

**Maynilad Water Services, Inc.
and Subsidiaries**
*(A Subsidiary of Maynilad Water Holding
Company, Inc.)*

Consolidated Financial Statements
December 31, 2016 and 2015
And Years Ended December 31, 2016,
2015 and 2014

and

Independent Auditor's Report



INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
Maynilad Water Services, Inc.

Opinion

We have audited the consolidated financial statements of Maynilad Water Services, Inc. and Subsidiaries (the Group), a subsidiary of Maynilad Water Holding Company, Inc., which comprise the consolidated statements of financial position as at December 31, 2016 and 2015, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

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

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report for the year ended December 31, 2016, but does not include the consolidated financial statements and our auditor's report thereon. The Annual Report for the year ended December 31, 2016 is expected to be made available to us after the date of this auditor's report.

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

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



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

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

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

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

Auditors' Responsibilities for the Audit of the Financial Statements

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

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

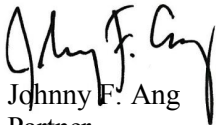
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.



- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

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

SYCIP GORRES VELAYO & CO.



Johnny F. Ang
Partner

CPA Certificate No. 0108257

SEC Accreditation No. 1284-AR-1 (Group A),
June 9, 2016, valid until June 9, 2019

Tax Identification No. 221-717-423

BIR Accreditation No. 08-001998-101-2015,
November 25, 2015, valid until November 24, 2018

PTR No. 5908662, January 3, 2017, Makati City

February 27, 2017



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES
(A Subsidiary of Maynilad Water Holding Company, Inc.)

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Amounts in Thousands)

	December 31	
	2016	2015
ASSETS		
Current Assets		
Cash and cash equivalents (Notes 4, 24 and 25)	₱5,024,754	₱3,093,012
Short-term investments (Notes 4, 24 and 25)	3,041,000	6,088,541
Trade and other receivables (Notes 5, 24 and 25)	2,492,645	2,428,812
Other current assets (Notes 6, 10, 24 and 25)	3,470,767	3,216,752
Total Current Assets	14,029,166	14,827,117
Noncurrent Assets		
Service concession assets (Notes 7, 10, 12, 14 and 22)	69,297,460	62,488,321
Deferred tax assets - net (Notes 15 and 20)	1,032,194	2,139,574
Property and equipment (Note 8)	1,254,339	833,821
Goodwill (Note 2)	288,082	288,082
Available-for-sale financial assets (Notes 9, 24 and 25)	132,387	132,387
Other noncurrent assets (Notes 2, 5, 24 and 25)	1,145,282	643,548
Total Noncurrent Assets	73,149,744	66,525,733
	₱87,178,910	₱81,352,850
LIABILITIES AND EQUITY		
Current Liabilities		
Trade and other payables (Notes 11, 14, 16, 23, 24 and 25)	10,892,909	11,327,222
Current portion of interest-bearing loans (Notes 7, 10, 24 and 25)	₱1,808,101	₱1,742,164
Current portion of service concession obligation payable to MWSS (Notes 7, 12, 24 and 25)	1,328,978	1,357,705
Total Current Liabilities	14,029,988	14,427,091
Noncurrent Liabilities		
Interest-bearing loans - net of current portion (Notes 7, 10, 24 and 25)	24,879,755	23,337,175
Service concession obligation payable to MWSS - net of current portion (Notes 7, 12, 24 and 25)	6,500,131	6,737,157
Deferred credits (Notes 2, 7, 24 and 25)	631,975	583,643
Customers' deposits (Notes 2, 24 and 25)	279,363	244,434
Pension liability (Note 16)	317,329	416,234
Deferred tax liabilities - net (Notes 15 and 20)	28,885	-
Other noncurrent liabilities (Note 16)	249,830	68,461
Total Noncurrent Liabilities	32,887,268	31,387,104
Total Liabilities <i>(Carried Forward)</i>	46,917,256	45,814,195



	December 31	
	2016	2015
Total Liabilities (<i>Carried Forward</i>)	₱46,917,256	₱45,814,195
Equity		
Capital stock (Notes 1 and 13)	4,546,982	4,546,982
Additional paid-in capital (Note 13)	10,021,200	9,979,786
Treasury shares (Note 13)	(32,672)	(104,654)
Other comprehensive income (Notes 9 and 16)	34,718	27,219
Other equity adjustments (Note 13)	(309,220)	(163,152)
Retained earnings (Note 13)		
Unappropriated	14,500,646	13,752,474
Appropriated	11,500,000	7,500,000
Total Equity	40,261,654	35,538,655
	₱87,178,910	₱81,352,850

See accompanying Notes to Consolidated Financial Statements.



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES
(A Subsidiary of Maynilad Water Holding Company, Inc.)

CONSOLIDATED STATEMENTS OF INCOME
(Amounts in Thousands, Except Earnings per Share Value)

	Years Ended December 31		
	2016	2015	2014
OPERATING REVENUE			
Water services:			
West zone	₱16,116,765	₱15,161,712	₱14,509,367
Outside west zone	194,622	173,937	134,930
Sewer services -			
West zone	3,508,118	3,367,186	3,294,000
Others	404,241	395,402	424,378
	20,223,746	19,098,237	18,362,675
COSTS AND EXPENSES			
Amortization of service concession assets (Note 7)	2,343,969	2,037,684	1,804,448
Salaries, wages and benefits (Notes 13, 14 and 16)	2,004,436	1,847,947	2,029,042
Contracted services	946,240	913,880	819,463
Utilities	877,986	831,853	846,894
Repairs and maintenance	515,011	388,703	495,833
Depreciation and amortization (Note 8)	291,491	260,174	256,745
Materials and supplies	283,014	223,597	183,370
Taxes and licenses	214,383	189,184	168,791
Rental (Notes 22 and 23)	143,736	150,624	167,654
Collection charges	136,201	137,113	122,050
Business meetings and representations	125,835	95,834	82,147
Regulatory costs	101,200	94,344	71,431
Transportation and travel	98,434	122,587	185,013
Provision (reversal of provision) for doubtful accounts (Note 5)	(76,852)	(231,978)	358
Advertising and promotion	58,699	52,450	40,867
Insurance	51,603	43,541	42,990
Others	257,711	87,947	97,413
	8,373,097	7,245,484	7,414,509
INCOME BEFORE OTHER INCOME (EXPENSES)	11,850,649	11,852,753	10,948,166
OTHER INCOME (EXPENSES)			
Revenue from rehabilitation works (Note 7)	8,951,700	7,728,506	4,162,174
Cost of rehabilitation works	(8,951,700)	(7,728,506)	(3,993,120)
Interest expense and other financing charges (Note 17)	(1,810,575)	(1,983,288)	(2,163,476)
Interest income (Note 4)	119,919	134,894	81,283
Net foreign exchange losses (Note 2)	(510,811)	(152,683)	(112,619)
Foreign currency differential adjustments (FCDA) (Note 2)	510,644	200,344	110,012
Others - net (Notes 9, 10 and 11)	(161,289)	(434,096)	(807,802)
	(1,852,112)	(2,234,829)	(2,723,548)
INCOME BEFORE INCOME TAX	9,998,537	9,617,924	8,224,618
PROVISION FOR (BENEFIT FROM) INCOME TAX			
(Notes 15 and 20)			
Current	2,117,314	46,142	62,737
Deferred	1,133,051	21,155	(93,407)
	3,250,365	67,297	(30,670)
NET INCOME	₱6,748,172	₱9,550,627	₱8,255,288
Basic Earnings Per Share (Note 18)	₱1,522.22	₱2,152.51	₱1,850.78
Diluted Earnings Per Share (Note 18)	₱1,522.22	₱2,151.55	₱1,850.78

See accompanying Notes to Consolidated Financial Statements.



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES
(A Subsidiary of Maynilad Water Holding Company, Inc.)

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in Thousands)

	Years Ended December 31		
	2016	2015	2014
NET INCOME	₱6,748,172	₱9,550,627	₱8,255,288
OTHER COMPREHENSIVE INCOME (LOSS)			
Other comprehensive income (loss) not to be reclassified to profit or loss in subsequent period (Note 16):			
Remeasurement gain (loss) on retirement plans	10,713	(40,953)	18,917
Income tax effect	(3,214)	-	(5,675)
Other comprehensive income to be reclassified to profit or loss in subsequent period (Note 9) -			
Reversal of impairment loss on available-for-sale financial assets	-	22,010	-
	7,499	(18,943)	13,242
TOTAL COMPREHENSIVE INCOME	₱6,755,671	₱9,531,684	₱8,268,530

See accompanying Notes to Consolidated Financial Statements.



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES

(A Subsidiary of Maynilad Water Holding Company, Inc.)

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014

(Amounts in Thousands)

	Capital Stock (Notes 1 and 13)	Additional Paid-in Capital (Note 13)	Treasury Shares (Note 13)	Other Comprehensive Income (Loss) (Notes 9 and 16)	Other Equity Adjustments (Note 13)	Retained Earnings (Note 13)		Total
						Unappropriated	Appropriated	
At December 31, 2015	₱4,546,982	₱9,979,786	(₱104,654)	₱27,219	(₱163,152)	₱13,752,474	₱7,500,000	₱35,538,655
Total comprehensive income for the year	–	–	–	7,499	–	6,748,172	–	6,755,671
Issuance of ESOP shares (Note 13)	–	41,414	104,654	–	(146,068)	–	–	–
Treasury shares (Note 13)	–	–	(32,672)	–	–	–	–	(32,672)
Reversal of appropriation (Note 13)	–	–	–	–	–	4,000,000	(4,000,000)	–
Appropriation for capital expenditures (Note 13)	–	–	–	–	–	(5,000,000)	5,000,000	–
Appropriation for dividends (Notes 13 and 27)	–	–	–	–	–	(3,000,000)	3,000,000	–
Dividends declared (Note 13)	–	–	–	–	–	(2,000,000)	–	(2,000,000)
At December 31, 2016	₱4,546,982	₱10,021,200	(₱32,672)	₱34,718	(₱309,220)	₱14,500,646	₱11,500,000	₱40,261,654
At December 31, 2014	₱4,546,982	₱9,979,786	(₱98,526)	₱46,162	(₱309,220)	₱9,701,847	₱4,000,000	₱27,867,031
Total comprehensive income for the year	–	–	–	(18,943)	–	9,550,627	–	9,531,684
Treasury shares (Note 13)	–	–	(6,128)	–	–	–	–	(6,128)
Cost of share-based payments (Note 13)	–	–	–	–	146,068	–	–	146,068
Appropriation for capital expenditures (Note 13)	–	–	–	–	–	(3,500,000)	3,500,000	–
Dividends declared (Note 13)	–	–	–	–	–	(2,000,000)	–	(2,000,000)
At December 31, 2015	₱4,546,982	₱9,979,786	(₱104,654)	₱27,219	(₱163,152)	₱13,752,474	₱7,500,000	₱35,538,655



	Capital Stock (Notes 1 and 13)	Additional Paid-in Capital (Note 13)	Treasury Shares (Note 13)	Other Comprehensive Income (Loss) (Notes 9 and 16)	Other Equity Adjustments (Note 13)	Retained Earnings (Note 13)		Total
						Unappropriated	Appropriated	
At December 31, 2013	₱4,546,982	₱9,979,786	(₱4,110)	₱32,920	(₱309,220)	₱2,446,559	₱4,000,000	₱20,692,917
Total comprehensive income for the year	–	–	–	13,242	–	8,255,288	–	8,268,530
Treasury shares (Note 13)	–	–	(94,416)	–	–	–	–	(94,416)
Dividends declared (Note 13)	–	–	–	–	–	(1,000,000)	–	(1,000,000)
At December 31, 2014	₱4,546,982	₱9,979,786	(₱98,526)	₱46,162	(₱309,220)	₱9,701,847	₱4,000,000	₱27,867,031

See accompanying Notes to Consolidated Financial Statements.



