18,076	8,985
Amounts owed to related parties	28, 35, 36	32	24
Others	30, 35, 36	4,505	5,222
		<u>₱31,404</u>	<u>₱23,292</u>

Derivative liabilities included under “Others” amounted to ₱111 and ₱2,353 as of December 31, 2009 and 2008, respectively (Notes 35 and 36).

Non-trade payables consist of freight payable, contract growers/breeders’ fee, guarantee deposits, expense payable and the unpaid balance due next year related to the acquisition of Meralco shares of stock.

Others include payroll-related accruals and accrued interest payable.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

18. Long-term Debt

	<u>2009</u>	<u>2008</u>
Parent Company		
Unsecured term notes:		
Foreign currency-denominated:		
Floating interest rate based on LIBOR plus an agreed margin, with maturities up to 2012 ^(a)	P26,397	P —
Floating interest rate based on LIBOR plus an agreed margin, with maturities up to 2012 ^(b)	—	43,454
Peso-denominated:		
Floating interest rate based on 3month PDST-F plus an agreed margin with maturities up to 2012 and 2014 ^(c)	2,982	—
	<u>29,379</u>	<u>43,454</u>
Subsidiaries		
Unsecured term notes:		
Bonds:		
Fixed interest rate of 8.25%, 8.875% and 10.5% maturing in 2012, 2014 and 2019, respectively ^(d)	38,416	—
Fixed interest rate of 6.50% and 7.25% maturing in 2012 and 2014, respectively ^(e)	2,214	2,211
Foreign currency-denominated:		
Floating interest rate based on VNIBOR, THBFIX and discount from PBOC lending rate, plus an agreed margin ^(f)	2,953	4,098
	<u>43,583</u>	<u>6,309</u>
	72,962	49,763
Less current maturities	<u>1,077</u>	<u>9,044</u>
	<u>P71,885</u>	<u>P40,719</u>

^{a.} The amount represents drawdown by the Parent Company in 2009 from the US\$600 loan facility for general working capital purposes. Unamortized debt issue costs related to this loan facility amounted to P1,323 as of December 31, 2009.

^{b.} The amount represents drawdown by the Parent Company from the US\$1,200 loan facility to refinance a portion of its short-term loans and the remaining balance of its long-term loans. Unamortized debt issue costs related to this loan facility amounted to P407 as of December 31, 2008.

On June 3, 2009, the Parent Company paid off the remaining balance of US\$923 from the proceeds of the 6,665,023,690 shares sold by the Parent Company to Kirin representing 43.2499% stake in SMB.

^{c.} The amount represents drawdown by the Parent Company in 2009 from the P2,000 five-year term loan and from the P1,000 floating rate corporate notes issued by the Parent Company for general financing and corporate requirements. Unamortized debt issue costs related to this loan amounted to P18 as of December 31, 2009.

^{d.} SMB offered for sale and subscription to the public Philippine peso-denominated fixed rate bonds in the aggregate principal amount of P38,800 (Bonds) on April 3, 2009 (Issue Date). The Bonds was issued in three (3) series: Series A Bonds with an aggregate principal amount of P13,590 having a term of 3 years beginning on Issue Date and ending on April 3, 2012, with a fixed interest rate of 8.25% per annum; Series B Bonds with an aggregate principal amount of P22,400 having a term of 5 years and 1 day beginning on Issue Date and ending on April 4, 2014, with a fixed interest rate of 8.875% per annum; and Series C Bonds with an aggregate amount of P2,810 having a term of 10 years beginning on Issue Date and ending on April 3, 2019, with a fixed interest rate of 10.50% per annum. Proceeds from the issuance of the bonds was used to finance SMB's acquisition of the interest of the Parent Company in IBI for P32,000 and the balance will be used to acquire the interest of the Parent Company in BPI. Unamortized debt issue costs related to these bonds amounted to P384 as of December 31, 2009.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On November 17, 2009, the Philippine Dealing & Exchange Corp. (PDEX) approved SMB's application to list its peso-denominated fixed rate bonds for trading on the PDEX.

- e. The amount represents syndicated loans obtained by SMYAC which were used for capital expenditures. Unamortized debt issue costs related to these loans amounted to P11 and P14 as of December 31, 2009 and 2008, respectively.
- f. The amount includes loan obtained by SMFBIL's subsidiaries and SMYHG, which was used to finance their capital expenditures. It also includes the 44.9% share of the loan of TSML in 2009 and 2008 to finance its plant constructions and start up operations. Unamortized debt issue costs related to these loans amounted to P2 and P3 as of December 31, 2009 and 2008, respectively.

The debt agreements contain, among others, covenants relating to merger and consolidation, maintenance of certain financial ratios, working capital requirements, restrictions on loans and guarantees, disposal of a substantial portion of assets, significant changes in the ownership or control of subsidiaries, payments of dividends and redemption of capital stock.

As of December 31, 2009 and 2008, the Group is in compliance with the covenants of the debt agreements.

The movements in debt issue costs are as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Balance at beginning of year		P 424	P 797
Additions		1,889	1
Amortization	25	<u>(575)</u>	<u>(374)</u>
Balance at end of year		<u><u>P1,738</u></u>	<u><u>P 424</u></u>

Repayment Schedule

As of December 31, 2009, the annual maturities of long-term debt are as follows:

<u>Year</u>	<u>Gross Amount</u>	<u>Debt Issue Costs</u>	<u>Net</u>
2010	P 1,081	P 4	P 1,077
2011	1,481	954	527
2012	44,280	511	43,769
2013	519	4	515
2014	24,529	235	24,294
2019	<u>2,810</u>	<u>30</u>	<u>2,780</u>
	<u><u>P74,700</u></u>	<u><u>P1,738</u></u>	<u><u>P72,962</u></u>

19. Income Taxes

Deferred tax assets and liabilities arise from the following:

	<u>2009</u>	<u>2008</u>
Unrealized intercompany charges and others	P 4,998	P 2,752
Allowance for impairment losses on trade and other receivables and inventory	1,163	1,136
MCIT	1,145	916
NOLCO	753	775
Undistributed net earnings of foreign subsidiaries — net	<u>(11,213)</u>	<u>(15,792)</u>
	<u><u>P (3,154)</u></u>	<u><u>P(10,213)</u></u>

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The above amounts are reported in the consolidated statements of financial position as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Deferred tax assets	4	P 8,883	P 7,638
Deferred tax liabilities		(12,037)	(17,851)
		<u>P (3,154)</u>	<u>P(10,213)</u>

The undistributed earnings of foreign subsidiaries and cumulative translation adjustments for which deferred tax liabilities have not been recognized totaled P11,425 and P10,100 as of December 31, 2009 and 2008, respectively.

As of December 31, 2009, the NOLCO and MCIT of the Group that can be claimed as deduction from future taxable income and deduction from corporate income tax due, respectively, are as follows:

<u>Year Incurred/Paid</u>	<u>Carryforward Benefits Up To</u>	<u>NOLCO</u>	<u>MCIT</u>
2007	December 31, 2010	P 954	P 388
2008	December 31, 2011	566	410
2009	December 31, 2012	990	347
		<u>P2,510</u>	<u>P1,145</u>

The components of income tax expense are shown below:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current		P10,254	P 7,907	P 435
Deferred		(6,548)	(1,809)	4,085
Income tax expense from continuing operations		3,706	6,098	4,520
Income tax expense (benefit) from ordinary activities of discontinued operations	6	—	(7)	1,174
Income tax expense from gain on disposal of discontinued operations	6	—	2,921	4,596
		<u>P 3,706</u>	<u>P 9,012</u>	<u>P10,290</u>

The reconciliation between the statutory income tax rate on income before income tax from continuing operations and the Group's effective income tax rates are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statutory income tax rate	30.00%	35.00%	35.00%
Increase (decrease) in income tax rate resulting from:			
Gain on sale of investments subject to final or capital gains tax	(23.52)	(12.05)	(6.03)
Interest income subject to final tax	(2.79)	(11.17)	(5.80)
Equity in net losses (earnings) of associates	(1.31)	1.91	(0.46)
Loss (gain) on derivatives	(0.45)	18.06	4.44
Others, mainly income subject to different tax rates and change in tax rate — net	3.83	(2.38)	8.73
Effective income tax rate	<u>5.76%</u>	<u>29.37%</u>	<u>35.88%</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

20. Stockholders' Equity

a. On July 24, 2007, the stockholders of the Parent Company approved the increase in the Parent Company's authorized capital stock from ₱22,500 to ₱37,500, which will be made up of 3,600,000,000 Class "A" common shares, 2,400,000,000 Class "B" common shares and 1,500,000,000 preferred shares, all with a par value of ₱5.00 per share.

On July 23, 2009, during the Parent Company's annual stockholders' meeting, the stockholders approved amendments to the Parent Company's Articles of Incorporation providing for the reclassification of the common shares comprising the authorized capital stock of ₱22,500. The authorized capital stock of the Parent Company was divided into 2,034,000,000 Class "A" common shares, 1,356,000,000 Class "B" common shares and 1,110,000,000 Series "1" preferred shares, and defined the terms and features of the Series "1" preferred shares. The preferred shares shall be peso-denominated, perpetual, cumulative and non-voting Series "1" preferred shares with an issue price of ₱75.00 per share and a dividend rate of 8% per annum computed in reference to the issue price. The SEC approved these amendments to the Amended Articles of Incorporation of the Parent Company on August 20, 2009. The stockholders also approved in the same stockholders' meeting, further amendments to the resolutions on the increase in the authorized capital stock of the Parent Company which were passed during the 2007 annual stockholders' meeting to provide for the division of the increased authorized capital stock of the Parent Company into common shares and two series of preferred shares. The proposed increase in the authorized capital stock of the Parent Company has not been submitted to the SEC for approval.

Also, on July 23, 2009, the stockholders of the Parent Company approved the Offer by the Parent Company to exchange existing common shares of up to approximately 35% of the issued and outstanding capital stock of the Parent Company with Series "1" preferred shares. The exchange ratio was one (1) common share for one (1) Series "1" preferred share and the qualified shareholders of record as of July 2, 2009, were vested with the right to participate on the exchange.

On October 5, 2009, the Parent Company completed the exchange of 476,296,752 Class "A" common shares and 396,876,601 Class "B" common shares for Series "1" preferred shares.

On October 15, 2009, the Parent Company's BOD approved the issuance, through private placement, of up to 226,800,000 Series "1" preferred shares.

On December 22, 2009, the Parent Company issued 97,333,000 Series "1" preferred shares to qualified buyers and by way of private placement to not more than 19 non-qualified buyers at the issue price of ₱75.00 per Series "1" preferred share.

b. *Capital Stock*

Common Stock

Class "A" common shares and Class "B" common shares have the same rights and privileges. Only Philippine citizens or corporations or associations that are at least 60% owned by Filipino citizens can own Class "A" common shares.