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES
(A Subsidiary of Maynilad Water Holding Company, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in Thousands)

	Years Ended December 31		
	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	₱9,998,537	₱9,617,924	₱8,224,618
Adjustments for:			
Amortization of service concession assets (Note 7)	2,343,969	2,037,684	1,804,448
Interest expense and other financing charges (Note 17)	1,810,575	1,983,288	2,163,476
Depreciation and amortization (Note 8)	291,491	260,174	256,745
Interest income (Note 4)	(119,919)	(134,894)	(81,283)
Pension cost (income) (Note 16)	104,049	93,448	(155,111)
Gain on sale of property and equipment	(13,252)	(232)	(3,053)
Dividend income (Note 9)	(10,000)	(14,473)	–
Unrealized foreign exchange gains - net	(7,628)	(6,863)	(158)
Cost of share-based payments (Note 13)	–	146,068	–
Impairment loss on available-for-sale financial assets (Note 9)	–	–	100,207
Operating income before working capital changes	14,397,822	13,982,124	12,309,889
Decrease (increase) in:			
Short-term investments	3,047,541	(3,173,541)	712,000
Trade and other receivables	8,495	(295,136)	(247,488)
Other current assets	(254,015)	(572,121)	(281,749)
Additions to service concession assets (Note 7)	(9,060,721)	(7,732,006)	(4,170,046)
Increase (decrease) in trade and other payables	(569,848)	472,690	(1,696,858)
Cash generated from operations	7,569,274	2,682,010	6,625,748
Interest received	130,726	118,805	76,938
Income taxes paid	(1,654,232)	(46,467)	(65,245)
Net cash provided by operating activities	6,045,768	2,754,348	6,637,441
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisitions of property and equipment (Note 8)	(714,958)	(286,317)	(526,192)
Increase in other noncurrent assets	(99,964)	(13,815)	(50,837)
Proceeds from sale of property and equipment	16,201	2,272	11,054
Dividends received (Note 9)	10,000	14,473	–
Cash paid on acquisition of a subsidiary (Note 11)	–	(29,592)	(65,972)
Net cash used in investing activities	(788,721)	(312,979)	(631,947)
CASH FLOWS FROM FINANCING ACTIVITIES			
Payments of:			
Dividends (Note 13)	(1,999,620)	(1,999,991)	(1,000,135)
Interest-bearing loans (Note 10)	(1,742,164)	(1,692,164)	(1,721,331)
Service concession obligation payable to MWSS (Note 12)	(1,208,713)	(1,026,693)	(1,184,393)
Proceeds from the availment/drawdown of interest-bearing loans (Note 10)	3,173,095	2,539,775	567,487
Interest paid	(1,406,783)	(1,426,075)	(1,442,576)
Contributions to pension fund (Note 16)	(192,000)	–	–
Increase (decrease) in:			
Customers' deposits	83,261	75,551	23,021
Other noncurrent liabilities	291	(1,170)	170,982
Acquisition of treasury shares (Note 13)	(32,672)	(6,128)	(94,416)
Net cash used in financing activities	(3,325,305)	(3,536,895)	(4,681,361)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,931,742	(1,095,526)	1,324,133
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	3,093,012	4,188,538	2,864,405
CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 4)	₱5,024,754	₱3,093,012	₱4,188,538

See accompanying Notes to Consolidated Financial Statements.



MAYNILAD WATER SERVICES, INC. AND SUBSIDIARIES
(A Subsidiary of Maynilad Water Holding Company, Inc.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**(Amounts in Thousands, Except Number of Shares, Earnings per Share Value
and Unless Otherwise Specified)**

1. Corporate Information and Status of Operations

General

Maynilad Water Services, Inc. (Maynilad or Parent Company) was incorporated on January 22, 1997 in the Philippines primarily to bid for the operation of the privatized system of waterworks and sewerage services of the Metropolitan Waterworks and Sewerage System (MWSS) for Metropolitan Manila.

On October 26, 2011, the Securities and Exchange Commission (SEC) approved the amendment of the Articles of Incorporation to amend its primary purpose to include the provision of allied and ancillary services and undertaking such other activities incidental to its secondary purposes.

Effective Interest in Maynilad

MWHCI and Maynilad Subscription Agreements. Pursuant to the Subscription Agreements executed between Maynilad and Maynilad Water Holding Company, Inc. (MWHCI), a company incorporated in the Philippines and a 51.27% owned subsidiary of Metro Pacific Investments Corporation (MPIC), MWHCI subscribed to 134,022 common shares of Maynilad at par value on December 28, 2012. Such shares, however, were issued only on February 13, 2013 and together with the additional subscription to 402,067 common shares increased MWHCI ownership interest in Maynilad to 92.85% as at December 31, 2013.

MCNK JV Corporation and MWHCI Subscription Agreements. On December 28, 2012, a Subscription Agreement between MCNK JV Corporation (MCNK, a subsidiary of a Japan-listed entity Marubeni Corp.) and MWHCI was executed, wherein MCNK subscribed to 169,617,682 common shares of MWHCI. On February 13, 2013, MCNK and MWHCI entered into another Subscription Agreement for the subscription by MCNK to an additional 508,853,045 common shares resulting to 21.54% interest in MWHCI. On the same date, MPIC purchased 154,992,852 common shares of stock of MWHCI from DMCI Holdings, Inc. (DMCI, a listed Philippine entity) resulting in 51.27% and 27.19% ownership interest as at December 31, 2013 by MPIC and DMCI, respectively.

As at December 31, 2016 and 2015, Maynilad is a 92.85% owned subsidiary of MWHCI. In addition, MPIC directly owns 5.19% of Maynilad thereby having effective ownership interest of 52.80%.

Metro Pacific Holdings, Inc. (MPHI) owns 41.9% of the total issued common shares (or 42.0% of the total outstanding common shares) and 52.1% of the total issued and outstanding common shares of MPIC as at December 31, 2016 and 2015, respectively. The reduction in the ownership interest resulted from GT Capital Holdings, Inc.'s (GTCHI) acquisition of 1.3 billion MPIC common shares from MPHI on May 27, 2016. On the same date, MPIC entered into a Share Subscription Agreement with GTCHI for the subscription by GTCHI of 3.6 billion common shares in MPIC. As sole holder of the voting Class A Preferred Shares, MPHI's combined voting interest as a result of all of its shareholdings is estimated at 55.0% as at December 31, 2016.

MPHI is a Philippine corporation whose stockholders are Enterprise Investment Holdings, Inc. (EIH; 60.0% interest), Intalink B.V. (26.7% interest) and First Pacific International Limited (FPIL; 13.3% interest). First Pacific Company Limited (FPC), a company incorporated in Bermuda and listed in Hong Kong, through its subsidiaries, Intalink B.V. and FPIL, holds 40.0% equity interest



in EIH and an investment financing which under Hong Kong Generally Accepted Accounting Principles require FPC to account for the results and assets and liabilities of EIH and its subsidiaries as part of FPC group companies in Hong Kong.

The registered office address of the Parent Company is MWSS Compound, Katipunan Road, Balara, Quezon City.

The accompanying consolidated financial statements were approved by the Audit Committee on February 27, 2017 as authorized by the Board of Directors (BOD) in accordance with its resolution.

Concession Agreement

On February 21, 1997, the Parent Company entered into a Concession Agreement with the MWSS, a government-owned and controlled corporation organized and existing pursuant to Republic Act (RA) No. 6234 (the Charter), as clarified and amended, with respect to the MWSS West Service Area. The Concession Agreement sets forth the rights and obligations of the Parent Company throughout the concession period. The MWSS Regulatory Office (RO) acts as the regulatory body of the Concessionaires [the Parent Company and the East Concessionaire - Manila Water Company, Inc. (Manila Water)].

Under the Concession Agreement, MWSS grants the Parent Company (as contractor to perform certain functions and as agent for the exercise of certain rights and powers under the Charter), the sole right to manage, operate, repair, decommission and refurbish all fixed and movable assets required (except certain retained assets of MWSS) to provide water and sewerage services in the West Service Area for an extended period of 40 years commencing on August 1, 1997 (the Commencement Date) to May 6, 2037 or the early termination date as the case may be. The 15-year extension of the expiry of the Concession Agreement was approved by the MWSS in 2009 (see Notes 7, 12 and 22).

The Parent Company is also tasked to manage, operate, repair, decommission and refurbish certain specified MWSS facilities in the West Service Area. The legal title to these assets remains with MWSS. The legal title to all property, plant and equipment contributed to the existing MWSS system by the Parent Company during the concession period remains with the Parent Company until the Expiration Date (or on early termination date) at which time, all rights, titles and interest in such assets will automatically vest in MWSS.

Fourth Rate Rebasings

MWSS released Board of Trustees Resolution No. 2013-100-RO dated September 12, 2013 and RO Resolution No. 13-010-CA dated September 10, 2013 on the rate rebasing adjustment for the rate rebasing period 2013 to 2017 reducing Maynilad's 2012 average all-in basic water charge by 4.82% or ₱1.46 per cubic meter (cu.m.) or ₱0.29 per cu.m. over the next five years. Maynilad has formally notified its objection and initiated arbitration proceedings. On October 4, 2013, Maynilad filed its Dispute Notice before the Appeals Panel.

On December 17, 2013, the Regulatory Office released Resolution No. 13-011-CA regarding the implementation of a status quo for Maynilad's Standard Rates and FCDA for any and all its scheduled adjustments until such time that the Appeals Panel has issued the Final Award.

On January 5, 2015, Maynilad officially received the Appeals Panel's award dated December 29, 2014 (the "Arbitral Award") upholding Maynilad's alternative Rebasing Adjustment for the Fourth Rate Rebasing Period of 13.41% or its equivalent of ₱4.06 per cu.m. This increase has effectively been reduced to ₱3.06 per cu.m., following the integration of the



₱1.00 Currency Exchange Rate Adjustment (CERA) into the basic water charge. To mitigate the impact of the tariff increase on its customers, Maynilad offered to stagger its implementation over a three-year period.

With the Arbitral Award being final and binding on the parties, Maynilad asked the MWSS to cause its Board of Trustees to approve the 2015 Tariffs Table so that the same can be published and implemented 15 days after its publication.

However, the MWSS and the RO have chosen, over Maynilad's repeated objections, to defer the implementation of the Arbitral Award despite it being final and binding on the parties. In its letter dated February 9, 2015, the MWSS and RO, who received their copy of the Arbitral Award on January 7, 2015, informed Maynilad that they have decided to await the final outcome of their arbitration with the other concessionaire, Manila Water, before making any official pronouncements on the applicable resulting water rates for the two concessionaires.

On February 20, 2015, Maynilad wrote the Philippine Government, through the Department of Finance (DOF), to call on the undertaking which the Republic of the Philippines (the "Republic") issued in favor of Maynilad on July 31, 1997 and March 17, 2010 (the "Undertaking"). The Undertaking provides, among other things, that the Republic shall indemnify Maynilad in respect of any loss that is occasioned by a delay caused by the Republic or any government-owned agency in implementing any increase in the Standard Rates beyond the date for its implementation in accordance with the Concession Agreement.

On March 9, 2015, Maynilad again wrote the Republic, through the DOF, to reiterate its demand against the Undertaking. The letters dated February 20 and March 9, 2015 are collectively referred to as the "Demand Letters". Maynilad demanded that it be paid, immediately and without further delay, the ₱3.4 billion in revenue losses that it had sustained as a direct result of the MWSS' and the RO's refusal to implement its correct Rebasing Adjustment from January 1, 2013 (the commencement of the Fourth Rate Rebasing Period) to February 28, 2015.

On March 27, 2015, Maynilad served a Notice of Arbitration and Statement of Claim upon the Republic, through the DOF. Maynilad gave notice and demanded that the Republic's failure or refusal to pay the amounts required under the Demand Letters be, pursuant to the terms of the Undertaking, referred to arbitration before a three-member panel appointed and conduct proceedings in Singapore in accordance with the 1976 United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.

On April 21, 2015, the MWSS Board of Trustees in its Resolution No. 2015-004-CA dated March 25, 2015 approved to partially implement the Arbitral Award of a tariff adjustment of ₱0.64 per cu.m. which, net of the ₱1.00 CERA, actually translates to a tariff adjustment of negative ₱0.36 per cu.m. as opposed to the Arbitral Award of ₱3.06 per cu.m. tariff adjustment, net of CERA. For being contrary to the Final Award as well as the provisions of the Concession Agreement, Maynilad did not implement this tariff adjustment.

On May 14, 2015, the MWSS Board of Trustees in its Resolution No. 2015-060-RO approved a 7.52% increase in the prevailing average basic charge of ₱31.25 per cu.m. or an upward adjustment of ₱2.35 per cu.m. as partial implementation of the Arbitral Award. With the discontinuance of CERA, the net adjustment in average water charge is 4.32% or ₱1.35 per cu.m.

In the fourth quarter of 2015, the Arbitration Tribunal was constituted. On February 17, 2016, Maynilad again wrote the Republic, through the DOF, to reiterate its demand against the



Undertaking and to update its claim. Evidentiary hearings were completed in December 2016. As at February 27, 2017, the decision from the Arbitration Tribunal is still pending.

As at December 31, 2016 and 2015, Maynilad's revenue losses due to the delayed implementation of the Arbitral Award were estimated at ₱8.2 billion and ₱6.1 billion, respectively.

2. Summary of Significant Accounting and Financial Reporting Policies

Basis of Preparation

The consolidated financial statements have been prepared on a historical cost basis. The consolidated financial statements are presented in Philippine peso, which is the Parent Company's functional and presentation currency, and all amounts are rounded to the nearest thousand (₱000), except when otherwise indicated.

Statement of Compliance

The accompanying consolidated financial statements have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS include statements named PFRS and Philippine Accounting Standards (PAS), including Philippine Interpretations from International Financial Reporting Interpretations Committee (IFRIC) issued by the Financial Reporting Standards Council (FRSC) and Philippine Interpretations Committee (PIC).

Basis of Consolidation

The accompanying consolidated financial statements comprise the financial statements of the Parent Company and all of its subsidiaries (collectively referred to as the "Company").

Control is achieved when the Company is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Company controls an investee, if and only if, the Company has:

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

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

A change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction. If the Company loses control over a subsidiary, it:

- derecognizes the assets (including goodwill) and liabilities of the subsidiary;
- derecognizes the carrying amount of any non-controlling interest;
- derecognizes the cumulative translation differences recorded in equity;
- recognizes the fair value of the consideration received;
- recognizes the fair value of any investment retained;
- recognizes any surplus or deficit in profit or loss; and



- reclassifies the Company's share of components previously recognized in other comprehensive income to profit or loss or retained earnings, as appropriate.

The financial statements of Maynilad and the following subsidiaries that it controls comprise the consolidated financial statements.

<u>Subsidiaries</u>	<u>Nature of Business</u>
Philippine Hydro, Inc. (Phil Hydro)	Bulk water supply and water distribution (outside the West Service Area)
Amayi Water Solutions Inc. (Amayi)	Water distribution (outside the West Service Area)

All subsidiaries are wholly-owned and incorporated in the Philippines.

Phil Hydro. On August 3, 2012, the Parent Company through a Share Purchase Agreement with a third party acquired 100% ownership interest in Phil Hydro for a net consideration of ₱526.9 million. Goodwill arising from the acquisition amounted to ₱288.1 million.

Phil Hydro is engaged in waterworks construction, engineering and engineering consulting services. Phil Hydro is currently undertaking water supply projects outside Metro Manila in line with the thrusts of the government under Presidential Decree No. 198, also known as the Provincial Water Utilities Act of 1973, which mandates the local government units to create and operate local water utilities and provide potable water to the public.

Phil Hydro has existing 25-year Bulk Water Supply Agreements with various provincial municipalities outside the West Service Area and a Memorandum of Agreement with certain provincial municipality for the construction and operation of water treatment facilities for water distribution services.

Amayi. Amayi is incorporated for the purpose of operating, managing, maintaining and rehabilitating waterworks, sewerage and sanitation system and services outside the Concession Area.

The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company using consistent accounting policies. All significant intercompany balances, transactions, income and expense and profits and losses from intercompany transactions are eliminated in full upon consolidation.

Changes in Accounting Policies and Disclosures

The accounting policies adopted in the preparation of the consolidated financial statements are consistent with those of the previous financial year, except for the adoption of the following new accounting pronouncements starting January 1, 2016. Adoption of these pronouncements did not have any significant impact on the Company's financial position or performance except as otherwise indicated.

- PFRS 10, *Consolidated Financial Statements*, PFRS 12, *Disclosure of Interests in Other Entities*, and PAS 28, *Investments in Associates and Joint Ventures – Investment Entities: Applying the Consolidation Exception (Amendments)*
- PFRS 11, *Joint Arrangements – Accounting for Acquisitions of Interests in Joint Operations (Amendments)*
- PFRS 14, *Regulatory Deferral Accounts*



- PAS 1, *Presentation of Financial Statements* – Disclosure Initiative (Amendments)
- PAS 16, *Property, Plant and Equipment*, and PAS 38, *Intangible Assets* – Clarification of Acceptable Methods of Depreciation and Amortization (Amendments)
- PAS 16, *Property, Plant and Equipment*, and PAS 41, *Agriculture* – Bearer Plants (Amendments)
- PAS 27, *Separate Financial Statements* – Equity Method in Separate Financial Statements (Amendments)

Annual Improvements to PFRSs 2012 - 2014 Cycle

- PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* – Changes in Methods of Disposal (Amendments)
- PFRS 7, *Financial Instruments: Disclosures* – Servicing Contracts (Amendments)
- PFRS 7, *Financial Instruments: Disclosures* – Applicability of the Amendments to PFRS 7 to Condensed Interim Financial Statements
- PAS 19, *Employee Benefits* – Discount Rate: Regional Market Issue (Amendments)
- PAS 34, *Interim Financial Reporting* – Disclosure of Information ‘Elsewhere in the Interim Financial Report’ (Amendment)

Standards, Amendments and Interpretations Issued but Not Yet Effective

The Company did not early adopt the following pronouncements issued but not yet effective. Except as otherwise indicated, the Company does not expect the adoption of these pronouncements to have a significant impact on its consolidated financial statements. The Company intends to adopt the following pronouncements when they become effective.

Effective 2017

- PFRS 12, *Disclosure of Interests in Other Entities* – Clarification of the Scope of the Standard (Part of Annual Improvements to PFRSs 2014 - 2016 Cycle) (Amendments)
- PAS 7, *Statement of Cash Flows* – Disclosure Initiative (Amendments)

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

Application of amendments will result in additional disclosures in the 2017 consolidated financial statements of the Company.

- PAS 12, *Income Taxes* – Recognition of Deferred Tax Assets for Unrealized Losses (Amendments)



Effective 2018

- PFRS 2, *Share-based Payment – Classification and Measurement of Share-based Payment Transactions (Amendments)*
- PFRS 4, *Insurance Contracts – Applying PFRS 9, Financial Instruments, with PFRS 4 (Amendments)*
- PFRS 9, *Financial Instruments*

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

The adoption of PFRS 9 will have an effect on the classification and measurement of the Company's financial assets and impairment methodology for financial assets, but will have no impact on the classification and measurement of the Company's financial liabilities. The Company is currently assessing the impact of adopting this standard.

- PFRS 15, *Revenue from Contracts with Customers*

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

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

- PAS 28, *Investments in Associates and Joint Ventures – Measuring an Associate or Joint Venture at Fair Value (Part of Annual Improvements to PFRSs 2014 - 2016 Cycle) (Amendments)*
- PAS 40, *Investment Property – Transfers of Investment Property (Amendments)*
- Philippine Interpretation IFRIC 22, *Foreign Currency Transactions and Advance Consideration*

The interpretation clarifies that in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration, the date of the transaction is the date on which an entity initially recognizes the nonmonetary asset or nonmonetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The interpretation may be applied on a fully



retrospective basis. Entities may apply the interpretation prospectively to all assets, expenses and income in its scope that are initially recognized on or after the beginning of the reporting period in which the entity first applies the interpretation or the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which the entity first applies the interpretation.

Effective 2019

▪ PFRS 16, *Leases*

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

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

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

Deferred Effectivity

- PFRS 10, *Consolidated Financial Statements*, and PAS 28, *Investments in Associates and Joint Ventures – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments)*

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method of accounting. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in costs and expenses.

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

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, will be recognized in accordance with PAS 39 either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it is not remeasured until it is finally settled within equity.



Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the consolidated statement of income.

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

Where goodwill forms part of a cash-generating unit 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.

Fair Value Measurement

The Company measures financial instruments at fair value at each reporting date.

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

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

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

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

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

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

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

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities

Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable



Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

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

The Company's management determines the policies and procedures for both recurring and nonrecurring fair value measurements.

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

Fair value measurement disclosures are presented in Note 25.

Cash and Cash Equivalents

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

Short-term Investments

Short-term investments are investments with maturities of more than three months to one year.

Financial Assets and Financial Liabilities

Date of Recognition. The Company recognizes a financial asset or a financial liability in the consolidated statement 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 and derecognition, as applicable, are done using trade date accounting.

Initial Recognition. Financial assets and financial liabilities are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit or loss (FVPL).

Categories of Financial Assets and Financial Liabilities. Financial assets are classified into the following categories: financial assets at FVPL, loans and receivables, held-to-maturity (HTM) investments, and available-for-sale (AFS) financial assets. Financial liabilities are classified as financial liabilities at FVPL or other financial liabilities. The Company determines the classification at initial recognition and, where allowed and appropriate, re-evaluates this designation at each reporting date.

The Company has no financial assets classified as financial asset at FVPL and HTM investments, and has no financial liabilities classified as financial liabilities at FVPL as at December 31, 2016 and 2015.

'Day 1' difference. Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Company recognizes the difference between the transaction price and fair value (a 'Day 1' difference) in the



consolidated statement of income unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Company determines the appropriate method of recognizing the 'Day 1' difference amount.

Loans and Receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments 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 classified or designated as AFS financial assets or financial assets at FVPL. After initial recognition, loans and receivables are carried at amortized cost in the consolidated statement of financial position using the effective interest method, less allowance for impairment. Amortization is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. Gains and losses are recognized in the consolidated statement of income when loans and receivables are derecognized and impaired, as well as through the amortization process. Loans and receivables are included in current assets if maturity is within twelve months from the reporting date. Otherwise, these are classified as noncurrent assets.

This category includes the Company's cash and cash equivalents, short-term investments, trade and other receivables, sinking fund, deposits, and miscellaneous deposits shown as part of "Other noncurrent assets" account in the consolidated statements of financial position (see Notes 4, 5 and 6).

AFS Financial Assets. Available-for-sale financial assets are non-derivative financial assets that are designated as AFS or are not classified in any of the three preceding categories. These are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. After initial recognition, AFS financial assets are measured at fair value with unrealized gains or losses being recognized in the consolidated statement of comprehensive income and presented as a separate component of equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the consolidated statement of income. Investments in equity instruments that do not have a quoted market price in an active market and whose fair values cannot be reliably measured are carried at cost, net of impairment, if any. Assets under this category are classified as current assets if the Company intends to hold the assets within 12 months from financial reporting date and as noncurrent assets if it is more than a year from financial reporting date.

Other Financial Liabilities at Amortized Cost. Financial liabilities are classified in this category if these are not held for trading or not designated as at FVPL upon the inception of the liability. These include liabilities arising from operations or borrowings.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method.

Gains or losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

Debt issuance costs are amortized using the effective interest method. The unamortized debt issuance costs are netted against the related carrying value of the debt instrument.



This category includes trade and other payables (excluding statutory liabilities), interest-bearing loans, service concession obligation payable to MWSS and customers' deposits (see Notes 10, 11 and 12).

Classification of Financial Instruments between Debt and Equity

A financial instrument is classified as a liability 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 Company; 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 Company 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. The components of issued financial instruments that contain both liability and equity elements are accounted for separately, with the equity component being assigned the residual amount after deducting from the instrument as a whole the amount separately determined as the fair value of the liability component on the date of issue.

Impairment of Financial Assets

The Company assesses at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss' event) and that loss event (or events) has an impact on the estimated future cash flows of the financial assets that can be reliably measured. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and when observable data indicate that there is a measureable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial Assets Carried at Amortized Cost. If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, 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 (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the consolidated statement of income.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed 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 a collective assessment of impairment.

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 statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Financial Assets Carried at Cost. If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument has been incurred, 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 discounted at the current market rate of return for a similar financial asset.

AFS Financial Assets. The Company assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired. The evidence of impairment for equity securities classified as AFS financial assets would include a significant or prolonged decline in fair value of investments below its cost. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the other comprehensive income – is removed from other comprehensive income and recognized in profit or loss in the consolidated statement of income. Impairment losses on equity investments are not reversed through the profit or loss in the consolidated statement of income. Increases in fair value after impairment are recognized directly in other comprehensive income in the consolidated statement of comprehensive income.

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 Company's right to receive cash flows from the asset has expired; or
- the Company 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 Company has transferred its right to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the assets, 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 Company has transferred its right 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 Company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Financial Liabilities. A financial liability is derecognized when the obligation under the liability is discharged, cancelled or has 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, and the difference in the respective carrying amounts is recognized in the consolidated statement of income.



Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement 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. The Company assesses that it has a currently enforceable right of offset if the right is not contingent on a future event, and is legally enforceable in the normal course of business, event of default, and event of insolvency or bankruptcy of the Company and all of the counterparties.

Service Concession Assets

Parent Company. The Parent Company accounts for its concession arrangement with MWSS in accordance with IFRIC 12, *Service Concession Arrangement* under the Intangible Asset model as it receives the right (license) to charge users of public service. Under the Concession Agreement, the Parent Company is granted the sole and exclusive right and discretion during the concession period to manage, occupy, operate, repair, maintain, decommission and refurbish the identified facilities required to provide water services. The legal title to these assets shall vest in MWSS at the end of the concession period.

Phil Hydro. Phil Hydro accounts for its Bulk Water Supply Agreements in accordance with IFRIC 12 under the Intangible Asset model as it receives the right (license) to charge users of public service.