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The movements in the number of issued and outstanding shares of common stock are as follows:

	<u>2009</u>	<u>2008</u>
Class “A”		
Balance at beginning of year	1,975,940,615	1,975,292,245
Issuances during the year	<u>4,652,540</u>	<u>648,370</u>
Issued shares at end of year	1,980,593,155	1,975,940,615
Less treasury shares	<u>530,959,512</u>	<u>54,662,760</u>
Issued and outstanding shares at end of year	<u><u>1,449,633,643</u></u>	<u><u>1,921,277,855</u></u>
Class “B”		
Balance at beginning of year	1,246,527,833	1,246,527,833
Issuances during the year	<u>2,823,954</u>	<u>—</u>
Issued shares at end of year	1,249,351,787	1,246,527,833
Less treasury shares	<u>407,689,212</u>	<u>10,812,611</u>
Issued and outstanding shares at end of year	<u><u>841,662,575</u></u>	<u><u>1,235,715,222</u></u>

Preferred Shares

Series “1” preferred shares has a par value of ₱5.00 per share and are entitled to receive cash dividends upon declaration by and at the sole option of the Parent Company’s BOD at a fixed rate of 8% per annum calculated in respect of each Series “1” preferred share by reference to the Issue Price thereof in respect of each dividend period. Unless the Series “1” preferred shares are redeemed by the Parent Company, the dividend rate shall be adjusted at the end of the fifth year after the date of issue.

Series “1” preferred shares do not carry the right to vote. The Series “1” preferred shares are redeemable in whole or in part, at the sole option of the Parent Company, at the end of three years from the issue date at ₱75.00 plus any accumulated and unpaid cash dividends.

All shares rank equally with regard to the Parent Company’s residual assets, except that holders of preferred shares participate only to the extent of the issue price of the shares plus any accumulated and unpaid cash dividends.

As of December 31, 2009, the Parent Company has 970,506,353 outstanding Series “1” preferred shares.

c. Treasury shares, totaling 65,475,371 Class “A” and “B” common shares, are stated at acquisition cost, while 873,173,353 Class “A” and “B” common shares were acquired through the exchange of common shares to preferred shares on a one-for-one basis at ₱75.00 per share.

Out of the total treasury shares, 25,450,000 common shares (15,274,484 Class “A” common shares and 10,175,516 Class “B” common shares), with an acquisition cost of ₱481, [net of the cost of the 1,000,000 shares paid to Presidential Commission on Good Government (PCGG) as arbitral fee pursuant to the Compromise Agreement, as herein defined] 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 Parent Company shares 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.

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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.

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 ₱2,100; 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 compromised 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 Case No. 033-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 are 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

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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.

The Supreme Court affirmed its resolution, issued on September 17, 2009, allowing the PCGG to convert the 24% sequestered shares of the Parent Company in the name of CIIF into Series “1” preferred shares. The Court held that the conversion is necessary to preserve the value of the 753,848,312 common shares.

On February 11, 2010, the Supreme Court amended its Resolution dated September 17, 2009 and authorized the PCGG to exercise discretion in depositing on escrow, the net dividend earnings on, and/or redemption proceeds from, the Series “1” preferred shares of SMC, either with the Development Bank of the Philippines/ Land Bank of the Philippines or with the UCPB, having in mind the greater interest of the government and the coconut farmers.

In the meantime, the Parent Company has available cash and shares of stock for the dividends payable on the treasury shares.

The movements in the number of acquired shares of treasury stock are as follows:

	<u>2009</u>	<u>2008</u>
Class “A”		
Balance at beginning of year	54,662,760	54,662,760
Acquisition through exchange of common shares to preferred shares during the year	<u>476,296,752</u>	<u>—</u>
Balance at end of year	<u><u>530,959,512</u></u>	<u><u>54,662,760</u></u>
Class “B”		
Balance at beginning of year	10,812,611	10,812,611
Acquisition through exchange of common shares to preferred shares during the year	<u>396,876,601</u>	<u>—</u>
Balance at end of year	<u><u>407,689,212</u></u>	<u><u>10,812,611</u></u>

d. The Group’s unappropriated retained earnings include its accumulated equity in net earnings of subsidiaries and associates amounting to ₱18,184, ₱57,482 and ₱44,199 in 2009, 2008 and 2007, respectively. Such amounts are not available for declaration as dividends until declared by the respective investees.

The Parent Company’s unappropriated retained earnings as of December 31, 2009 and 2008 is restricted in the amount of ₱69,541 and ₱4,053, respectively, representing the cost of shares held in treasury.

e. The BOD of certain subsidiaries approved additional appropriations amounting to ₱15, ₱176 and ₱273 in 2009, 2008 and 2007, respectively, to finance future capital expenditure projects. Reversal of appropriations in 2009, 2008 and 2007 amounted to ₱40, ₱688 and ₱275, respectively.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

21. Cost of Sales

Cost of sales consists of:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Inventories		P 75,051	P 76,205	P 68,727
Taxes and licenses		21,515	19,703	18,878
Depreciation, amortization and impairment losses	23	4,994	4,660	4,461
Contracted services		4,682	4,296	3,206
Freight, trucking and handling		4,392	4,230	2,511
Personnel	24	3,802	3,815	2,926
Communications, light and water		3,662	4,232	4,260
Fuel and oil		2,170	3,267	2,150
Repairs and maintenance		1,827	1,584	1,786
Rent	4	455	550	648
Others		1,745	1,530	509
		<u>P124,295</u>	<u>P124,072</u>	<u>P110,062</u>

22. Selling and Administrative Expenses

Selling and administrative expenses consist of:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Selling	P12,905	P13,518	P10,331
Administrative	17,344	15,633	16,002
	<u>P30,249</u>	<u>P29,151</u>	<u>P26,333</u>

Selling expenses consist of:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Advertising and promotions		P 4,980	P 5,697	P 4,258
Personnel	24	3,635	3,251	2,592
Freight, trucking and handling		2,021	2,049	1,357
Rent	4	1,060	995	446
Supplies		251	281	447
Taxes and licenses		249	213	207
Depreciation, amortization and impairment losses	23	221	248	305
Communications, light and water		218	169	536
Professional Fees		45	43	86
Others		225	572	97
		<u>P12,905</u>	<u>P13,518</u>	<u>P10,331</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Administrative expenses consist of:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Personnel	24	P 7,385	P 6,771	P 5,900
Depreciation, amortization and impairment losses	23	2,110	1,859	1,750
Professional fees		2,383	1,283	1,150
Repairs and maintenance		952	867	1,669
Advertising and promotion		822	1,614	2,071
Supplies		711	710	433
Taxes and licenses		673	617	603
Communications, light and water		644	692	706
Rent	4	605	251	356
Others		1,059	969	1,364
		<u>P17,344</u>	<u>P15,633</u>	<u>P16,002</u>

23. Depreciation, Amortization and Impairment Losses

Depreciation, amortization and impairment losses are distributed as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cost of sales:				
Property, plant and equipment	11	P3,852	P3,604	P3,434
Deferred containers, biological assets and others		1,142	1,056	1,027
	21	<u>4,994</u>	<u>4,660</u>	<u>4,461</u>
Selling and administrative expenses:				
Property, plant and equipment	11	1,402	1,329	1,270
Deferred containers and others		929	778	785
	22	<u>2,331</u>	<u>2,107</u>	<u>2,055</u>
		<u>P7,325</u>	<u>P6,767</u>	<u>P6,516</u>

“Others” include amortization of computer software, land use rights, licenses and investment properties.

Depreciation expense amounting to P1,659 in 2007 was presented as part of discontinued operations (Note 6).

24. Personnel Expenses

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Salaries and wages		P 7,205	P 6,440	P 4,530
Retirement costs	30	594	857	1,236
Other employee benefits		7,023	6,540	5,652
		<u>P14,822</u>	<u>P13,837</u>	<u>P11,418</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Personnel expenses are distributed as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cost of sales	21	P 3,802	P 3,815	P 2,926
Selling expenses	22	3,635	3,251	2,592
Administrative expenses	22	7,385	6,771	5,900
		<u>P14,822</u>	<u>P13,837</u>	<u>P11,418</u>

25. Interest Expense and Other Financing Charges

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest expense	P6,780	P5,370	P5,442
Other financing charges	1,146	662	1,675
	<u>P7,926</u>	<u>P6,032</u>	<u>P7,117</u>

Amortization of debt issue costs in 2009, 2008 and 2007 included in other financing charges amounted to P575, P374 and P904, respectively (Note 18).

Interest expense on drafts and loans payable and long-term debt are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Drafts and loans payable	P2,916	P2,960	P2,165
Long-term debt	3,864	2,410	3,277
	<u>P6,780</u>	<u>P5,370</u>	<u>P5,442</u>

Interest expense and other financing charges amounting to P2,984 in 2007 was presented as part of discontinued operations (Note 6).

26. Interest Income

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest from short-term investments, cash in banks and others	7	P5,350	P4,320	P 939
Interest on amounts owed by a related party	8	639	2,310	1,148
		<u>P5,989</u>	<u>P6,630</u>	<u>P2,087</u>

Interest income amounting to P317 in 2007 was presented as part of discontinued operations (Note 6).

27. Other Income (Charges)

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Foreign exchange gains (losses)	P(3,364)	P 8,684	P 6,587
Loss on impairment of goodwill, trademark and brand name, property, plant and equipment and idle assets [see (a), (b), (c), (d) and (e) below and Note 10]	(4,756)	(322)	(1,744)
Gains (losses) on derivatives — net	962	(10,718)	(1,598)
Others	315	94	369
	<u>P(6,843)</u>	<u>P (2,262)</u>	<u>P 3,614</u>

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a. In 2009, the Group reduced the carrying value of certain assets of SMPPC by a total of ₱694 after the latter ceased its commercial operations on July 27, 2009.

b. In 2009, the Group recognized impairment loss against certain noncurrent assets of operations in mainland China, comprising mainly the production plant located in Shunde, Guangdong Province, trademarks, other tangible assets and goodwill. Over the past two years, the Group's business performance in mainland China had been adversely affected by factors including economic downturn, fierce market competition, counterfeit products and poor weather conditions. In view of this, a cash flow projection was prepared to estimate the recoverable amount of the cash-generating unit to which these assets belong ("the cash-generating unit") using a value-in-use calculation. This calculation uses the discounted value of the projected cash flows to be generated over the remaining useful life of the cash-generating units. Pre-tax discount rates ranging from 11.45% to 13.17% were applied to the projected cash flows. As of December 31, 2009, the Group recognized impairment loss amounting to HK\$590 (₱3,705) against these assets.

On September 30, 2007, the Yuen Long plant of SMBHK has temporarily ceased operations. SMBHK reviewed the recoverable amount of the fixed assets of its plant and the carrying amount of such assets was written down by ₱1,461 to the value in use (Note 11). Value in use was calculated using the discounted value of the projected future cash flows to be generated over the remaining useful life of the plant. A pre-tax discount rate of 9.91% was applied to the projected future cash flows of the plant.

c. In 2009, the Group recognized provisions for impairment loss on land and idle assets (included under "Other noncurrent assets") amounting to ₱54, computed as the difference between the carrying amount of the assets and their fair value based on reports by qualified property appraisers, less costs to sell (Note 15).

d. On December 31, 2008, the Group reviewed the recoverable amount of its investment in shares of stock of SDI. It was determined that the carrying amount of the investment is higher than its value in use and an impairment loss of ₱322 was recognized. The discount rate applied to after tax cash flow projections of SDI was 12%. The impairment loss was allocated fully to goodwill (Note 14).

e. In 2007, SMPSI ceased operating two of its plants and one of its furnace. The corresponding building, machinery and equipment with an aggregate net book value of ₱405 have been reclassified from "Property, plant and equipment" account to "Other noncurrent assets" account (Note 15). These assets have been written down to their net realizable value based on reports by qualified property appraisers. The impairment charges relating to these assets amounted to ₱283.

28. Related Party Disclosures

Transactions with related parties are made at normal market prices. For the periods ended December 31, 2009, 2008 and 2007, the Group did not provide any allowance for impairment losses relating to amounts owed by related parties. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

a. The Parent Company has advances to SMCRP amounting to ₱2,785 and ₱6,323 as of December 31, 2009 and 2008, respectively, included as part of "Trade and other receivables" account (Note 8).

b. The significant transactions of the Group and Meralco include the following:

<u>Year</u>	<u>Purchases of Utilities</u>	<u>Included under "Trade and Other Receivables" Account (Note 8)</u>	<u>Included Under "Accounts Payable and Accrued Expenses" Account</u>
2009	<u>₱692</u>	<u>₱72</u>	<u>₱32</u>
2008	<u>277</u>	<u>168</u>	<u>24</u>

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In 2009, the Group has noncurrent receivables and deposits from Meralco amounting to ₱68 (Note 15).

c. As of December 31, 2009, the Parent Company has advances to SMEC which amounted to ₱313 and ₱2 included as part of “Trade and other receivables” and “Other noncurrent assets” accounts, respectively (Notes 8 and 15).

d. The compensation of key management personnel of the Group, by benefit type, follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Short-term employee benefits	₱378	₱200	₱262
Retirement costs	37	19	49
Share-based payments	<u>56</u>	<u>53</u>	<u>58</u>
	<u>₱471</u>	<u>₱272</u>	<u>₱369</u>

Some of the personnel performing key management functions in certain subsidiaries are employed by the Parent Company. This is covered by a management agreement executed by and between the Parent Company and the subsidiaries. The salaries and benefits of these personnel are billed to the subsidiaries through management fees, with details as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Short-term employee benefits		₱46	₱118	₱259
Retirement costs		1	9	87
Share-based payments		<u>43</u>	<u>55</u>	<u>23</u>
	24	<u>₱90</u>	<u>₱182</u>	<u>₱369</u>

29. Leasing Agreements

Finance Leases

Leases as Lessee

The Group’s finance leases cover automobiles needed for business operations. The agreements do not allow subleasing. Some leases provide the Group with the option to purchase the equipment at a beneficial price. As of December 31, 2009 and 2008, the net carrying amount of leased transportation equipment was ₱30 and ₱90, respectively.

The Group’s share in the minimum lease payments for these finance lease liabilities are as follows:

	<u>Minimum Lease Payable</u>	<u>Interest</u>	<u>Principal</u>
Within one year	₱13	₱1	₱12
After one year but not more than five years	<u>17</u>	<u>2</u>	<u>15</u>
	<u>₱30</u>	<u>₱3</u>	<u>₱27</u>

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Leases as Lessor

The Group's lease receivable under finance lease as of December 31, 2009 and 2008 are as follows:

	<u>Minimum Lease Receivable</u>	<u>Interest</u>	<u>Principal</u>
2009			
Less than one year	P 5	P—	P 5
2008			
Less than one year	P 6	P 1	P 5
Between one and five years	<u>5</u>	<u>—</u>	<u>5</u>
	<u>P11</u>	<u>P 1</u>	<u>P10</u>

Operating Leases

Leases as Lessor

The Group has entered into various property leases. These non-cancellable leases will expire up to year 2014. All leases include a clause to enable upward revision of the rental charge on an annual basis based on prevailing market conditions.

As of December 31, 2009, 2008 and 2007, the future minimum lease receipts under non-cancellable operating leases are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Within one year	P 78	P 94	P278
After one year but not more than five years	<u>62</u>	<u>114</u>	<u>280</u>
	<u>P140</u>	<u>P208</u>	<u>P558</u>

Rent income recognized in the consolidated statements of income amounted to P545, P402 and P256 in 2009, 2008 and 2007, respectively.

Leases as Lessee

The Group leases a number of office, warehouse and factory facilities under operating leases. The leases typically run for a period of two to seven years. Some leases provide an option to renew the lease at the end of the lease term and are being subjected to reviews to reflect current market rentals.

As of December 31, 2009, 2008 and 2007, non-cancellable operating lease rentals are payable as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Within one year	P 35	P 290	P118
After one year but not more than five years	109	748	151
More than five years	<u>409</u>	<u>35</u>	<u>124</u>
	<u>P553</u>	<u>P1,073</u>	<u>P393</u>

30. Retirement Plans

The Parent Company and majority of its subsidiaries have funded, noncontributory retirement plans covering all of their permanent employees. Contributions and costs are determined in accordance with the actuarial studies made for the plans. Annual cost is determined using the projected unit credit method.

SAN MIGUEL CORPORATION AND SUBSIDIARIES
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Majority of the Group's latest actuarial valuation date is December 31, 2009. Valuations are obtained on a periodic basis.

Retirement costs charged by the Parent Company to operations amounted to P65, P422 and P975 in 2009, 2008 and 2007, respectively, while those charged by the subsidiaries amounted to P529, P435 and P383 in 2009, 2008 and 2007, respectively. The Group's annual contribution to the retirement plans consists of payments covering the current service cost and amortization of past service costs.

The components of retirement costs recognized in the consolidated statements of income in 2009, 2008 and 2007 and the amounts recognized in the consolidated statements of financial position as of December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current service cost	P 486	P 532	P 493
Interest cost	992	834	796
Expected return on plan assets	(868)	(772)	(894)
Net actuarial loss (gain)	(64)	49	397
Past service costs	6	41	—
Effect of curtailment	(24)	—	772
Effect of asset limit	—	—	(102)
Amortization of transitional liability	66	173	120
Others	—	—	(224)
Net retirement costs	<u>P 594</u>	<u>P 857</u>	<u>P1,358</u>
Actual return on plan assets	<u>P6,099</u>	<u>P 477</u>	<u>P3,614</u>

The retirement costs are recognized in the following line items in the consolidated statements of income:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cost of sales		P123	P144	P 120
Selling and administrative expenses		471	713	1,116
Retirement costs of continuing operations	24	594	857	1,236
Reclassified to discontinued operations		—	—	122
		<u>P594</u>	<u>P857</u>	<u>P1,358</u>

The reconciliation of the assets and liabilities recognized in the consolidated statements of financial position is as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Present value of defined benefit obligation		P12,362	P11,080
Fair value of plan assets		<u>15,178</u>	<u>10,232</u>
		(2,816)	848
Unrecognized actuarial gain (loss)	4	3,271	(268)
Unrecognized net transitional liability		—	(66)
Unrecognized past service costs		(1)	(2)
Net retirement liabilities		<u>P 454</u>	<u>P 512</u>

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Net retirement assets and liabilities in 2009 are included as part of “Prepaid expenses and other current assets” and “Others” under “Other noncurrent assets” accounts amounting to ₱150 and ₱160, respectively, and under “Accounts payable and accrued expenses” and “Other noncurrent liabilities” accounts amounting to ₱572 and ₱192, respectively (Notes 15 and 17).

Net retirement assets and liabilities in 2008 are included as part of “Others” under “Other noncurrent assets” accounts amounting to ₱219 and under “Accounts payable and accrued expenses” and “Other noncurrent liabilities” accounts amounting to ₱613 and ₱118, respectively (Notes 15 and 17).

The movements in the present value of defined benefit obligation are as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	₱11,080	₱11,332
Interest cost	992	834
Current service cost	486	532
Past service costs	4	41
Benefits paid	(1,817)	(1,496)
Actuarial losses (gains)	1,628	(163)
Effect of curtailment	(11)	—
Balance at end of year	<u>₱12,362</u>	<u>₱11,080</u>

The movements in the fair value of the plan assets are as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	₱10,232	₱10,726
Expected return	868	772
Contributions by employer	660	525
Benefits paid	(1,813)	(1,496)
Actuarial gains (losses)	5,231	(295)
Balance at end of year	<u>₱15,178</u>	<u>₱10,232</u>

Plan assets consist of the following:

	<u>In Percentages</u>	
	<u>2009</u>	<u>2008</u>
Stock trading portfolio	4	20
Fixed income portfolio	62	40
Others	34	40

The plan assets include 10,000 and 751,362,391 Class “A” common shares and 20,000 and 153,609,529 Class “B” common shares of the Parent Company as of December 31, 2009 and 2008, respectively. The fair market values per share were ₱68.50 and ₱40.50 for Class “A” common shares and ₱68.50 and ₱42.50 for Class “B” common shares as of December 31, 2009 and 2008, respectively.

On October 5, 2009, SMCRP exchanged on a one-for-one basis its 6,715,543 Class “A” common shares and 78,606,542 Class “B” common shares to Series “I” preferred shares of the Parent Company at an issue price of ₱75.00 per share.

SMCRP’s 21% and 4% investment in shares of stock of BOC as of December 31, 2009 and 2008, respectively, is presented in the above list of plan assets under “Others”.

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The overall expected rate of return is determined based on historical performance of investments.

The principal actuarial assumptions used to determine retirement benefits are as follows:

	In Percentages	
	2009	2008
Discount rate	8 - 11	7 - 11
Salary increase rate	8	6
Expected return on plan assets	10	9

The historical information for the current and previous four annual periods is as follows:

	2009	2008	2007	2006	2005
Present value of the defined benefit obligation	₱12,362	₱11,080	₱11,332	₱14,236	₱15,045
Fair value of plan assets	15,178	10,232	10,726	10,241	11,873
Deficit (excess) in the plan	(2,816)	848	606	3,995	3,172
Experience adjustments on plan liabilities . .	927	6	933	(188)	—

The Group expects to contribute ₱594 to its defined benefit plans in 2010.