Service concession assets are recognized to the extent that the Company receives a license or right to charge the users of the public service. The service concession assets pertain to the fair value of the service concession obligations at drawdown date and construction costs related to the rehabilitation works performed by the Company. The Parent Company's service concession assets is amortized using unit of production (UOP) method over the projected total billable water volume during the remaining term of the service concession arrangement. Phil Hydro amortizes its service concession assets using straight-line method over the terms of the Bulk Water Supply Agreements.

The Company recognizes and measures revenue from rehabilitation works using the percentage-of-completion method. Under this method, revenue is recognized as the related obligations are fulfilled, measured principally on the basis of the estimated physical completion of the contract work.

Cost of rehabilitation works, which includes all direct materials, labor costs, and those indirect costs related to contract performance, is recognized consistent with the revenue recognition method applied. Expected losses on contracts are recognized immediately when it is probable that the total contract costs will exceed total contract revenue. Changes in contract performance, contract conditions and estimated profitability including those arising from contract penalty provisions and final contract settlements which may result in revisions to estimated costs and gross margins are recognized in the year in which the revisions are determined.

Subsequent costs and expenditures related to the concession agreement are recognized as additions to service concession assets at fair value of obligations at drawdown date and cost of rehabilitation works.

Property and Equipment

Property and equipment, except land, are stated at cost less accumulated depreciation and any impairment in value (see policy on "Impairment of Nonfinancial Assets"). Land is stated at cost.



The initial cost of property and equipment comprises its 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. Expenditures incurred after the property and equipment have been put into operation, such as repairs and maintenance, are normally charged to income in the period such costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional costs of property and equipment.

Depreciation is calculated on a straight-line basis over the following estimated useful lives:

Land improvements	5 to 25 years
Instrumentation, tools and other equipment	5 years
Office furniture, fixtures and equipment	5 years
Transportation equipment	5 years

The Company computes for depreciation charges based on the significant component of the asset.

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

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

An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statement of income in the year the item is derecognized.

Impairment of Nonfinancial Assets

An assessment is made at each reporting date to determine whether there is any indication of impairment of any nonfinancial assets (i.e., property and equipment and service concession assets), or whether there is any indication that an impairment loss previously recognized for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its fair value less cost to sell. 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. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

An impairment loss is recognized only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to operations in the year in which it arises.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however, not to an amount higher than the carrying amount that would have been determined (net of any depreciation and



amortization) had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is credited to current operations.

Goodwill

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognized for controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in the consolidated statement of income. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash-generating units that are expected to benefit from synergies of the combination irrespective of whether other assets or liabilities of the acquiree are assigned to those units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Company at which the goodwill is monitored for internal management purposes; and
- not larger than an operating segment determined in accordance with PFRS 8, *Operating Segments*.

Where goodwill forms part of a cash-generating unit 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.

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

Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed, 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 and the portion of the cash-generating unit retained. Impairment loss with respect to goodwill is not reversed.

Transfers of assets between commonly-controlled entities are accounted for under historical cost accounting.

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.

When subsidiaries are sold, the difference between the selling price and the net assets plus cumulative translation adjustments and goodwill is recognized in the consolidated statement of income.



Foreign Currency-Denominated Transactions

Foreign exchange differentials arising from foreign currency transactions are credited or charged to operations. As approved by the MWSS Board of Trustees under Amendment No. 1 of the Concession Agreement, the following will be recovered through billings to customers:

- Restatement of foreign currency-denominated loans;
- Excess of actual concession fee payments over the amounts of concession fee translated using the base exchange rate assumed in the business plan approved every rate rebasing exercise;
- Excess of actual interest payments translated at exchange spot rates on settlement dates over the amounts of interest translated at drawdown date rates; and
- Excess of actual payments of other financing charges relating to foreign currency-denominated loans translated at exchange spot rates on settlement dates over the amount of other financing charges translated at drawdown date rates.

In view of the automatic reimbursement mechanism, the Parent Company recognizes deferred FCDA (included as part of “Other noncurrent assets” or “Deferred credits” accounts in the consolidated statement of financial position) with a corresponding credit (debit) to FCDA revenues for the unrealized foreign exchange losses (gains) which have not been billed or which will be refunded to the customers. The write-off of the deferred FCDA or reversal of deferred credits pertaining to concession fees will be made upon determination of the new base foreign exchange rate, which is assumed in the business plan approved by the RO during the latest Rate Rebasing exercise, unless indication of impairment of deferred FCDA would be evident at an earlier date.

Deferred FCDA and deferred credits are calculated as the difference between the drawdown or rebased rate and the closing rate. These are presented as part of “Other noncurrent assets” and “Deferred credits” accounts in the consolidated statement of financial position, respectively.

As at December 31, 2016 and 2015, deferred FCDA amounted to ₱764.0 million and ₱279.1 million, respectively.

Customers’ Deposits

Customers’ deposits are initially measured at fair value. After initial recognition, these deposits are subsequently measured at amortized cost using the effective interest method. Accretion of customers’ deposits is included under “Interest expense and other financing charges” account in the consolidated statement of income. The discount is recognized as deferred credits and amortized over the remaining concession period using the effective interest method. Amortization of deferred credits is included as part of “Other income” account in the consolidated statement of income.

As at December 31, 2016 and 2015, the discount, shown as part of “Deferred credits” account in the consolidated statements of financial position, amounted to ₱632.0 million and ₱583.6 million, respectively.

Assets Held in Trust

Assets which are owned by MWSS but are used in the operations of the Parent Company under the Concession Agreement are not reflected in the consolidated statement of financial position but carried as Assets Held in Trust, except for certain assets transferred to the Parent Company as mentioned in Note 23.



Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of consideration received or receivable, excluding discounts, rebates and value-added tax (VAT). Water and sewerage are billed every month according to the bill cycles of the customers. As a result of bill cycle cut-off, monthly service revenue earned but not yet billed at the end of the month are estimated and accrued. These estimates are based on historical consumption of the customers.

Revenue from water and sewerage services is recognized upon supply of water to the customers and when the related services are rendered. Billings to customers consist of the following:

a. Water charges

- Basic charges represent the basic tariff charged to consumers for the provision of water services.
- FCDA is the tariff mechanism that allows the Parent Company to recover foreign exchange losses or to compensate foreign exchange gains on a current basis beginning January 1, 2002 until the Expiration Date.
- Maintenance service charge represents a fixed monthly charge per connection. The charge varies depending on the meter size.

b. Environmental charge (included as part of revenue from sewer/sanitation services) represents 20% of the water charges, except for maintenance charge.

c. Sewerage charge represents 20% of the water charges, excluding maintenance service charge, for all consumers connected to the Company's sewer lines. Effective January 1, 2012, pursuant to RO Resolution No. 11-007-CA, sewerage charge applies only to commercial and industrial customers connected to sewer lines.

Interest income is recognized as the interest accrues, taking into account the effective yield on the asset.

When the Company provides construction or upgrade services, the consideration received or receivable is recognized at its fair value. The Company accounts for revenue and costs relating to operation services based on the percentage of completion (shown as "Revenue from rehabilitation works" and "Cost of rehabilitation works" accounts in the consolidated statement of income).

Cost and Expense Recognition

Expenses are decreases in economic benefits during the accounting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decrease in equity, other than those relating to distributions to equity participants. Expenses are recognized in the consolidated statement of income as incurred.

Leases

The determination of whether an arrangement is, or contains a lease, is based on the substance of the arrangement at inception date, whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or 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 of 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 specified asset; or
- (d) There is a substantial change to the asset.

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

A lease where the lessor retains substantially all the risks and benefits of ownership of the asset is classified as an operating lease.

Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term.

Borrowing Costs

Borrowing costs are generally expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset shall be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization shall be determined by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to the borrowings of the Company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period shall not exceed the amount of borrowing costs incurred during that period.

Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Capitalization of borrowing costs ceases when all the activities necessary to prepare the asset for its intended use or sale are substantially complete. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized.

Equity

Capital stock is measured at par value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown in equity as a deduction from proceeds, net of tax. Proceeds and fair value of consideration received in excess of par value are recognized as additional paid-in capital.

Treasury shares, which represent own equity instruments that are reacquired, are recognized at cost and deducted from equity. No gain or loss is recognized in the consolidated statement of income on the purchase, sale, issuance or the cancellation of the Parent Company's own equity instruments.



Retained earnings represent the Company's accumulated earnings, net of dividends declared.

Value-Added Tax (VAT)

Revenues, expenses and assets are recognized net of the amount of VAT except:

- when the VAT incurred on a purchase of assets or services is not recoverable from the tax authority, in which case, the sales 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 VAT included.

The net amount of current VAT recoverable from and payable to the tax authority is included as part of "Other current assets" and "Trade and other payables" accounts in the consolidated statement of financial position.

Income Taxes

Current Income Tax. Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authority. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted as at the financial reporting date.

Deferred Income Tax. Deferred income tax is provided, using the liability method, on all 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:

- when 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 income nor taxable income or loss; and
- with respect to taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when 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 from excess minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT) and unused tax losses from net operating loss carryover (NOLCO) to the extent that it is probable that taxable income will be available against which the deductible temporary differences and the carryforward benefits of MCIT and NOLCO can be utilized, except:

- when 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 income nor taxable income 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 income 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 assets 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 all or part of the deferred tax assets to be recovered.

Deferred tax assets and deferred tax liabilities are measured at the tax rate that is expected to apply to the period when the assets are realized or the liabilities are settled, based on the tax rates (and tax laws) that have been enacted or substantively enacted as at the reporting date.

Deferred tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

Deferred tax assets and deferred tax liabilities are offset only if a legally enforceable right exists to offset current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations and a reliable estimate can be made of the amount of the obligation. When the Company expects a provision to be reimbursed, such as under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Pension Cost

The Parent Company has a funded, noncontributory defined benefit plan. The cost of providing benefits under the defined benefit plans is actuarially determined using the projected unit credit method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries.

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

Defined benefit costs comprise the following: (1) service cost; (2) net interest on the net defined benefit liability or asset; and (3) remeasurements of net defined benefit liability or asset.

Service costs, which include current service costs, past service costs and gains or losses on non-routine settlements, are recognized as part of "Salaries, wages and benefits" account in the consolidated statement of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuaries.

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



Net interest on the net defined benefit liability or asset is recognized as expense or income in profit or loss.

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

Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the creditors of the Parent Company, nor can they be paid directly to the Parent Company. Fair value of plan assets is based on market price information. When no market price is available, the fair value of plan assets is estimated by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligations). If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

Long-term Employee Benefits

The Long Term Incentive Plan (LTIP) of the Parent Company grants cash incentives to eligible employees of the Parent Company. Liability under the LTIP is determined using the projected unit credit method. Employee benefit costs include current service costs, interest cost, actuarial gains and losses, and past service costs. Past service costs and actuarial gains and losses are recognized immediately.

The long-term employee benefit liability is determined based on the present value of the defined benefit obligation (using discount rate based on government bonds) vested at the end of the reporting period.

Share-based Payments

Employees of the Parent Company receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments (equity-settled transactions) under the Employee Stock Option Plan (ESOP).

The cost of equity-settled transactions is determined as the fair value at the date when the grant is made using an appropriate valuation model. That cost is recognized, together with a corresponding increase in other equity adjustments, over the period in which the performance and/or service conditions are fulfilled, and is shown as part of "Salaries, wages and benefits" account in the consolidated statement of income.

The cumulative expense recognized for equity-settled 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.

No expense is recognized for awards that do not ultimately vest, except for equity-settled transactions for which vesting is conditional upon a market or non-vesting condition. These are treated as vesting irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

When the terms of an equity-settled award are modified, the minimum expense recognized is the expense had the terms not been modified if the original terms of the award are met. An additional



expense is recognized for any modification that increases the total fair value of the share-based payment transaction, or is otherwise beneficial to the employee as measured at the date of modification.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to 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 in the notes to consolidated financial statements when an inflow of economic benefits is probable. Contingent assets are not recognized unless virtually certain.

Events after the Reporting Period

Post year-end events that provide additional information about the Company's position at the financial 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.

Earnings per Share (EPS)

Basic EPS is computed based on the weighted average number of outstanding shares and adjusted to give retroactive effect to any stock split during the year. The dilutive effect of outstanding ESOP shares is reflected as additional share dilution in the computation of diluted EPS (see Note 18).

3. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the consolidated financial statements in accordance with PFRS requires the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent liabilities at the reporting date. In preparing the Company's consolidated financial statements, management has made its best estimates and judgments of certain amounts, giving due consideration to materiality. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as at the date of the consolidated financial statements. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the consolidated financial statements as they become reasonably determinable.