31. Cash Dividends

Cash dividends declared by the Parent Company's BOD to common shareholders amounted to ₱0.70 per share in 2009 and ₱1.40 per share in 2008.

On January 6, 2010, the Parent Company's BOD declared cash dividend of ₱0.35 per share to common shareholders and ₱1.50 per share to preferred shareholders of record as of October 5, 2009 (issue date). For preferred shareholders of record after issue date, dividend rate was adjusted proportionately. These dividends were paid on February 15, 2010 to all stockholders of record as of January 22, 2010.

On February 2, 2010, the Parent Company's BOD declared cash dividend of ₱0.35 per share to common shareholders, paid on March 8, 2010 to all common stockholders of record as of February 19, 2010.

On March 15, 2010, the Parent Company's BOD declared cash dividend of ₱0.35 per share to common shareholders, paid on April 12, 2010 to all common stockholders of record as of March 29, 2010.

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32. Basic and Diluted Earnings Per Share

Basic and Diluted EPS is computed as follows:

	<u>Note</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Income from continuing operations attributable to equity holders of the Parent Company		P57,799	P13,935	P8,160
Dividends on preferred shares for the period		<u>(1,281)</u>	<u>—</u>	<u>—</u>
Net income from continuing operations attributable to common shareholders(a)		<u>56,518</u>	<u>13,935</u>	<u>8,160</u>
Income from discontinued operations attributable to equity holders of the Parent Company(b)	6	<u>—</u>	<u>5,413</u>	<u>470</u>
Net income attributable to common shareholders of the Parent Company		<u>P56,518</u>	<u>P19,348</u>	<u>P8,630</u>
Weighted average number of shares outstanding (in millions) — basic(c)		2,942	3,157	3,153
Effect of dilution		<u>17</u>	<u>12</u>	<u>7</u>
Weighted average number of shares outstanding (in millions) — diluted(d)		<u>2,959</u>	<u>3,169</u>	<u>3,160</u>
Basic EPS from continuing operations(a/c)		P 19.21	P 4.41	P 2.59
Basic EPS from discontinued operations(b/c)		<u>—</u>	<u>1.72</u>	<u>0.15</u>
		<u>P 19.21</u>	<u>P 6.13</u>	<u>P 2.74</u>
Diluted EPS from continuing operations(a/d)		P 19.10	P 4.40	P 2.58
Diluted EPS from discontinued operations(b/d)		<u>—</u>	<u>1.71</u>	<u>0.15</u>
		<u>P 19.10</u>	<u>P 6.11</u>	<u>P 2.73</u>

33. Supplemental Cash Flow Information

Supplemental information with respect to the consolidated statements of cash flows is presented below:

a. Changes in noncash current assets and certain current liabilities and others are as follows (amounts reflect actual cash flows rather than increases or decreases of the accounts in the consolidated statements of financial position):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Trade and other receivables	P 558	P 728	P (4,402)
Inventories	1,085	(4,100)	3,001
Prepaid expenses and other current assets	(874)	759	(2,550)
Accounts payable and accrued expenses	6,381	1,779	23,341
Income and other taxes payable and others	<u>(8,345)</u>	<u>(457)</u>	<u>(4,198)</u>
	<u>P(1,195)</u>	<u>P(1,291)</u>	<u>P15,192</u>

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b. Acquisitions of subsidiaries — JHK Investments and HLC (Note 10)

	<u>Note</u>	<u>2009</u>
Cash and cash equivalents		P 193
Trade and other receivables — net		1,243
Inventories — net		664
Prepaid expenses and other current assets.		23
Property, plant and equipment — net		1,430
Other intangible assets — net.		20
Deferred tax assets		72
Accounts payable and accrued expenses.		(2,076)
Drafts and loans payable		(839)
Deferred tax liabilities		(40)
Other noncurrent liabilities		(88)
Non-controlling interests		(211)
Net assets		391
Cash and cash equivalents		(193)
Goodwill in subsidiaries	14	1,296
Net cash flows		<u>P 1,494</u>

34. Share-Based Transactions

ESPP

Under the ESPP, 80,396,659 shares (inclusive of stock dividends declared) of the Parent Company's unissued shares have been reserved for the employees of the Group until 2009 (as amended and approved by the SEC in 2001 and 2003, respectively). A participating employee may acquire at least 100 shares of stock through payroll deductions.

On December 5, 2002, the Parent Company's BOD approved amendments to the ESPP. Under the amended ESPP, all permanent Philippine-based employees of the Group, who have been employed for a continuous period of one year prior to the subscription period, will be allowed to subscribe at 15% discount to the market price equal to the weighted average of the daily closing prices for three months prior to the offer period. The amendments to the ESPP are prospective in application. Existing subscriptions shall not be entitled to the rights granted under the amendments. The amendments of the ESPP were approved by the SEC on February 20, 2003.

The ESPP requires the subscribed shares and stock dividends accruing thereto to be pledged to the Parent Company until the subscription is fully paid. The right to subscribe under the ESPP cannot be assigned or transferred. A participant may sell his shares after the second year from the exercise date. The current portion of subscriptions receivable as of December 31, 2009 and 2008 amounted to P147 and P269, respectively, presented as part of "Others" under "Trade and other receivables" account (Note 8). The noncurrent portion of P363 and P259 as of December 31, 2009 and 2008, respectively, is reported as part of "Noncurrent receivables and deposits" under "Other noncurrent assets" account (Note 15).

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The number of subscribed shares under the ESPP as of December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Class “A”		
Paid subscribed shares	28,263,285	26,787,935
Unpaid subscriptions	8,461,300	6,365,600
Class “B”		
Paid subscribed shares	10,386,120	9,070,020
Unpaid subscriptions	8,803,550	7,053,700
Total shares subscribed	<u>55,914,255</u>	<u>49,277,255</u>

The ESPP also allows subsequent withdrawal and cancellation of participants’ subscriptions under certain terms and conditions. The shares pertaining to withdrawn or cancelled subscriptions shall remain issued shares and shall revert to the pool of shares available under the ESPP.

The table below shows the number and weighted average exercise prices of grants:

	<u>2009</u>		<u>2008</u>		<u>2007</u>	
	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Class “A”						
Subscribed during the year	2,189,450	₱ 42.46	3,745,100	₱ 42.36	4,045,100	₱ 56.14
Cancelled during the year.	<u>(248,100)</u>	<u>(50.62)</u>	<u>(3,125,900)</u>	<u>(53.07)</u>	<u>(876,750)</u>	<u>(55.71)</u>
Class “B”						
Subscribed during the year	2,688,750	44.92	2,602,450	41.53	3,970,300	63.26
Cancelled during the year.	<u>(383,700)</u>	<u>(60.18)</u>	<u>(2,602,450)</u>	<u>(62.10)</u>	<u>(1,010,650)</u>	<u>(67.06)</u>

The average market prices of the shares granted were ₱49.95, ₱52.84 and ₱70.40 per share in 2009, 2008 and 2007, respectively, for Class “A” common shares and ₱49.83, ₱48.86 and ₱74.14 per share in 2009, 2008 and 2007, respectively, for Class “B” common shares.

The average remaining contractual life of the ESPP was 1.04, 0.60 and 1.06 years as of December 31, 2009, 2008 and 2007, respectively, for Class “A” common shares and 1.72, 0.46 and 1.06 years as of December 31, 2009, 2008 and 2007, respectively, for Class “B” common shares.

LTIP

The Parent Company also maintains LTIP for executives of the Group. The options are exercisable at the fair market value of the Parent Company shares as of date of grant, with adjustments depending on the average stock prices of the prior three months. A total of 54,244,905 shares, inclusive of stock dividends declared, are reserved for the LTIP over its 10-year life. The LTIP is administered by the Executive Compensation Committee of the Parent Company’s BOD.

On June 26, 2008, the Parent Company approved the grant of stock options to 742 executives consisting of 7,456,452 shares based on the closing price of the Parent Company’s share, computed in accordance with the provisions of LTIP. Also on June 25, 2009, the Parent Company approved the grant of stock options to 755 executives consisting of 5,750,941 shares.

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Options to purchase 5,750,941 shares and 7,456,452 shares in 2009 and 2008, respectively, were outstanding at the end of each year. Options which were exercised and cancelled totaled about 3,230,094 shares and 29,170 shares in 2009 and 2008, respectively.

The stock options granted under the LTIP cannot be assigned or transferred by a participant and are subject to a vesting schedule. After one complete year from the date of the grant, 33% of the stock option becomes vested. Another 33% is vested on the second year and the remaining option lot is fully vested on the third year.

Vested stock options may be exercised at any time, up to a maximum of eight years from the date of grant. All unexercised stock options after this period are considered forfeited.

A summary of the status of the outstanding share stock options and the related weighted average exercise price under the LTIP is shown below:

	2009		2008		2007	
	Number of Share Stock Options	Weighted Average Exercise Price	Number of Share Stock Options	Weighted Average Exercise Price	Number of Share Stock Options	Weighted Average Exercise Price
Class "A"						
Balance at beginning of year . .	20,203,940	₱ 56.71	16,056,434	₱ 62.36	6,917,048	₱ 59.69
Granted during the year	4,922,958	58.05	5,219,517	40.50	10,987,673	63.50
Exercised during the year	(2,711,190)	(52.61)	(29,170)	(56.53)	(1,743,868)	(58.93)
Expired during the year	(360,924)	(62.58)	(1,042,841)	(62.58)	(104,419)	(62.97)
Balance at end of year	<u>22,054,784</u>	<u>₱ 57.39</u>	<u>20,203,940</u>	<u>₱ 56.71</u>	<u>16,056,434</u>	<u>₱ 62.36</u>
Class "B"						
Balance at beginning of year . .	11,911,370	₱ 69.94	10,359,853	₱ 76.79	3,663,962	₱ 78.39
Granted during the year	843,627	58.05	2,236,935	40.50	7,325,109	75.50
Exercised during the year	(518,904)	(41.30)	—	—	(527,510)	(68.42)
Expired during the year	(237,160)	(84.71)	(685,418)	(77.39)	(101,708)	(84.97)
Balance at end of year	<u>11,998,933</u>	<u>₱ 70.21</u>	<u>11,911,370</u>	<u>₱ 69.94</u>	<u>10,359,853</u>	<u>₱ 76.79</u>

The shares covered by the LTIP are offered for subscription to the participants for three years from approval of the LTIP by the SEC.

The fair value of equity-settled share options granted is estimated as at the date of grant using Black-Scholes option-pricing model, taking into account the terms and conditions upon which the options were granted.

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The inputs to the model used to measure the fair value of the shares granted in 2009 and 2008 are as follows:

	2009 Grant		2008 Grant	
	Class "A"	Class "B"	Class "A"	Class "B"
Dividend yield	2.41%	2.41%	3.46%	3.46%
Expected volatility	53%	43%	54%	43%
Historical volatility	53%	43%	54%	43%
Risk-free interest rate	5.15% to 7.76%	5.15% to 7.76%	6.33% to 9.18%	6.33% to 9.18%
Expected life option	1 to 8 years	1 to 8 years	1 to 8 years	1 to 8 years
Weighted average share price	58.05	58.05	40.50	40.50

The weighted average fair value of options granted in 2009 and 2008 was ₱19.24 and ₱12.31, respectively, for Class "A" common shares and ₱16.19 and ₱10.60, respectively, for Class "B" common shares.

The range of exercise prices for options outstanding was ₱58.05 to ₱40.50 as of December 31, 2009 and 2008 for Class "A" common shares and ₱58.05 to ₱40.50 as of December 31, 2009 and 2008 for Class "B" common shares.

The average remaining contractual life of the LTIP was 1.11, 1.43 and 1.99 years as of December 31, 2009, 2008 and 2007, respectively, for Class "A" common shares and 0.63, 1.30 and 1.99 years as of December 31, 2009, 2008 and 2007, respectively, for Class "B" common shares.

Share-based payment charged to operations, included under "Administrative expenses" account, amounted to ₱217, ₱253 and ₱258 in 2009, 2008 and 2007, respectively.

35. Financial Risk Management Objectives and Policies

Objectives and Policies

The Group has significant exposure to the following financial risks primarily from its use of financial instruments:

- Interest rate risk
- Foreign currency risk
- Commodity price risk
- Liquidity risk
- Credit risk

This note presents information about the Group's exposure to each of the foregoing risks, the Group's objectives, policies and processes for measuring and managing these risks, and the Group's management of capital.

The Group's principal non-trade related financial instruments include cash and cash equivalents, AFS financial assets, short-term and long-term loans, and derivative instruments. These financial instruments, except derivative instruments, are used mainly for working capital management purposes. The Group's trade-related financial assets and financial liabilities such as trade and other receivables, noncurrent receivables and deposits, accounts payable and accrued expenses and other noncurrent liabilities arise directly from and are used to facilitate its daily operations.

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The Group's outstanding derivative instruments such as commodity and currency options, forwards and swaps are intended mainly for risk management purposes. The Group uses derivatives to manage its exposures to foreign currency, interest rate and commodity price risks arising from the Group's operating and financing activities.

The BOD has the overall responsibility for the establishment and oversight of the Group's risk management framework. The BOD has established the Risk Management Committee, which is responsible for developing and monitoring the Group's risk management policies. The committee reports regularly to the BOD on its activities.

The Group's risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures, and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The Group's accounting policies in relation to derivatives are set out in Note 3 to the consolidated financial statements.

Interest Rate Risk

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group's exposure to changes in interest rates relates primarily to the Group's long-term borrowings and investment securities. Investment acquired or borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, investment securities or borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest cost by using an optimal combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rate and ensures that the mark-up rates charged on its borrowings are optimal and benchmarked against the rates charged by other creditor banks.

On the other hand, the Group's investment policy is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the Group's operations and working capital management. However, the Group invests only in high-quality securities while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term fluctuations on the Group's earnings. Over the longer term, however, permanent changes in interest rates would have an impact on the consolidated statements of income.

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The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios. Interest rate movements affect reported equity in the following ways:

- retained earnings arising from increases or decreases in interest income or interest expense as well as fair value changes reported in profit or loss, if any;
- fair value reserves arising from increases or decreases in fair values of AFS financial assets reported as part of other comprehensive income; and
- hedging reserves arising from increases or decreases in fair values of hedging instruments designated in qualifying cash flow hedge relationships reported as part of other comprehensive income.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P301 and P474 in 2009 and 2008, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. There is no impact on the Group's other comprehensive income.

Interest Rate Risk Table

As at December 31, 2009 and 2008, the terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

<u>December 31, 2009</u>	<u><1 Year</u>	<u>1-<2 Years</u>	<u>>2-<3 Years</u>	<u>>3-<4 Years</u>	<u>>4-<5 Years</u>	<u>>5 Years</u>	<u>Total</u>
Fixed rate							
Philippine peso-denominated	P—	P—	P14,545	P—	P23,670	P2,810	P41,025
Interest rate			6.50% - 8.25%		7.25% - 8.875%	10.50%	
Floating rate							
Philippine peso-denominated	—	400	1,400	400	800	—	3,000
Interest rate		PDST-F for 3 months +margin	PDST-F for 3 months +margin	PDST-F for 3 months +margin	PDST-F for 3 months +margin		
Foreign currency-denominated (expressed in Philippine peso)	1,081	1,081	28,335	119	59	—	30,675
Interest rate	THBFIX, VNIBOR +margin; and discount from PBOC lending rate	THBFIX, VNIBOR +margin; and discount from PBOC lending rate	LIBOR, THBFIX, VNIBOR +margin	THBFIX +margin	THBFIX +margin		
							<u>P74,700</u>
<u>December 31, 2008</u>	<u><1 Year</u>	<u>1-<2 Years</u>	<u>>2-<3 Years</u>	<u>>3-<4 Years</u>	<u>>4-<5 Years</u>	<u>>5 Years</u>	<u>Total</u>
Fixed rate							
Philippine peso-denominated	P—	P—	P—	P955	P—	P1,270	P2,225
Interest rate				6.50%		7.25%	
Floating rate							
Foreign currency-denominated (expressed in Philippine peso)	9,233	17,411	17,391	3,751	117	59	47,962
Interest rate	LIBOR, THBFIX, VNIBOR +margin; and discount from PBOC lending rate	LIBOR, THBFIX, VNIBOR +margin; and discount from PBOC lending rate	LIBOR, THBFIX, VNIBOR +margin; and discount from PBOC lending rate	LIBOR, THBFIX, VNIBOR +margin	THBFIX +margin	THBFIX +margin	
							<u>P50,187</u>

Foreign Currency Risk

The Group's exposure to foreign currency risk results from significant movements in foreign exchange rates that adversely affect the foreign currency-denominated transactions of the Group. The Group's risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity. The Group enters into foreign currency hedges using a combination of non-

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derivative and derivative instruments such as foreign currency forwards or swaps to manage its foreign currency risk exposure.

Short-term currency forward contracts (deliverable and non-deliverable) are entered into to manage foreign currency risks arising from importations, revenue and expense transactions, and other foreign currency-denominated obligations. Currency swaps are entered into to manage foreign currency risks relating to long-term foreign currency-denominated borrowings.

Information on the Group's foreign currency-denominated monetary assets and liabilities and their Philippine peso equivalents are as follows:

	2009		2008	
	US Dollar	Peso Equivalent	US Dollar	Peso Equivalent
Assets				
Cash and cash equivalents	US\$2,817	₱130,134	US\$1,845	₱87,660
Trade and other receivables	96	4,413	88	4,159
Noncurrent receivables	101	4,656	118	5,616
	<u>3,014</u>	<u>139,203</u>	<u>2,051</u>	<u>97,435</u>
Liabilities				
Drafts and loans payable	137	6,332	191	9,077
Accounts payable and accrued expenses	98	4,528	102	4,853
Long-term debt (including current maturities) . . .	664	30,674	1,009	47,961
	<u>899</u>	<u>41,534</u>	<u>1,302</u>	<u>61,891</u>
Net foreign currency- denominated monetary assets	<u>US\$2,115</u>	<u>₱97,669</u>	<u>US\$ 749</u>	<u>₱35,544</u>

The Group reported net foreign exchange gains (losses) amounting to (₱2,256), (₱7,298) and ₱4,683 in 2009, 2008 and 2007, respectively, with the translation of its foreign currency-denominated assets and liabilities. These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

	Peso to US Dollar
December 31, 2007	41.28
December 31, 2008	47.52
December 31, 2009	46.20

The management of foreign currency risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various foreign currency exchange rate scenarios. Foreign exchange movements affect reported equity in the following ways:

- retained earnings arising from increases or decreases in unrealized and realized foreign exchange gains or losses;
- translation reserves arising from increases or decreases in foreign exchange gains or losses recognized directly as part of other comprehensive income; and
- hedging reserves arising from increases or decreases in foreign exchange gains or losses of the hedged item and the hedging instrument.

SAN MIGUEL CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) and the Group's equity (due to translation of results and financial position of foreign operations) as of December 31, 2009 and 2008:

	P1 Decrease in the US Dollar Exchange Rate		P1 Increase in the US Dollar Exchange Rate	
	Effect on Income Before Income Tax	Effect on Equity	Effect on Income Before Income Tax	Effect on Equity
2009				
Cash and cash equivalents	P(2,685)	P(1,743)	P2,685	P1,743
Trade and other receivables	(7)	(93)	7	93
Noncurrent receivables	(100)	(61)	100	61
	<u>(2,792)</u>	<u>(1,897)</u>	<u>2,792</u>	<u>1,897</u>
Drafts and loans payable	69	109	(69)	(109)
Accounts payable and accrued expenses	8	95	(8)	(95)
Long-term debt (including current maturities) . .	600	424	(600)	(424)
	<u>677</u>	<u>628</u>	<u>(677)</u>	<u>(628)</u>
	<u><u>P(2,115)</u></u>	<u><u>P(1,269)</u></u>	<u><u>P2,115</u></u>	<u><u>P1,269</u></u>

	P1 Decrease in the US Dollar Exchange Rate		P1 Increase in the US Dollar Exchange Rate	
	Effect on Income Before Income Tax	Effect on Equity	Effect on Income Before Income Tax	Effect on Equity
2008				
Cash and cash equivalents	P(1,623)	P(1,276)	P 1,623	P1,276
Trade and other receivables	(12)	(83)	12	83
Noncurrent receivables	(99)	(82)	99	82
	<u>(1,734)</u>	<u>(1,441)</u>	<u>1,734</u>	<u>1,441</u>
Drafts and loans payable	140	142	(140)	(142)
Accounts payable and accrued expenses	6	100	(6)	(100)
Long-term debt (including current maturities) . .	923	686	(923)	(686)
	<u>1,069</u>	<u>928</u>	<u>(1,069)</u>	<u>(928)</u>
	<u><u>P (665)</u></u>	<u><u>P (513)</u></u>	<u><u>P 665</u></u>	<u><u>P 513</u></u>

Commodity Price Risk

Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in market prices. The Group enters into various commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show marked-to-market losses; however, any loss in the marked-to-market position is offset by the resulting lower physical raw material cost.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Parent Company enters into commodity derivative transactions on behalf of its subsidiaries and affiliates to reduce cost by optimizing purchasing synergies within the Group and managing inventory levels of common materials.