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

Judgments

In the process of applying the Company'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:

Fourth Rate Rebasing. In September 2013, the MWSS released its resolutions on the rate rebasing adjustment for the rebasing period 2013 to 2017 reducing Maynilad's 2012 average all-in tariff. Maynilad has formally notified its objection and filed its Dispute Notice before the Appeals Panel. On January 5, 2015, Maynilad officially received the Appeals Panel's award dated December 29, 2014. Maynilad already wrote the Philippine Government, through the DOF, to call



on the Undertaking after the MWSS and RO's delayed approval of the adjusted rates. Maynilad had subsequently served a Notice of Arbitration and Statement of Claim upon the Republic, through the DOF.

On May 14, 2015, the MWSS Board of Trustees in its Resolution No. 2015-060-RO approved a net adjustment of 4.32% to be applied to the prevailing average basic charge of ₱31.25 per cu.m. as partial implementation of the Arbitral Award. As at December 31, 2016 and 2015, Maynilad's cumulative revenue losses due to the delayed implementation of the Arbitral Award are estimated at ₱8.2 billion and ₱6.1 billion, respectively (see Note 1). The consolidated financial statements do not include any adjustments that might result from the decision of the Arbitration Tribunal and approval by the MWSS and RO.

Amortization of Service Concession Assets. The Parent Company accounts for its concession arrangement with MWSS in accordance with IFRIC 12 under the Intangible Asset model as it receives the right (license) to charge users of public service.

The Parent Company amortizes its service concession assets using UOP method, given that the economic benefit of these assets are more closely aligned with billed volume, which the Parent Company can already estimate reliably. Service concession assets, net of accumulated amortization of ₱21.1 billion and ₱18.7 billion, amounted to ₱69.3 billion and ₱62.5 billion as at December 31, 2016 and 2015, respectively (see Note 7).

Disputes with MWSS. Pending resolution of the dispute between the Parent Company and MWSS on certain claims of MWSS, the disputed amount of ₱5.1 billion as at December 31, 2016 and 2015, is considered as contingent liability (see Notes 7, 12 and 19).

Contingencies. The Company is currently involved in various legal and administrative proceedings. The Company's estimate of the probable costs for the resolution of these claims has been developed in consultation with outside legal counsel handling defense in these matters and is based upon an analysis of potential results. The Company currently does not believe these proceedings will have a material adverse effect on the Company's financial position. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings (see Notes 12 and 19).

Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Fair Value of Service Concession Payable. The determination of the cost of service concession payable requires management to make estimates and assumptions to determine the extent to which the Company receives a right or license to charge users of the public service. In making those estimates, management is required to determine a suitable discount rate to calculate the present value of these cash flows. While the Company believes that the assumptions used are reasonable and appropriate, these estimates and assumptions can materially affect the consolidated financial statements.

Estimated Billable Water Volume. The Parent Company estimated the billable water volume, where the amortization of service concession assets is derived from, based on the period over which the Parent Company's concession agreement with MWSS is in force. The Parent Company reviews annually the billable water volume based on factors that include market conditions such as population growth and consumption, and the status of the Parent Company's projects and their impact on non-



revenue water. It is possible that future results of operations could be materially affected by changes in the Parent Company's estimates brought about by changes in the aforementioned factors. A reduction in the projected billable water volume would increase amortization and decrease noncurrent assets.

Service concession assets, net of accumulated amortization of ₱21.1 billion and ₱18.7 billion, amounted to ₱69.3 billion and ₱62.5 billion as at December 31, 2016 and 2015, respectively (see Note 7).

Allowance for Doubtful Accounts. The Company estimates the allowance for doubtful accounts related to the trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount of allowance. First, the Company evaluates specific accounts that are considered individually significant for any objective evidence that certain customers are unable to meet their financial obligations. In these cases, the Company uses judgment, based on the best available facts and circumstances, including but not limited to, the length of its relationship with the customer and the customer's current credit status based on third party credit reports and known market factors. The allowance provided is based on the difference between the present value of the receivables that the Company expects to collect, discounted at the receivables' original effective interest rate and the carrying amount of the receivable. This specific allowance is re-evaluated and adjusted as additional information received affects the amounts estimated. Second, if it is determined that no objective evidence of impairment exists for an individually assessed receivable, the receivable is included in a group of receivables with similar credit risk characteristics and is collectively assessed for impairment. The provision under collective assessment is based on historical collection, write-off, experience and change in customer payment terms. Impairment assessment is performed throughout the year.

The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made. Reversal of provision for doubtful accounts amounted to ₱76.9 million, ₱232.0 million and nil in 2016, 2015 and 2014, respectively, while provision for doubtful accounts amounted to nil in 2016 and 2015 and ₱0.4 million in 2014. An increase in allowance for doubtful accounts would increase the Company's recorded expenses and decrease trade and other receivables. Trade and other receivables, net of allowance for doubtful accounts, amounted to ₱2.5 billion and ₱2.4 billion as at December 31, 2016 and 2015, respectively (see Note 5).

Determination of Impairment of AFS Financial Assets. The Company determines that AFS financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The Company determines that a decline in fair value of greater than 20% of cost is considered to be a significant decline and a decline for a period of more than 12 months is considered to be a prolonged decline. This determination of what is significant or prolonged requires judgment. In making this judgment, the Company evaluates, among other factors, the normal volatility in share price for quoted equities. AFS financial assets are considered impaired when the Company believes that future cash flows generated from the investment is expected to decline significantly. The Company's management makes significant estimates and assumptions on the future cash flows expected and the appropriate discount rate to determine if impairment exists. Impairment may also be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as AFS are not reversed through profit or loss. Subsequent increases in the fair value after the impairment are recognized directly in other comprehensive income.



Impairment loss on AFS financial assets recognized in 2014 amounted to ₱100.2 million while reversal of impairment loss amounted to ₱22.0 million in 2015 due to the improvement in future cash flows. No additional impairment loss on AFS financial assets was recognized in 2016. The carrying value of AFS financial assets is disclosed in Note 9.

Estimated Useful Lives of Property and Equipment. The useful life of each item of the Company's property and equipment is estimated based on the period over which the asset is expected to be available for use. Such estimation is based on a collective assessment of practices of similar businesses, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed periodically and 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 asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any item of property and equipment would increase the recorded depreciation expense and decrease property and equipment.

There was no change in estimated useful lives of property and equipment in 2016 and 2015.

Property and equipment, net of accumulated depreciation and amortization of ₱1.9 billion and ₱1.7 billion, amounted to ₱1.3 billion and ₱0.8 billion as at December 31, 2016 and 2015, respectively (see Note 8).

Recognition of Deferred Tax Assets and Liabilities. 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 assets to be utilized. However, there is no assurance that sufficient taxable profit will be generated to allow all or part of the deferred tax assets to be utilized.

Starting 2016, the Parent Company is no longer under income tax holiday (ITH) and elected to use Optional Standard Deduction (OSD) in computing its taxable income (see Notes 15 and 20). The Parent Company's assessment is based on actual gross income in the current year that is at a level where it is favorable to use OSD method. The Parent Company expects to continue to use OSD method in computing its taxable income each year up to the end of the concession period except for certain years when the Parent Company expects that it would be more favorable to use itemized deduction method. Accordingly, deferred tax assets and liabilities which were previously valued in 2015 using the itemized deduction method are now valued based on the forecasted gross and taxable income and expected method of deduction more beneficial to the Parent Company.

The Company did not recognize deferred tax assets on deductible temporary differences where doubt exists as to the tax benefits they will bring in the future.

Net deferred tax assets recognized amounted to ₱1.0 billion and ₱2.1 billion as at December 31, 2016 and 2015, respectively (see Note 15). Unrecognized deferred tax assets amounted to nil and ₱47.8 million as at December 31, 2016 and 2015, respectively (see Note 15).

Deferred FCDA and Deferred Credits. Under Amendment No. 1 of the Concession Agreement, the Parent Company is entitled to recover (refund) foreign exchange losses (gains) arising from MWSS loans and any concessionaire loans. For the unrealized foreign exchange losses, the Parent Company recognized deferred FCDA as an asset since this is a resource controlled by the Company as a result of past events and from which future economic benefits are expected to flow to the Parent Company. Unrealized foreign exchange gains, however, are presented as deferred credits and will be refunded to the customers.



Pursuant to MWSS-RO Resolution No. 2014-099-RO, the new base foreign exchange rate was changed from ₱48.04 to ₱41.19 effective January 1, 2015 (see Note 7).

Deferred FCDA representing the net effect of unrealized foreign exchange losses on service concession obligation payable to MWSS, and restatement of foreign currency-denominated interest-bearing loans and related interest that are recoverable from the customers amounted to ₱764.0 million and ₱279.1 million as at December 31, 2016 and 2015, respectively.

Asset Impairment. The Company assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Company considers important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- significant negative industry or economic trends.

The Company recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is computed using the value in use (VIU) approach. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs. 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 results of operations.

Noncurrent nonfinancial assets carried at cost and subjected to impairment test when certain impairment indicators are present are as follows:

	2016	2015
Service concession assets (see Note 7)	₱69,297,460	₱62,488,321
Property and equipment (see Note 8)	1,254,339	833,821
Goodwill (see Note 2)	288,082	288,082
Total	₱70,839,881	₱63,610,224

The goodwill arising from the acquisition of Phil Hydro represents the fair value of expected incremental economic benefits that the Parent Company expects to obtain. The impairment test of goodwill is based on VIU calculations that used the discounted cash flow model. The VIU was based on the cash flow projections on the most recent financial budgets and forecast of Phil Hydro. The length of the projections is up to 2035 based on the existing Bulk Water Supply Agreements and Memorandum of Agreement. The discount rate applied was 10.3%, which was based on the weighted average cost of capital. Based on the impairment test, the Parent Company did not identify any impairment loss. As at December 31, 2016 and 2015, no impairment loss on goodwill was recognized.

The Company performs its annual impairment test close to year-end, after finalizing the annual financial budget and forecast. The impairment test of goodwill is based on VIU calculation that uses the discounted cash flow model. Cash flow projections are based on most recent financial budget and forecast. Discount rate applied is based on market weighted average cost of capital with estimated



premium over cost of equity. The key assumptions used to determine the recoverable amount are discussed below.

Based on the impairment test performed, management did not identify impairment loss on goodwill. Management also believes that no reasonably possible change in any of the key assumptions would cause the carrying value to materially exceed the recoverable amount.

	2016	2015
Revenue growth rate*	3.0%	2.0%
Average forecast period	19 years	20 years
Discount rate	10.3%	8.7%

**Average growth represents average of year-over-year growth over the terms of the Bulk Water Supply Agreements and Memorandum of Agreement*

The forecasted period is greater than five (5) years as management can reliably estimate the cash flow for the entire duration of Phil Hydro's concession period covered by the Bulk Water Supply Agreements and Memorandum of Agreement.

Computation of Pension Cost and Other Post-employment Benefits. The cost of defined benefit pension plans and other post-employment benefits as well as the present value of the pension obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. These include the determination of the discount rate, turnover rate, mortality rate and salary increase rate. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, defined benefit obligations are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of government bonds that are denominated in the currency in which the benefits will be paid, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. Turnover rate is based on a 3-year historical information of voluntary separation and resignation by plan members.

The mortality rate is based on publicly available mortality tables for the specific country and is modified accordingly with estimates of mortality improvements. Future salary increases and pension increases are based on expected future inflation rates for the specific country.

Pension cost (income) presented as part of "Salaries, wages and benefits" account in the consolidated statements of income amounted to ₱104.0 million, ₱93.4 million and (₱155.1 million) in 2016, 2015 and 2014, respectively. Pension liability amounted to 317.3 million and ₱416.2 million as at December 31, 2016 and 2015, respectively (see Note 16).

Computation of Share-based Payment Transactions. The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payments requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the option, volatility, discount rates and dividend yield and making assumptions about them. The assumptions and models used for estimating fair value for share-based payments are disclosed in Note 13.

Equity-based compensation expense presented as part of "Salaries, wages and benefits" account in consolidated statements of income amounted to nil in 2016 and 2014 and ₱146.1 million in 2015 (see Note 13).



Determination of Other Long-term Incentives Benefits. The LTIP for key executives of MPIC and certain subsidiaries, including the Parent Company, was approved by the Executive Compensation Committee and the BOD of MPIC which is based on profit targets for the covered Performance Cycle.

In 2013, the Parent Company has approved an LTIP for its managers and executives which is also based on profit targets for the covered Performance Cycle of 2013 to 2015. Payments were made on March 18, 2016 amounting to ₱369.0 million.

In 2016, a proposal for new LTIP covering Performance Cycle of 2016 to 2018 for its managers and executives which is also based on profit targets was prepared for approval by the Parent Company's BOD. The final terms and conditions are still not approved by the BOD and is still pending as at February 27, 2017.

The cost of LTIP is determined using the projected unit credit method based on prevailing discount rates and profit targets. While management's assumptions are believed to be reasonable and appropriate, significant differences in actual results or changes in assumptions may materially affect the Company's other long-term incentive benefits.