Commodity Swaps, Futures and Options. Commodity swaps, futures and options are used to manage the Group's exposures to volatility in prices of certain commodities such as fuel oil, aluminum, soybean meal, wheat, kraft paper and freight.

Commodity Forwards. The Group enters into forward purchases of various commodities. The prices of the commodity forwards are fixed either through direct agreement with suppliers or by reference to a relevant commodity price index.

Liquidity Risk

Liquidity risk pertains to the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group's objectives to manage its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps or surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

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The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted payments used for liquidity management as of December 31, 2009 and 2008.

2009

	<u>Carrying Amount</u>	<u>Contractual Cash Flow</u>	<u>1 Year or Less</u>	<u>> 1 Year — 2 Years</u>	<u>>2 Years — 5 Years</u>	<u>Over 5 Years</u>
Financial Assets						
Cash and cash equivalents	P209,411	P209,411	P209,411	P —	P —	P —
Trade and other receivables — net	49,082	49,082	49,082	—	—	—
Derivative assets (included under “Prepaid expenses and other current assets” account in the consolidated statements of financial position)	202	202	202	—	—	—
AFS financial assets (included under “Investments and advances” account in the consolidated statements of financial position)	351	351	—	351	—	—
Noncurrent receivables and deposits — net (included under “Other noncurrent assets” account in the consolidated statements of financial position)	5,933	5,933	—	—	5,933	—
Financial Liabilities						
Drafts and loans payable	56,789	56,925	56,925	—	—	—
Accounts payable and accrued expenses (excluding current retirement liabilities)	30,721	30,721	30,721	—	—	—
Derivative liabilities (included under “Accounts payable and accrued expenses” account in the consolidated statements of financial position)	111	111	111	—	—	—
Long-term debt (including current maturities)	72,962	89,747	4,836	5,318	75,526	4,067
Other noncurrent liabilities (excluding noncurrent retirement liabilities)	19,410	19,410	—	7,817	11,593	—

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

2008

	<u>Carrying Amount</u>	<u>Contractual Cash Flow</u>	<u>1 Year or Less</u>	<u>> 1 Year - 2 years</u>	<u>>2 Years — 5 Years</u>	<u>Over 5 Years</u>
Financial Assets						
Cash and cash equivalents	₱116,939	₱116,939	₱116,939	₱ —	₱ —	₱ —
Trade and other receivables — net	50,814	50,814	50,814	—	—	—
Derivative assets (included under “Prepaid expenses and other current assets” and “Other noncurrent assets” accounts in the consolidated statements of financial position amounting to ₱190 and ₱1, respectively)	191	191	190	1	—	—
AFS financial assets (included under “Investments and advances” account in the consolidated statements of financial position)	590	590	—	590	—	—
Noncurrent receivables and deposits — net (included under “Other noncurrent assets” account in the consolidated statements of financial position)	7,439	7,439	—	—	7,439	—
Financial Liabilities						
Drafts and loans payable	48,560	48,790	48,790	—	—	—
Accounts payable and accrued expenses (excluding current retirement liabilities)	20,326	20,326	20,326	—	—	—
Derivative liabilities (included under “Accounts payable and accrued expenses” account in the consolidated statements of financial position)	2,353	2,353	2,353	—	—	—
Long-term debt (including current maturities)	49,763	53,241	10,151	18,402	23,127	1,561
Other noncurrent liabilities (excluding noncurrent retirement liabilities)	25,573	25,573	—	7,425	18,148	—

Credit Risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group’s trade receivables and investment securities. The Group also manages its credit risk mainly through the application of transaction limits and close risk monitoring. It is the Group’s policy to enter into transactions with a wide diversity of creditworthy counterparties to mitigate any significant concentration of credit risk.

The Group has regular internal control reviews to monitor the granting of credit and management of credit exposures. Goods are subject to retention of title clauses so that in the event of default, the Group would have a secured claim. Where appropriate, the Group obtains collateral or arranges master netting agreements.

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Trade and Other Receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on the credit risk.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The Group ensures that sales on account are made to customers with appropriate credit history. The Group has detailed credit criteria and several layers of credit approval requirements before engaging a particular customer or counterparty. The Group's review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer and are reviewed on a regular basis. Customers that fail to meet the Group's benchmark creditworthiness may transact with the Group only on a prepayment basis.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Investments

The Group recognizes provision for impairment losses based on specific and collective impairment tests, when objective evidence of impairment has been identified either on an individual account or on a portfolio level.

Financial information on the Group's maximum exposure to credit risk as of December 31, 2009 and 2008, without considering the effects of collaterals and other risk mitigation techniques, is presented below.

	<u>Note</u>	<u>2009</u>	<u>2008</u>
Cash and cash equivalents	7	₱209,411	₱116,939
Trade and other receivables — net	8	49,082	50,814
Derivative assets	36	202	191
AFS financial assets	10	351	590
Noncurrent receivables and deposits — net	15	5,933	7,439
		<u>₱264,979</u>	<u>₱175,973</u>

The Group has no significant concentration of credit risk with any counterparty.

Financial and Other Risks Relating to Livestock

The Group is exposed to financial risks arising from the change in cost and supply of feed ingredients and the selling prices of chicken, hogs and cattle and related products, all of which are determined by constantly changing market forces of supply and demand, and other factors. The other factors include environmental regulations, weather conditions and livestock diseases for which the Group has little control. The mitigating factors are listed below.

- The Group is subject to risks affecting the food industry, generally, including risks posed by food spoilage and contamination. Specifically, the fresh meat industry is regulated by environmental, health and food safety organizations and regulatory sanctions. The Group has put into place systems to

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monitor food safety risks throughout all stages of manufacturing and processing to mitigate these risks. Furthermore, representatives from the government regulatory agencies are present at all times during the processing of dressed chicken in all dressing plants and issue certificates accordingly. The authorities, however, may impose additional regulatory requirements that may require significant capital investment at short notice.

- The Group is subject to risks relating to its ability to maintain animal health status considering that it has no control over neighboring livestock farms. Livestock health problems could adversely impact production and consumer confidence. However, the Group monitors the health of its livestock on a daily basis and proper procedures are put in place.
- The livestock industry is exposed to risk associated with the supply and price of raw materials, mainly grain prices. Grain prices fluctuate depending on the harvest results. The shortage in the supply of grain will result in adverse fluctuation in the price of grain and will ultimately increase the Group's production cost. If necessary, the Group enters into forward contracts to secure the supply of raw materials at reasonable price.

Capital Management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize shareholder value.

The Group manages its capital structure and makes adjustments, in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, pay-off existing debts, return capital to shareholders or issue new shares.

The Group defines capital as paid-in capital stock, additional paid-in capital and retained earnings, both appropriated and unappropriated. Other components of equity such as treasury stock and cumulative translation adjustments are excluded from capital for purposes of capital management.

The BOD has overall responsibility for monitoring capital in proportion to risk. Profiles for capital ratios are set in the light of changes in the Group's external environment and the risks underlying the Group's business, operation and industry.

The Group monitors capital on the basis of debt-to-equity ratio, which is calculated as total debt divided by total equity. Total debt is defined as total current liabilities and total noncurrent liabilities, while equity is total equity as shown in the consolidated statements of financial position.

There were no changes in the Group's approach to capital management during the year.

The Group is not subject to externally imposed capital requirements.

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36. Financial Assets and Financial Liabilities

The table below presents a comparison by category of carrying amounts and fair values of the Group's financial instruments as of December 31, 2009 and 2008:

	2009		2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Cash and cash equivalents	P209,411	P209,411	P116,939	P116,939
Trade and other receivables — net	49,082	49,082	50,814	50,814
Derivative assets (included under “Prepaid expenses and other current assets” account in the consolidated statements of financial position amounting to P202 and P190 in 2009 and 2008, respectively, and “Other noncurrent assets” account in the consolidated statements of financial position amounting to P1 in 2008)	202	202	191	191
AFS financial assets (included under “Investments and advances” account in the consolidated statements of financial position)	351	351	590	590
Noncurrent receivables and deposits — net (included under “Other noncurrent assets” account in the consolidated statements of financial position)	5,933	5,933	7,439	7,439
Financial Liabilities				
Drafts and loans payable	56,789	56,789	48,560	48,560
Accounts payable and accrued expenses (excluding current retirement liabilities)	30,721	30,721	20,326	20,326
Derivative liabilities (included under “Accounts payable and accrued expenses” account in the consolidated statements of financial position) . . .	111	111	2,353	2,353
Long-term debt (including current maturities)	72,962	77,773	49,763	49,826
Other noncurrent liabilities (excluding noncurrent retirement liabilities)	19,410	17,871	25,573	22,087

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents, Trade and Other Receivables and Noncurrent Receivables and Deposits. The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of long-term receivables, the fair value is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

Derivatives. The fair values of forward exchange contracts are calculated by reference to current forward exchange rates. In the case of freestanding currency and commodity derivatives, the fair values are determined based on quoted prices obtained from their respective active markets. Fair values for stand-alone derivative instruments that are not quoted from an active market and for embedded derivatives are based on valuation models used for similar instruments using both observable and non-observable inputs.

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AFS Financial Assets. The fair values of publicly traded instruments and similar investments are based on quoted market prices in an active market. For debt instruments with no quoted market prices, a reasonable estimate of their fair values is calculated based on the expected cash flows from the instruments discounted using the applicable discount rates of comparable instruments quoted in active markets. Unquoted equity securities are carried at cost less impairment.

Drafts and Loans Payable and Accounts Payable and Accrued Expenses. The carrying amount of drafts and loans payable and accounts payable and accrued expenses approximates fair value due to the relatively short-term maturities of these financial instruments.

Long-term Debt and Other Noncurrent Liabilities. The fair value of interest-bearing fixed-rate loans is based on the discounted value of expected future cash flows using the applicable market rates for similar types of instruments as of reporting date. As of December 31, 2009 and 2008, discount rates used range from 4.3% to 8.0% and 5.7% to 6.9%, respectively. The carrying values of floating rate loans with quarterly interest rate repricing approximate their fair values.

Derivative Financial Instruments

The Group's derivative financial instruments according to the type of financial risk being managed and the details of freestanding and embedded derivative financial instruments that are categorized into those accounted for as hedges and those that are not designated as hedges are discussed below.

The Group enters into various commodity derivative contracts to manage its exposure on commodity price risk. The portfolio is a mixture of instruments including forwards, swaps and options covering the Group's requirements on fuel oil, aluminum and wheat.

Derivative Instruments Accounted for as Hedges

Cash Flow Hedges

Commodity Options

As of December 31, 2008, the Group has outstanding bought and sold options designated as hedge of forecasted purchases of fuel oil with a notional quantity of 12,000 metric tons. The call and put options can be exercised at various calculation dates in 2009 with specified quantities on each calculation date. The net unrealized fair value change (after tax) reported in equity and the amount charged to profit and loss on these call and put options as of December 31, 2008 amounted to ₱123 and ₱9, respectively.

As of December 31, 2009, the Group has no outstanding options designated as hedge on the purchase of commodity. However, the amount charged to profit and loss in 2009 amounted to ₱159.

These option contracts were used to hedge the commodity price risk of the Group's commitments. There was no ineffective portion on these hedges.

Other Derivative Instruments Not Designated as Hedges

The Group enters into certain derivatives as economic hedges of certain underlying exposures. These include freestanding and embedded derivatives found in host contracts, which are not designated as accounting hedges. Changes in fair value of these instruments are accounted for directly in the 2009 and 2008 consolidated statements of income. Details are as follows:

Freestanding Derivatives

Freestanding derivatives consist of commodity derivatives and currency derivatives entered into by the Group.

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Short-term Currency Swaps

As of December 31, 2008, the Group has outstanding short-term currency swap agreements with an aggregate notional amount of US\$881. The net negative fair value of these currency swaps amounted to ₱905 as of December 31, 2008. These swaps matured in 2009.

As of December 31, 2009, the Group has no outstanding short-term currency swap agreements.

Commodity Swaps

The Group has outstanding swap agreements covering its aluminum requirements, with various maturities in 2009, 2010 and 2011. Under the agreement, payment is made either by the Group or its counterparty for the difference between the agreed fixed price of aluminum and the price based on the relevant price index. The outstanding equivalent notional quantity covered by the commodity swaps as of December 31, 2009 and 2008 is 1,875 and 450 metric tons, respectively. As of December 31, 2009 and 2008, the positive (negative) fair value of these swaps amounted to ₱60 and (₱19), respectively.

Commodity Options

As of December 31, 2008, the Group has outstanding bought and sold options covering its fuel oil requirements with notional quantity of 58,800 metric tons. These options have monthly maturities in 2009 with specified quantities on each maturity date. The net negative fair value of these options as of December 31, 2008 amounted to ₱920. As of December 31, 2009, there were no outstanding options on the purchase of fuel oil.

The Group has outstanding bought and sold options covering its wheat requirements with notional quantities as of December 31, 2009 and 2008 of 59,874 and 34,292 metric tons, respectively. These options can be exercised at various calculation dates in 2009 and 2010 with specified quantities on each calculation date. As of December 31, 2009 and 2008, the net negative fair value of these options amounted to ₱6 and ₱94, respectively.

Embedded Derivatives

The Group's embedded derivatives include currency derivatives (forwards and options) embedded in non-financial contracts.

Embedded Currency Forwards

As of December 31, 2009 and 2008, the total outstanding notional amount of currency forwards embedded in non-financial contracts amounted to US\$112 and US\$73, respectively. These non-financial contracts consist mainly of foreign currency- denominated purchase orders, sales agreements and capital expenditures. The embedded forwards are not clearly and closely related to their respective host contracts. As of December 31, 2009 and 2008, the net positive (negative) fair value of these embedded currency forwards amounted to ₱73 and (₱26), respectively.

Embedded Currency Options

As of December 31, 2009 and 2008, the total outstanding notional amount of currency options embedded in non-financial contracts amounted to US\$36 and US\$15, respectively. These non-financial contracts consist mainly of sales agreements. These embedded options are not clearly and closely related to their host contracts. As of December 31, 2009 and 2008, the net positive (negative) fair value of these embedded currency options amounted to (₱36) and ₱10, respectively.

For the years ended December 31, 2009, 2008 and 2007, the Group recognized marked-to-market gains (losses) from freestanding and embedded derivatives amounting to ₱962, (₱10,718) and (₱1,726), respectively.

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Fair Value Changes on Derivatives

The net movements in fair value of all derivative instruments for the years ended December 31, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	P(2,162)	P 29
Net changes in fair value of derivatives:		
Designated as accounting hedges	77	(245)
Non-accounting hedges	<u>914</u>	<u>(10,832)</u>
	(1,171)	(11,048)
Less fair value of settled instruments	<u>(1,262)</u>	<u>(8,886)</u>
Balance at end of year	<u>P 91</u>	<u>P (2,162)</u>

Hedge Effectiveness Results

The effective fair value changes, net of tax, on the Group's cash flow hedges that were deferred in equity as of December 31, 2008 amounted to P123. As of December 31, 2009, the Group has no outstanding derivatives designated as hedge.

Fair Value Hierarchy

The table below analyzes financial instruments carried at fair value, by valuation method as of December 31, 2009. The different levels have been defined as follows:

- *Level 1:* quoted prices (unadjusted) in active markets for identical assets or liabilities.
- *Level 2:* inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- *Level 3:* inputs for the asset or liability that are not based on observable market data.

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Financial Assets			
Derivative assets	P65	P137	P202
AFS financial assets	—	351	351
Financial Liabilities			
Derivative liabilities	11	100	111

As of December 31, 2009, the Group has no financial instruments valued based on Level 3. During the year, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

37. Events After the Reporting Date

a. Investment in Top Frontier Holdings, Inc. (Top Frontier)

On January 6, 2010, the Parent Company's BOD approved an investment in Top Frontier through the acquisition of a 49% stake via equity infusion. Said investment consists of the Parent Company's:

(i) subscription of 2,401,960 common shares of Top Frontier from its unissued capital stock; (ii) deposit for future subscription amounting to P48,324, with the option granted to the Parent Company to convert the same to non-voting, redeemable, participating preferred shares upon the amendment by Top Frontier of its Articles of Incorporation and Top Frontier's compliance of its obligations related to the aforementioned investment. As of April 14, 2010, no such conversion has been effected.

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b. SMPFC

On February 2, 2010, the Parent Company's BOD approved the following corporate actions:

- Sale to SMPFIL, a wholly-owned subsidiary of SMPFC, of the Parent Company's 51% interest in SMPFI at book value.
- Potential subscription of up to ₱5,200 worth of new SMPFC shares.
- Sale of the Parent Company's food-related brands and intellectual property rights to SMPFC at a purchase price of ₱3,200.
- Sale of up to 40% of the Parent Company's interest in SMPFC, by way of a trade sale or marketed placements to investors, which may include investors outside the United States (Reg S) or and to not more than 19 non-qualified buyers domestically to be determined by Management.

On February 2, 2010, the BOD of SMPFC approved the proposal of SMPFC management to a) purchase food-related brands and intellectual property rights from the Parent Company at a purchase price of ₱3,200, and b) acquire, through SMPFIL, a BVI company and a wholly-owned subsidiary of SMPFC, the Parent Company's 51% interest, through SMFBIL, in SMPFI at book value. SMPFI owns 100% of SMPFVN.

On February 2, 2010 and March 12, 2010, SMPFC's stockholders approved, among others, the following corporate actions, subject to the necessary approvals of the SEC:

- Potential issuance of up to 75,000,000 new SMPFC shares to the Parent Company or third parties.
- Amendment of Amended Articles of Incorporation of SMPFC to reflect the following:
 - i. de-classification of SMPFC's common shares;
 - ii. increase in SMPFC's authorized capital stock by ₱1,000 or 100,000,000 shares at ₱10.00 par value; and
 - iii. denial of Pre-emptive rights to the proposed issuance of shares of up to 75,000,000 new SMPFC shares to the Parent Company or third parties.
- Declaration of 18% stock dividend based on the issued and outstanding shares to be taken out of the proposed increase in authorized capital stock.

c. Investment in Universal LRT Corporation (BVI) Limited (ULC) and ULCOM Company, Inc. (ULCOM)

The Parent Company has been offered a majority stake in ULC and ULCOM. ULC is the company undertaking the Metro Rail Transit System — Line 7 Project (MRT 7 Project), while ULCOM is the entity designated by ULC to operate and maintain the MRT 7 Project. The MRT 7 Project involves the development, financing, operation and maintenance of an integrated transportation system consisting of: (i) a 22-kilometer rail transit system which shall be built from the North Avenue Station in EDSA to San Jose del Monte, Bulacan; (ii) an Intermodal Transportation Terminal (ITT); and (iii) a 22-kilometer, 6-lane highway from the Bocaue interchange of the North Luzon Expressway to the ITT.

d. Investment in Daguma-Agro Minerals Inc. (Daguma)

On January 28, 2010, SMEC acquired 100% of the outstanding capital stock of Daguma, a coal mining company with coal property located at Lake Sebu, South Cotabato, consisting of 2 coal blocks with a total area of 2,000 hectares covered by a Coal Operating Contract with the Department of Energy.

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e. Investment in Caticlan International Airport Development Corp. (CIADC)

On April 8, 2010, the Parent Company, through its wholly-owned subsidiary, SMHC, executed a share sale purchase agreement with the consortium of certain individuals and a corporation (the “Agreement”). Under the terms of the Agreement, SMHC shall acquire, initially, a majority interest in CIADC. CIADC holds the exclusive rights, obligations and privileges to finance, design, construct, operate and maintain the Caticlan Airport by virtue of the Concession Agreement, dated June 22, 2009, with the Republic of the Philippines, through the Department of Transportation and Communications and the Civil Aviation Authority.

38. Other Matters

a. 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.

On April 12, 2004 and May 26, 2004, the Parent Company was assessed by the BIR for deficiency excise tax on one of its beer products. The Parent Company contested the assessments before the Court of Tax Appeals (CTA) under CTA case numbers 7052 and 7053. In the opinion of management and its legal counsel, the Parent Company has strong legal grounds to contest the assessments.

In relation to the aforesaid contested assessments, the Parent Company, on January 31, 2006, filed with the CTA, under CTA case number 7405, a claim for refund of taxes paid in excess of what it believes to be the excise tax rate applicable to it. An independent Certified Public Accountant (CPA) commissioned by the CTA to conduct an examination, verification and audit to validate the documents supporting the claim for refund has submitted a report stating, among other things, that the claim is properly supported by the relevant documents.

On November 27, 2007, the Parent Company filed with the CTA, under CTA case number 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. An independent CPA was likewise commissioned by the CTA in this case for the purpose of conducting an examination, verification and audit of the documents supporting the aforesaid claim. In a report recently submitted to the CTA, the independent CPA stated that the second claim is properly supported by the relevant documents. This case is now deemed submitted for decision by the CTA.