Accrued LTIP amounted to ₱181.1 million and ₱429.0 million as at December 31, 2016 and 2015, respectively. The total cost of the LTIP recognized by the Company presented as part of "Salaries, wages and benefits" account in the consolidated statements of income amounted to ₱181.1 million, ₱149.8 million and ₱130.9 million in 2016, 2015 and 2014, respectively (see Notes 11 and 16).

4. Cash and Cash Equivalents and Short-term Investments

Cash and cash equivalents account consists of:

	2016	2015
Cash on hand and in banks	₱977,357	₱982,791
Cash equivalents	4,047,397	2,110,221
	₱5,024,754	₱3,093,012

Cash in banks earn interest at the respective bank deposit rates. Cash equivalents are made for varying periods from one day to three months depending on the immediate cash requirements of the Company and earn interest at the respective short-term deposit rates.

Short-term investments amounting to ₱3.0 billion and ₱6.1 billion as at December 31, 2016 and 2015, respectively, with original maturities of more than three months to one year are separately shown in the consolidated statements of financial position.

Interest income earned from cash in banks, cash equivalents and short-term investments, net of applicable final tax, amounted to ₱119.9 million, ₱134.9 million and ₱81.3 million in 2016, 2015 and 2014, respectively.



5. Trade and Other Receivables

This account consists of receivables from:

	2016	2015
Customers:		
Residential	₱1,776,481	₱1,908,889
Semi-business	271,113	241,700
Commercial	856,010	721,963
Industrial	226,938	155,901
Bulk water supply	56,777	42,362
	3,187,319	3,070,815
Employees	45,897	39,899
Others	213,201	348,722
	3,446,417	3,459,436
Less allowance for doubtful accounts	953,772	1,030,624
	₱2,492,645	₱2,428,812

The classes of the Company's receivables from customers are as follows:

- Residential – pertains to receivables arising from water and sewer service use for domestic purposes only.
- Semi-business – pertains to receivables arising from water and sewer service use for small businesses.
- Commercial – pertains to receivables arising from water and sewer service use for commercial purposes.
- Industrial – pertains to receivables arising from water and sewer service use for industrial purposes, including services for manufacturing.
- Bulk water supply – pertains to receivables arising from water service to water districts outside the West Service Area.

Receivables from customers and bulk water supply are non-interest bearing and generally have 60-day term.

Other receivables consist mainly of receivables from collecting agents normally received within 30 days and advances for construction and installation of water reticulation systems for subdivisions in the West Service Area payable on installment basis over a period of 3-5 years. Portion of advances for water reticulation systems expected to be collected beyond one year amounting to ₱61.3 million and ₱144.6 million as at December 31, 2016 and 2015, respectively, is presented as part of "Other noncurrent assets" account in the consolidated statements of financial position.

The movements in the Company's allowance for doubtful accounts follow:

	2016					
	Receivables from Customers				Other	
	Residential	Semi-business	Commercial	Industrial	Receivables	Total
At January 1	₱450,773	₱120,234	₱276,971	₱106,076	₱76,570	₱1,030,624
Reversal during the year	(36,292)	(9,690)	(22,321)	(8,549)	-	(76,852)
At December 31	₱414,481	₱110,544	₱254,650	₱97,527	₱76,570	₱953,772



2015						
	Receivables from Customers				Other	Total
	Residential	Semi-business	Commercial	Industrial	Receivables	
At January 1	₱566,133	₱149,377	₱344,104	₱131,787	₱76,570	₱1,267,971
Reversal during the year	(109,991)	(29,143)	(67,133)	(25,711)	–	(231,978)
Write-off	(5,369)	–	–	–	–	(5,369)
At December 31	₱450,773	₱120,234	₱276,971	₱106,076	₱76,570	₱1,030,624

6. Other Current Assets

This account consists of:

	2016	2015
Sinking fund (see Note 10)	₱1,777,626	₱1,773,843
Advances to contractors	1,020,883	987,035
Input VAT	332,683	191,749
Deposits	150,549	140,250
Prepayments (see Note 22)	112,977	59,311
Others	76,049	64,564
	₱3,470,767	₱3,216,752

Sinking fund represents the amount set aside to cover semi-annual principal and interest payment of loans, and unutilized proceeds from the US\$137.5 million loan drawdowns for the Metro Manila Wastewater Management Project maintained in a designated bank account (see Note 10).

Advances to contractors are normally applied within a year against progress billings.

Input VAT is an indirect tax on the goods and services which the Company uses in its operations. The Company recovers its input VAT by offsetting it against the output VAT. Management believes that the amount of recorded input VAT is fully realizable in the future.

Deposits mainly consist of refundable rental deposits.

Prepayments mainly pertain to insurance, performance bond, and taxes (see Note 22).

7. Service Concession Assets

The movements in this account are as follows:

	2016	2015
Cost:		
Balance at beginning of year	₱81,233,098	₱73,633,419
Additions	9,153,108	8,232,006
Effect of change in rebased rate	–	(632,327)
Balance at end of year	90,386,206	81,233,098
Accumulated amortization:		
Balance at beginning of year	18,744,777	16,707,093
Amortization	2,343,969	2,037,684
Balance at end of year	21,088,746	18,744,777
	₱69,297,460	₱62,488,321



Service concession assets consist of the present value of total estimated concession fee payments pursuant to the Concession Agreement and the costs of rehabilitation works incurred.

The aggregate Concession Fees pursuant to the Concession Agreement is equal to the sum of the following:

- a. 90% of the aggregate peso equivalent due under any MWSS loan which has been disbursed prior to the Commencement Date, including MWSS loans for existing projects and the raw water conveyance component of the Umiray-Angat Transbasin Project (UATP), on the relevant payment date set forth on the pertinent schedule of the Concession Agreement;
- b. 90% of the aggregate peso equivalent due under any MWSS loan designated for the UATP which has not been disbursed prior to the Commencement Date on the relevant payment date set forth on the pertinent schedule of the Concession Agreement;
- c. 90% of the local component costs and cost overruns related to the UATP in accordance with the pertinent schedule of the Concession Agreement;
- d. 100% of the aggregate peso equivalent due under any MWSS loan designated for existing projects, which have not been disbursed prior to the Commencement Date and have been either awarded to third party bidders or been elected by the Parent Company for continuation in accordance with the pertinent sections of the Concession Agreement;
- e. 100% of the local component costs and cost overruns related to the existing projects in accordance with relevant schedule of the Concession Agreement; and
- f. Maintenance and operating expenditure (MOE) representing one-half of the annual budget for MWSS for that year, provided that such annual budget shall not exceed ₱200.0 million (as at 1997), subject to annual CPI adjustment (see Note 22).

Service concession assets also include Tranche B Concession Fees, which pertain to additional concession fees charged by MWSS to the Parent Company representing the cost of borrowings by MWSS as at December 2004. In 2005, pursuant to the Debt and Capital Restructuring Agreement (DCRA), the Parent Company had recognized and fully paid Tranche B Concession Fees amounting to US\$36.9 million and the related accrued interest thereon (see Note 12).

Pursuant to the recommendation of the Receiver under the DCRA, the disputed amount being claimed by MWSS of additional Tranche B Concession Fees of US\$18.1 million is considered as contingent liability of the Parent Company, as discussed in Note 19.

The Parent Company recognized additional concession fees amounting to ₱188.4 million and ₱503.5 million in 2016 and 2015, respectively, mainly pertaining to various rehabilitation projects and UATP-related local component costs (see Note 12).

Specific borrowing costs capitalized as part of service concession assets amounted to ₱198.8 million and ₱99.4 million in 2016 and 2015, respectively (see Note 10).

On March 11, 2015, the MWSS Board of Trustees approved and confirmed the recommendation of the MWSS-RO to set aside the status quo of the FCDA and resume its normal operation starting first quarter of 2015. Under MWSS-RO Resolution No. 2014-002-CA, the MWSS-RO approved an FCDA equivalent to 1.12% of the 2015 basic charge of ₱33.97 per cu.m. or ₱0.38 per cu.m., effective January 1, 2015. The said FCDA adjustment was determined using the new rebased rate of ₱41.19 approved by the MWSS-RO, applicable to concession fee payments starting January 1, 2013.



In 2015, the effect of change in rebased rate amounting to ₱632.3 million was accounted for as an adjustment to “Service concession assets” and “Deferred credits” accounts to adjust their carrying value based on the newly-determined and approved rebased rate (see Note 3).

8. Property and Equipment

The rollforward analysis of this account follows:

	2016				
	Land and Land Improvements	Instrumentation, Tools and Other Equipment	Office Furniture, Fixtures and Equipment	Transportation Equipment	Total
Cost					
At January 1	₱41,275	₱1,290,735	₱887,574	₱297,180	₱2,516,764
Additions	5,180	253,075	189,936	266,767	714,958
Disposals	–	(10,804)	(406)	(58,304)	(69,514)
At December 31	46,455	1,533,006	1,077,104	505,643	3,162,208
Accumulated Depreciation and Amortization					
At January 1	3,623	793,353	701,707	184,260	1,682,943
Depreciation and amortization	705	120,668	112,558	57,560	291,491
Disposals	–	(10,804)	(390)	(55,371)	(66,565)
At December 31	4,328	903,217	813,875	186,449	1,907,869
Net Book Value at December 31	₱42,127	₱629,789	₱263,229	₱319,194	₱1,254,339

	2015				
	Land and Land Improvements	Instrumentation, Tools and Other Equipment	Office Furniture, Fixtures and Equipment	Transportation Equipment	Total
Cost					
At January 1	₱41,275	₱1,177,403	₱773,756	₱259,111	₱2,251,545
Additions	–	114,659	124,858	46,800	286,317
Disposals	–	(1,327)	(11,040)	(8,731)	(21,098)
At December 31	41,275	1,290,735	887,574	297,180	2,516,764
Accumulated Depreciation and Amortization					
At January 1	2,876	677,662	606,032	155,257	1,441,827
Depreciation and amortization	747	117,018	106,677	35,732	260,174
Disposals	–	(1,327)	(11,002)	(6,729)	(19,058)
At December 31	3,623	793,353	701,707	184,260	1,682,943
Net Book Value at December 31	₱37,652	₱497,382	₱185,867	₱112,920	₱833,821

Net gain on disposals of property and equipment amounting to ₱13.3 million, ₱0.2 million and ₱3.1 million in 2016, 2015 and 2014, respectively, is presented as part of “Others - net” account under “Other income (expenses)” in the consolidated statements of income. The company sold items of property and equipment for a total consideration of ₱16.2 million, ₱2.3 million and ₱11.1 million in 2016, 2015 and 2014, respectively.

No property and equipment as at December 31, 2016 and 2015 have been pledged as security or collateral.

9. AFS Financial Assets

The Company’s AFS financial assets consists of its 10% ownership investment in the unquoted equity shares of Subic Water and Sewerage Co., Inc. The carrying amount of the AFS Financial asset, net of allowance for impairment loss of ₱88.7 million, amounted to ₱132.4 million as at December 31, 2016 and 2015.



In 2015, the Company recognized reversal of impairment loss amounting to ₱22.0 million in “Other comprehensive income” in the consolidated statement of comprehensive income.

Dividend income on AFS financial assets presented as part of “Others – net” account under “Other income (expenses)” in the consolidated statements of income amounted to ₱10.0 million, ₱14.5 million and nil in 2016, 2015 and 2014, respectively.

10. Interest-bearing Loans

This account consists of:

	2016	2015
₱21.2 billion Term Loan	₱15,229,475	₱16,921,639
₱5.0 billion Corporate Notes	4,950,000	5,000,000
US\$137.5 million Loan	3,357,711	2,016,649
₱5.2 billion Corporate Notes	3,000,000	1,000,000
Peso-denominated Bank Loan	255,000	255,000
	26,792,186	25,193,288
Less unamortized debt issuance costs	104,330	113,949
	26,687,856	25,079,339
Less current portion	1,808,101	1,742,164
	₱24,879,755	₱23,337,175

₱21.2 billion Term Loan

On March 22, 2013, the Parent Company entered into several loan agreements for the refinancing of all of its existing loans under the 2008 and 2011 Omnibus Notes Facility and Security Agreements (ONFSA) (collectively referred to as “Corporate Notes”), whereby the Parent Company was granted a Term Loan Facility (the “Term Loan”) in the aggregate amount of ₱21.2 billion. Under the new terms, the loans shall be payable in semi-annual installments within ten years to commence at the end of the 6th month after the initial issue date and bears an interest rate per annum equal to the higher of (i) the applicable benchmark rate plus 0.75% per annum, or (ii) 5.75% per annum. The benchmark rate shall be determined by reference to the PDST-F rate. The Term Loan is secured by a negative pledge. The change in the terms of the loan contracts was assessed as substantial modification of the Corporate Notes and thus, resulted to derecognition of the old loan and recognition of new financial liability.