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 numbers 7052 and 7053 “in order to obviate the necessity of issuing a Warrant of Dstraint 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 Dstraint and Garnishment and/or Levy against the Parent Company, especially in view of the Parent Company’s pending claims for refund. As of April 14, 2010, 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, under CTA case number 7953, also in relation to the contested assessments. This case is now undergoing pre-trial.

b. Restructuring Plan

At the annual stockholders’ meeting held on July 24, 2008, the stockholders authorized (i) the Parent Company to pursue and implement a corporate restructuring plan which may require, among others, the divestment of the Parent Company’s interest in its major subsidiaries, such as beer, food and packaging

SAN MIGUEL CORPORATION AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

subsidiaries, with the Parent Company retaining controlling interests/ownership of at least 51% in each of these major subsidiaries, and (ii) the BOD to approve the implementing transactions of such corporate restructuring plan after evaluation and study by Management, subject to applicable laws.

c. Top Frontier

On November 27, 2009, Top Frontier acquired 857,115,914 common shares of the issued and outstanding common shares of the Parent Company from SMCPR at ₱75.00 per share for a total of ₱64,284. In addition, Top Frontier plans to acquire the 327,000,000 common Class “B” shares of the Parent Company held by Q-Tech Alliance Holdings, Inc. (“Q-Tech”) and an option over the 301,666,000 common shares. The purchase will raise Top Frontier’s current equity ownership interest beyond the 35% threshold under tender offer rules.

Top Frontier offered to buy 235,141,533 Class “A” and 85,797,844 Class “B” common shares of the Parent Company at the price of seventy five pesos (₱75.00) per share. The tender offer period was from March 10 and expired at 12:00 pm of April 8, 2010. Out of the total Tender Offer shares, a total of 47,700,679 Class “A” shares and 31,759,499 Class “B” shares were tendered by the Parent Company’s shareholders and accepted for purchase by Top Frontier. At the offer price of ₱75.00 per share, the total consideration of the shares tendered amounted to ₱5,959, inclusive of taxes, brokers’ commissions and other fees. On April 13, 2010, Top Frontier acquired 327,000,000 common Class “B” shares of the Parent Company held by Q-Tech at the price of ₱66.00 per share. The tendered shares and the 327,000,000 common Class “B” shares were crossed in the PSE on April 13, 2010. As of April 14, 2010, Top Frontier had a total shareholdings of 1,263,576,092 common shares of the Parent Company.

d. Commitments

The outstanding purchase commitments of the Group as of December 31, 2009 amounted to ₱13,468.

Amount authorized but not yet disbursed for capital projects as of December 31, 2009 is approximately ₱4,251.

e. Foreign Exchange Rates

The foreign exchange rates used in translating the US dollar accounts of foreign subsidiaries and associates to Philippine peso were closing rates of ₱46.20 in 2009 and ₱47.52 in 2008 for statement of financial position accounts; and average rates of ₱47.64 in 2009, ₱44.47 in 2008 and ₱46.18 in 2007 for income and expense accounts.

f. Option Agreement with Sea Refinery Holdings B.V. (SEA BV)

On December 24, 2008, the Parent Company entered into an option agreement with SEA BV pursuant to which SEA BV granted to the Parent Company an option to acquire and purchase up to 100% of its interests in SEA BV’s wholly-owned subsidiary, SEA Refinery Corporation (SRC), consisting of 40,000,000 shares of stock with a par value of ₱1.00 per share (Option Shares). SRC owns 50.1% stake in Philippine oil refinery, Petron Corporation. The option may be exercised by the Parent Company within a period of two (2) years from December 24, 2008. The exercise price for the Option Shares will be the sum of (a) the paid-up capital of SEA BV in SRC amounting to ₱40 and (b) the value of the shares acquired by SRC in Petron Corporation plus the assumption of, if any, liability or obligation and expenses incurred by SRC for the acquisition of the said shares. The Parent Company and SEA BV have agreed that during the option period the Parent Company shall have representation in the board and management of Petron Corporation. As of April 14, 2010, the Parent Company has not yet exercised the Option Shares.

SAN MIGUEL CORPORATION
CONSOLIDATED PRO FORMA FINANCIAL INFORMATION
FOR THE YEAR ENDED DECEMBER 31, 2010

SMC's consolidated pro forma financial information presented below as of and for the year ended December 31, 2010 was prepared by SMC. The information presented below should be read in conjunction with the assumptions set forth below. See "Management's discussion and analysis of financial condition and results of operations" and the consolidated financial information included elsewhere in this Offering Circular for more detailed information regarding the acquisitions underlying the financial information presented below.

For the Year Ended December 31, 2010					
	Actual	SRC and Petron from January 1 to December 14, 2010	SMCGP from January 1 to July 31, 2010	Other Pro forma adjustments	Pro forma Combined
(In millions, except per share data)					
Sales	₱246,109	₱208,199 ⁽¹⁾	₱20,301 ⁽²⁾	—	₱474,609
Cost of sales	173,906	189,612 ⁽¹⁾	13,576 ⁽²⁾	—	377,094
Gross profit	72,203	18,587	6,725	—	97,515
Selling and administrative expenses . . .	(37,426)	(6,825) ⁽¹⁾	(114) ⁽²⁾	—	(44,365)
Interest expense and other financing charges	(16,578)	(4,803) ⁽¹⁾	(4,559) ⁽²⁾	846 ⁽³⁾	(25,094)
Interest income	3,023	739 ⁽¹⁾	23 ⁽²⁾	(1,928) ⁽⁴⁾	1,857
Equity in net earnings of associates . . .	6,817	(151) ⁽¹⁾	—	(4,596) ⁽⁵⁾	2,070
Gain on sale of investments and property and equipment	529	(8) ⁽¹⁾	—	—	521
Other income (charges) — net	6,926	1,620 ⁽¹⁾	7,421 ⁽²⁾	(3,832) ^(6,7)	12,135
Income before income tax	35,494	9,159	9,496	(9,510)	44,639
Income tax expense (benefit)	11,438	2,160 ⁽¹⁾	(367) ⁽²⁾	(132) ⁽⁸⁾	13,099
Net income	<u>₱ 24,056</u>	<u>₱ 6,999</u>	<u>₱ 9,863</u>	<u>₱ (9,378)</u>	<u>₱ 31,540</u>
Net income attributable to :					
equity holders of SMC.	20,091	7,071	9,376	(11,446)	25,092
Non-controlling interests	3,965	(72) ⁽¹⁾	487 ⁽²⁾	2,068 ^(9,10)	6,448
	<u>₱ 24,056</u>	<u>₱ 6,999</u>	<u>₱ 9,863</u>	<u>₱ (9,378)</u>	<u>₱ 31,540</u>
Basic Earnings Per share	<u>₱ 6.18</u>	<u>₱ 3.06</u>	<u>₱ 4.06</u>	<u>₱ (4.95)</u>	<u>₱ 8.34</u>
Adjusted EBITDA ⁽¹¹⁾	<u>₱ 52,536</u>	<u>₱ 15,037</u>	<u>₱14,821</u>	<u>—</u>	<u>₱ 71,646</u>

⁽¹⁾ Represents the results of SRC and Petron from January 1 to December 14, 2010.

⁽²⁾ Represents results of SMCGP and its subsidiaries SMEC and SPDC from January 1 to July 31, 2010.

⁽³⁾ Represents adjustment in interest expense of SRC assuming that SRC used a portion of the amount advanced by SMC to pay off SRC's loans payable as of January 1, 2010.

⁽⁴⁾ Represents reduction in interest income assuming:

- a. SMC used ₱50,277 million in cash on January 1, 2010 in connection with the acquisition of SRC and Petron and that such cash would have generated interest totalling ₱1,807 million, computed at the prevailing market interest rate for the relevant period.
- b. SMC had used ₱4,320 million in cash on January 1, 2010 in connection with the acquisition of SMCGP and that such cash would have generated interest totalling ₱121 million, computed at the prevailing market interest rate for the relevant period.

⁽⁵⁾ Adjustments in equity in net earnings of associates:

- a. Represents reversal of SMC's share in net income of Petron for the period commencing June 15 and ending December 15, 2010 totalling ₱1,599 million, assuming SMC acquired SRC and Petron on January 1, 2010.

SAN MIGUEL CORPORATION

- b. Represents reversal of SMC's 40% share in the net income of SMEC and SPDC for the period commencing January 1 and ending September 30, 2010 totalling ₱3,361 million, assuming SMC acquired 100% equity interests in SMCGRP on January 1, 2010.
- c. Represents adjustment in SMCGRP's 6.2% share in the net income of Meralco for the period commencing January 1 and ending July 31, 2010 totalling ₱364 million, assuming that the investment in shares of Meralco was classified as investment in associates from January 1, 2010.
- ⁽⁶⁾ Represents reversal of SMCGRP's (i) dividend income of ₱390 million from Meralco and (ii) unrealized fair value gain of ₱5,762 million from its investment in shares of Meralco, assuming that such investment was classified as investment in associates from January 1, 2010.
- ⁽⁷⁾ Adjustment for acquisition of SMCGRP at less than book value, assuming the acquisition occurred on January 1, 2010.
- ⁽⁸⁾ Assumes adjustments for (i) interest income in connection with the acquisition of SMCGRP, SRC and Petron were subject to the Philippine stock transaction tax rate of 0.5% and (ii) the reversal in interest expense and other financing charges in connection with the acquisition of SRC and Petron were subject to the Philippine statutory income tax rate of 30.0%.
- ⁽⁹⁾ Represents reversal of Non-controlling Interests (i) for SMC's 40.0% share in the net income of SMEC and SPDC for the period commencing January 1 and ending Sept 30, 2010 totalling ₱487 million and (ii) for the 25.0% share of other shareholders in the net loss of SMCGRP for the month of August 2010 totalling ₱49 million, assuming SMC acquired SMCGRP on January 1, 2010.
- ⁽¹⁰⁾ Represents the net income attributable to the 31.74% interest held by Non-controlling Interests in Petron for the period commencing January 1 and ending December 14, 2010 totalling ₱2,506, assuming SMC acquired SRC and Petron on January 1, 2010.
- ⁽¹¹⁾ Adjusted EBITDA is a measure used by SMC's management to internally evaluate the performance of its business. Adjusted EBITDA is calculated as net income plus the following: income tax expense, net financing charges (interest income net of interest expense), gain on sale of investments, other income (charges), foreign exchange losses (gains), marked-to-market losses (gains), plus depreciation and amortization and impairment losses. Adjusted EBITDA is not a measure determined in accordance with PFRS, and prospective investors should not consider Adjusted EBITDA as an alternative to net income as a measure of operating performance or to cash flow as a measure of free cash flow for management's discretionary use, as it does not reflect certain cash requirements such as interest payments, tax payments and capital expenditures. SMC's calculation of Adjusted EBITDA may be different from the calculations used by other companies, and, as a result, SMC's Adjusted EBITDA may not be comparable to other similarly titled measures of other companies.

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