₱5.0 billion Corporate Notes

On April 29, 2013, the Parent Company entered into a Loan Agreement (Corporate Notes) with a local bank. The loan shall be payable in semi-annual installments within ten years to commence at the end of the 42nd month, and bears a fixed rate per annum equal to the higher of (i) the applicable benchmark rate plus 0.75% per annum, or (ii) 5.75% per annum. The benchmark rate shall be determined by reference to the PDST-F rate. The ₱5.0 billion Corporate Notes is secured by a negative pledge.

Debt Issuance Costs. All legal and professional fees incurred in relation to the debt totaling ₱42.8 million were capitalized in 2013. Debt issuance costs are amortized using the effective interest method. Amortization of debt issuance costs attributed to this loan amounting to ₱4.0 million, ₱3.9 million and ₱3.6 million in 2016, 2015 and 2014, respectively, is presented as part of “Interest expense and other financing charges” account in the consolidated statements of income (see Note 17).



US\$137.5 million Loan

The World Bank (WB), through the Metro Manila Wastewater Management Project (MWMP), provided a US\$275.0 million loan to the Land Bank of the Philippines (LBP) for relending at an equal share to the two Concessionaires of the MWSS namely, Maynilad and Manila Water. The MWMP is expected to finance investments in wastewater collection and treatment, and septage management in Metro Manila.

The loan will fund the following projects:

1. Rehabilitation of Ayala Alabang Sewage Treatment Plant (STP)
2. Talayan STP (part of the San Juan River Basin Project)
3. Valenzuela STP and associated wastewater conveyance system
4. Pasay STP and associated wastewater conveyance system
5. Muntinlupa STP and associated wastewater conveyance system
6. South Septage Treatment Plant

The WB and the LBP signed the Loan Agreement on May 31, 2012 while the Subsidiary Loan Agreement between LBP and Maynilad was executed on October 25, 2012.

The loan shall be payable in semi-annual installments within 25 years, inclusive of seven years grace period. The interest shall be paid semi-annually based on the same rate of interest payable by LBP under the WB Loan Agreement, plus fixed spread of 1.25% per annum. The loan is secured by a negative pledge.

Summary of transactions during the year is as follows:

	2016	2015
Balance at beginning of year	US\$6,222	US\$4,862
Amount received during the year	24,680	28,029
Net amount	30,902	32,891
Expenditures during the year	(26,343)	(26,669)
Balance at end of year	US\$4,559	US\$6,222

The US\$4.6 million (₱226.7 million) and US\$6.2 million (₱292.8 million) balance as at December 31, 2016 and 2015, respectively, represents the outstanding balance of LBP designated account No. 3404-031-936, under the account name MWMP - Category 2 - MWSI, and is presented as part of “Sinking fund” under “Other current assets” account in the consolidated statements of financial position (see Note 6).

The US\$67.5 million (₱3.4 billion) and US\$42.9 million (₱2.0 billion) cumulative drawn amount as at December 31, 2016 and 2015, respectively, is presented as part of the noncurrent portion of the interest-bearing loans. As at December 31, 2016, undrawn amount from this facility amounting to US\$70.0 million out of Maynilad’s share of US\$137.5 million from the facility is available until June 30, 2017. On November 29, 2016, Maynilad requested to extend the availability of the undrawn amount until June 30, 2019. As at February 27, 2017, the request is not yet granted.

The proceeds of the World Bank loan have been expended in accordance with the intended purposes as specified in the Loan Agreement.

Debt Issuance Costs. All legal and professional fees incurred in relation to the debt totaling ₱42.8 million were capitalized in 2013. Debt issuance costs are amortized using the effective interest method. Amortization of debt issuance costs attributed to this loan amounting to



₱2.6 million, ₱2.5 million and ₱3.0 million in 2016, 2015 and 2014, respectively, is presented as part of “Interest expense and other financing charges” account in the consolidated statements of income (see Note 17).

Specific borrowing costs capitalized as part of service concession assets amounted to ₱107.3 million and ₱54.8 in 2016 and 2015, respectively (see Note 7).

₱5.2 billion Corporate Notes

On February 24, 2014, the Parent Company entered into a Loan Agreement (Corporate Notes) with the Development Bank of the Philippines. The loan proceeds shall be used to finance the first stage of the Parañaque-Las Piñas STP and associated wastewater conveyance system. The loan shall be payable in semi-annual payments within fifteen years to commence at the end of the fifth year, which bears a fixed rate per annum equal to 6.0%. The first and second drawdowns amounting to ₱1.0 billion and ₱2.0 billion were made on March 2, 2015 and October 4, 2016, respectively. Undrawn amount from this facility amounting to ₱2.2 billion as at December 31, 2016 is available until February 2017. On January 17, 2017, Maynilad proposed to amend further the schedule of borrowing under the Loan Agreement as follows: (i) the third borrowing date be rescheduled (August 1, 2017), (ii) a fourth borrowing date be added in the schedule of borrowing (March 5, 2018), and (iii) the total borrowing be reduced to ₱4.8 billion. The ₱5.2 Billion Corporate Notes is secured by a negative pledge. Amendment is not yet approved as at February 27, 2017.

Debt Issuance Costs. All legal and professional fees incurred in relation to the debt totaling ₱46.1 million were capitalized in 2015. Debt issuance costs are amortized using the effective interest method. Amortization of debt issuance costs attributed to this loan amounting to ₱2.8 million and ₱2.2 million in 2016 and 2015, respectively, is presented as part of “Interest expense and other financing charges” account in the consolidated statements of income (see Note 17).

Specific borrowing costs capitalized as part of service concession assets amounted to ₱91.5 million and ₱44.6 million in 2016 and 2015, respectively (see Note 7).

Covenants. The loan agreements contain, among others, covenants regarding the maintenance of certain financial ratios such as debt-to-equity ratio and debt service coverage ratio, and maintenance of debt service reserve account (see Note 6). As at December 31, 2016 and 2015, the Parent Company has complied with these covenants.

Under the terms of the loan agreements, the Parent Company may, at its option and without premium and penalty, redeem the Corporate Notes in whole or in part, subject to the conditions stipulated in the agreements. The embedded early redemption and prepayment options are clearly and closely related to the host debt contract, and thus, do not require to be bifurcated and accounted for separately from the host contract.

Peso-denominated Loan of Phil Hydro

On May 4, 2015, Phil Hydro entered into a Loan Agreement with the Land Bank of the Philippines. The loan shall be payable in quarterly installments within eight years to commence after the end of the 8th quarter, and bears an interest rate per annum equal to the higher of (i) the applicable benchmark rate plus 1.0% per annum, or (ii) 5.5% per annum. The benchmark rate shall be determined by reference to the PDST-R2 rate. The peso-denominated loan is secured by a negative pledge.



Debt Issuance Costs. All legal and professional fees incurred in relation to the debt totaling ₱1.3 million were capitalized in 2015. Debt issuance costs are amortized using the effective interest method. Amortization of debt issuance costs attributed to this loan amounting to ₱0.2 million and ₱0.1 million in 2016 and 2015, respectively, is presented as part of “Interest expense and other financing charges” account in the consolidated statements of income (see Note 17).

Covenants. The loan agreement contains, among others, covenants regarding the maintenance of certain financial ratios such as debt-to-equity ratio and debt service coverage ratio. As at December 31, 2016 and 2015, Phil Hydro has complied with these covenants.

The movements in the balance of unamortized debt issuance costs related to all interest-bearing loans are as follows:

	2016	2015
Balance at beginning of year	₱113,949	₱75,293
Additions during the year	–	47,326
Amortization during the year (see Note 17)	(9,619)	(8,670)
	₱104,330	₱113,949

The repayments of loans based on existing terms are scheduled as follows:

Year	In Original Currency		Total Peso Equivalent*
	US Dollar-denominated*	Peso Loans <i>(In Millions)</i>	
2017	\$–	₱1,808.1	₱1,808.1
2018	–	1,824.0	1,824.0
2019	1.9	1,824.0	1,917.4
2020	3.7	1,924.0	2,110.7
2021 onwards	61.9	16,054.4	19,132.0
	\$67.5	₱23,434.5	₱26,792.2

*Translated using the December 31, 2016 exchange rate of ₱49.72: US\$1.

11. Trade and Other Payables

This account consists of:

	2016	2015
Accrued expenses (see Note 16)	₱5,586,916	₱6,134,784
Trade payables	2,576,222	2,304,384
Accrued construction costs (see Note 14)	2,727,871	2,886,154
Due to a related party (see Note 14)	1,900	1,900
	₱10,892,909	₱11,327,222

Accrued expenses mainly consist of provisions, salaries, wages and benefits, contracted services and interest payable to the banks. Details of provisions required by PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, are not disclosed as these may prejudice the Company’s positions in relation to the cases pending before the courts or quasi-judicial bodies.

Trade and other payables are non-interest bearing and are normally settled within one year.



Trade payables include liabilities relating to assets held in trust (see Note 23) used in the Company's operations amounting to ₱97.3 million each as at December 31, 2016 and 2015.

Accrued construction costs represents unbilled construction costs from contractors and normally settled upon receipt of billings.

12. Service Concession Obligation Payable to MWSS

This account consists of:

	2016	2015
Concession fees payable (see Note 7)	₱7,221,892	₱7,487,645
Accrued interest	607,217	607,217
	7,829,109	8,094,862
Less current portion	1,328,978	1,357,705
	₱6,500,131	₱6,737,157

Disputes with MWSS

The Parent Company has been contesting certain charges billed by MWSS relating to: (a) the basis of the computation of interest; (b) MWSS cost of borrowings; and (c) additional penalties. Consequently, the Parent Company has not provided for these additional charges. These disputed charges were effectively reflected and recognized by the Parent Company as Tranche B Concession Fees amounting to US\$30.1 million by virtue of the DCRA entered into in 2005. The Parent Company also paid US\$6.8 million in 2005 as an additional amount of Tranche B Concession Fees determined by the Receiver (see Note 7).

The Parent Company reconciled its liability to MWSS with the confirmation and billings of MWSS. The difference between the amount confirmed by MWSS and the amount recognized by the Parent Company amounted to ₱5.1 billion as at December 31, 2016 and 2015. The difference mainly pertains to disputed claims of MWSS consisting of additional Tranche B Concession Fees (see Note 7), borrowing cost and interest penalty under the Concession Agreement (prior to the DCRA). The Parent Company's position on these charges is consistent with the Receiver's recommendation which was upheld by the Rehabilitation Court (see Notes 7 and 19).

Following the issuance of the Rehabilitation Court's Order on December 19, 2007 disallowing the MWSS' disputed claims and the termination of the Parent Company's rehabilitation proceedings, the Parent Company and MWSS sought to resolve the matter in accordance with the dispute resolution requirements of the transitional and clarificatory agreement (TCA).

Prior to the DCRA, the Parent Company has accrued interest on its payable to MWSS based on the terms of the Concession Agreement, which was disputed by the Parent Company before the Rehabilitation Court. These already amounted to ₱985.3 million as at December 31, 2011 and have been charged to interest expense in prior years. The Parent Company maintains that the accrued interest on its payable to MWSS has been adequately replaced by the Tranche B Concession Fees discussed above. The Parent Company's position is consistent with the Receiver's recommendation which was upheld by the Rehabilitation Court (see Notes 7 and 19). With the prescription of the TCA and in light of the Parent Company's current negotiation and outstanding offer of US\$14.0 million to fully settle the claim of MWSS, the Parent Company reversed the amount of accrued interest in excess of the US\$14.0 million settlement offer amounting to ₱378.1 million and charged to other income in 2012. The remaining balance of



₱607.2 million as at December 31, 2016 and 2015, which pertains to the disputed interest penalty under the Concession Agreement prior to DCRA, has remained in the books pending resolution of the remaining disputed claims of MWSS.

The schedule of undiscounted estimated future concession fee payments, based on the term of the Concession Agreement, is as follows:

Year	In Original Currency		Total Peso Equivalent*
	Foreign Currency Loans (Translated to US\$)*	Peso Loans/ Project Local Support	
		<i>(In Millions)</i>	
2017	\$14.3	₱561.9	₱1,270.7
2018	14.2	543.1	1,250.8
2019	14.2	543.1	1,251.5
2020	13.8	543.2	1,228.2
2021-2037	45.1	9,219.2	11,459.7
	\$ 101.6	₱11,410.5	₱16,460.9

*Translated using the December 31, 2016 exchange rate of ₱49.72: US\$1.

Additional concession fee liability relating to the extension of the Concession Agreement (see Note 1) is only determinable upon loan drawdown of MWSS and the actual construction of the related concession projects.

13. Equity

- a. The Parent Company's authorized and issued shares as at December 31, 2016 and 2015 are presented below:

	Number of Shares	
	2016	2015
Authorized and issued - ₱1,000 par value		
Common shares		
Class A	4,222,482	4,222,482
Class B	236,000	236,000
ESOP	88,500	88,500
	4,546,982	4,546,982

Class A shares, comprising sixty percent (60%) of the authorized common shares, may only be subscribed by Filipino citizens or corporations or associations organized under the laws of the Philippines with at least sixty percent (60%) of the capital owned by Filipino citizens.

Class B shares, comprising forty percent (40%) of the authorized common shares, may be subscribed by, transferred to and owned by either Filipino citizens or by aliens.

- b. ESOP

The employees of the Parent Company are allowed equity participation of up to six percent (6%) of the issued and outstanding capital stock of the Parent Company upon the effective date of the increase in authorized capital stock of the Parent Company pursuant to and in accordance with the provisions of Clause 2.6 of the DCRA. For this purpose, a series of



88,500,000 nonvoting convertible redeemable shares (ESOP Shares) was created from common Class A shares as reflected in the Parent Company's amended Articles of Incorporation. In 2008, the ESOP shares were effectively reduced to 88,500 shares due to change in par value from ₱1 to ₱1,000. The ESOP shares have no voting rights, except for those provided under Section 6 of the Corporation Code and have no pre-emptive rights to purchase or subscribe to future or additional issuances or disposition of shares of the Parent Company.

Within thirty (30) days after the earlier of (i) the end of the fifth year from the creation of the ESOP Shares, and (ii) the listing date for common shares in a recognized Philippine Stock Exchange, the Parent Company may redeem the ESOP shares at a redemption ratio equal to one common share for every ESOP share held and such common shares so exchanged shall have the same rights and privileges as all other common shares.

Each ESOP Share will be convertible, at the option of the holder thereof, at any time during the period commencing the earlier of (i) the end of the fifth year from the creation of the ESOP Shares; or (ii) the listing date for common shares in a recognized Philippine Stock Exchange into one fully-paid and non-assessable common share. Such common share shall have the same rights and privileges as all other common shares. Conversion of the ESOP Share may be effected by surrendering the certificates representing such shares to be converted to the Parent Company common shares at the Parent Company's principal office or at such other office or offices as the BOD may designate, and a duly signed and completed notice of conversion in such form as may from time to time be specified by the Parent Company (a "Conversion Notice"), together with such evidence as the Parent Company may reasonably require to prove the title of the person exercising such right. A Conversion Notice once given may not be withdrawn without the consent in writing of the Parent Company.

In 2012, the Board and shareholders of the Parent Company approved the amendment of its Articles of Incorporation to allow for the reissuance of ESOP shares that have been bought back by the Parent Company from separated employees. Upon approval by the SEC of the amendment on January 31, 2013, ESOP shares reacquired by the Parent Company from its resigned employees were subsequently reissued to all qualified employees.

In 2014, ESOP shares reacquired by the Company from employees who availed of the Special Opportunity Program (SOP) amounting to ₱94.4 million were presented as part of "Treasury shares" account shown under the equity section of the consolidated statements of financial position.

ESOP shares reacquired by the Parent Company from its resigned employees amounting to ₱32.7 million and ₱6.1 million in 2016 and 2015, respectively, were presented as treasury shares.

c. Dividends

On February 24, 2014, during the regular meeting, the Parent Company's BOD set and approved the declaration of cash dividends of ₱220.01 per common share amounting to ₱1.0 billion to all shareholders of record as at February 24, 2014. Payments were made in tranches from April 2, 2014 to June 25, 2014.

On February 23, 2015, during the regular meeting, the Parent Company's BOD set and approved the declaration of cash dividends of ₱442.09 per common share amounting to



₱2.0 billion to all shareholders of record as at March 1, 2015. Payments were made on March 17, 2015.

On January 25, 2016, during the regular meeting, the Parent Company's BOD set and approved the declaration of cash dividends of ₱440.17 per common share amounting to ₱2.0 billion to all shareholders of record as at February 9, 2016. Payments were made on March 4, 2016.

d. Appropriation of Retained Earnings

On February 23, 2015, the Parent Company's BOD approved the appropriation of its retained earnings amounting to ₱3.5 billion for various water and sewerage projects expected to be implemented in the next two years.

In 2016, the Parent Company reversed the appropriated retained earnings in 2013 amounting to ₱4.0 billion. On February 27, 2017, the Parent Company's BOD approved the appropriation of its retained earnings amounting to ₱5.0 billion for various water and sewerage projects expected to be implemented in the next two years and ₱3.0 billion for cash dividends.

e. Equity Adjustments

Redemption of Preferred Shares

The Parent Company issued and redeemed preferred shares in 2008. Foreign exchange fluctuation from date of issuance of the preferred shares to the date of issuance of notice of redemption, amounting to ₱351.0 million, is recognized as part of "Other equity adjustments" account shown under the equity section of the consolidated statements of financial position.

MPIC Share-based Payment

On June 24, 2007, the shareholders of MPIC approved a share option scheme (the Plan) under which MPIC's directors may, at their discretion, invite executives of MPIC upon the regularization of employment of eligible executives, to take up share option of MPIC to obtain an ownership interest in MPIC and for the purpose of long-term employment motivation. The scheme became effective on June 14, 2007 and is valid for 10 years. An amended plan was approved by the stockholders on February 20, 2009.

As amended, the overall limit on the number of shares that may be issued upon exercise of all options to be granted and yet to be exercised under the Plan must not exceed 5.0% of the shares in issue from time to time.

The exercise price in relation to each option shall be determined by the Parent Company's Compensation Committee, but shall not be lower than the highest of: (i) the closing price of the shares for one or more board lots of such shares on the PSE on the option offer date; (ii) the average closing price of the shares for one or more board lots of such shares on the PSE for the five business days on which dealings in the shares are made immediately preceding the option offer date; and (iii) the par value of the shares.

MPIC allocated and set aside stock options relating to an additional 145,000,000 common shares, of which, (a) 94,300,000 common shares were granted to its new directors and senior management officers, as well as members of the management committee of certain MPIC subsidiaries (includes 15,200,000 common shares granted to officers of the Parent Company)



at the exercise price of ₱2.73 per common share on July 2, 2010 and (b) another 10,000,000 common shares were granted at the exercise price of ₱3.50 on December 21, 2010 to officers of the Parent Company.

On March 8, 2011, 1,000,000 common shares were granted at the exercise price of ₱3.53 to senior management of the Parent Company.

The weighted average remaining term to expiry for the share options outstanding for the third grant is nil and 0.1 year as at December 31, 2016 and 2015, respectively.

The fair value of the options granted is estimated at the date of grant using Black-Scholes-Merton formula, taking into account the terms and conditions upon which the options were granted. The following tables list the inputs to the model used for the ESOP:

	Grant dated July 2, 2010		
	30.0%	35.0%	35.0%
	vesting on July 2, 2011	vesting on July 2, 2012	vesting on July 2, 2013
Spot price	₱2.65	₱2.65	₱2.65
Exercise price	₱2.73	₱2.73	₱2.73
Risk-free rate	4.61%	5.21%	5.67%
Expected volatility*	69.27%	67.52%	76.60%
Term to vesting (in days)	365	731	1,096
Call price	₱0.73	₱1.03	₱1.39

	Grant dated December 21, 2010		
	30.0%	35.0%	35.0%
	vesting on August 1, 2011	vesting on August 1, 2012	vesting on August 1, 2013
Spot price	₱3.47	₱3.47	₱3.47
Exercise price	₱3.50	₱3.50	₱3.50
Risk-free rate	1.62%	2.83%	3.73%
Expected volatility*	46.62%	68.23%	72.82%
Term to vesting (in days)	223	589	954
Call price	₱0.46	₱1.20	₱1.62

	Grant dated March 8, 2011		
	30.0%	35.0%	35.0%
	vesting on March 8, 2012	vesting on March 8, 2013	vesting on March 8, 2014
Spot price	₱3.53	₱3.53	₱3.53
Exercise price	₱3.53	₱3.53	₱3.53
Risk-free rate	2.56%	4.38%	5.01%
Expected volatility*	39.32%	61.39%	64.42%
Term to vesting (in days)	366	731	1,096
Call price	₱0.58	₱1.28	₱1.62

**The expected volatility reflects the assumption that the historical volatility over a period similar to the life of the options is indicative of future trends, which may also not necessarily be the actual outcome.*

Starting in 2012, no additional stock option activity was received from MPIC.



Maynilad Share-based Payment

On November 23, 2015, the BOD approved the awarding of 23,777 ESOP shares to all qualified Maynilad employees to be paid through stock purchase bonus (equity-settled transaction). The ESOP covers employees who have met the following eligibility criteria:

- a. The employee has completed a full year’s service, from November 2, 2014 to November 1, 2015 (the “Period”);
- b. The employee has obtained at least a satisfactory performance rating for the appraisal period immediately preceding November 1, 2015;
- c. The employee has not been suspended at any time during the Period;
- d. The employee has not exceeded 10 days of absences without official leave during the Period; and
- e. The employee has not exceeded 20 days of leave without pay during the Period.

Communication to eligible employees was made on December 1, 2015.

The fair value of ESOP shares amounting to ₱6,143.22 per share was determined based on the Parent Company’s equity value at the date of grant using the discounted cash flows (DCF) method.

The grant of shares under the ESOP does not require an exercise price to be paid by the employees nor are there cash alternatives. All ESOP shares will be held in treasury until issuance. On February 9, 2016, the ESOP shares were issued to qualified employees.

Equity-based compensation expense recognized by the Parent Company under “Salaries, wages and benefits” account in the consolidated statements of income amounted to nil in 2016 and 2014, and ₱146.1 million in 2015.

Carrying value of the ESOP recognized under “Other equity adjustments” in the equity section of the consolidated statements of financial position amounted to ₱41.8 million and ₱187.9 million as at December 31, 2016 and 2015, respectively.

14. Related Party Transactions

Parties are considered to be related if one party has the ability to control, directly or indirectly, the other party or exercise influence over the other party in making financial and operating decisions. Parties are considered to be related if they are subject to common control or common significant influence.

Category	Year	Amount/ Volume of Transactions	Outstanding Receivable (Payable)	Terms	Conditions
<i>Subsidiary of a significant influence investor</i>					
DM Consunji, Inc.					
Revenue from water and sewer services	2016	₱17.9 million	₱1.1 million	Noninterest-bearing, settlement in cash and payable on demand	Unsecured, not impaired
	2015	15.2 million	1.6 million		
Construction costs (see Note 11)	2016	2.9 billion	(102.4 million)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
	2015	952.0 million	284.6 million		
<i>Significant influence investees of FPC</i>					
Manila Electric Company					
Revenue from water and sewer services	2016	4.7 million	1.0 million	Noninterest-bearing, settlement in cash and payable on demand	Unsecured, not impaired
	2015	6.0 million	1.0 million		



Category	Year	Amount/ Volume of Transactions	Outstanding Receivable (Payable)	Terms	Conditions
Electricity costs	2016 2015	₱820.4 million 776.8 million	(₱29.9 million) (29.6 million)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Indra Philippines, Inc.					
Commercial outsourcing of information technology and system services	2016 2015	247.6 million 170.8 million	(39.1 thousand) (26.0 thousand)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Meralco Industrial Engineering Services Corporation					
Construction costs (see Note 11)	2016 2015	36.6 million 195.5 million	(2.6 million) (24.5 million)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Philippine Long Distance Telephone Company and Subsidiaries					
Revenue from water and sewer services	2016 2015	5.2 million 5.4 million	0.4 million 0.3 million	Noninterest-bearing, settlement in cash and payable on demand	Unsecured, not impaired
Communication expenses	2016 2015	11.3 million 10.8 million	(1.4 million) (0.4 million)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Outsourced services	2016 2015	14.5 million 15.3 million	(1.5 million) (1.6 million)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Entity under common control					
Ecosystem Technologies International, Inc.					
Construction costs (see Note 11)	2016	8.5 million	–	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Others					
Revenue from water and sewer services	2016 2015	7.9 million 7.9 million	55.2 thousand 50.5 thousand	Noninterest-bearing, settlement in cash and payable on demand	Unsecured, not impaired
Communication expenses	2016 2015	35.2 million 32.4 million	(13.7 thousand) (73.0 thousand)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Insurance	2016 2015	8.6 million 6.5 million	(10.0 thousand) (10.0 thousand)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Sponsorship fees	2016 2015	49.0 thousand 25.0 thousand	(25.0 thousand) (25.0 thousand)	Noninterest-bearing, settlement in cash and payable on demand	Unsecured
Repairs and maintenance	2016 2015	– 17.8 thousand	– –	Noninterest-bearing, settlement in cash and payable on demand	Unsecured

Terms and Conditions of Transactions with Related Parties

Outstanding balances at year-end are unsecured, interest-free, settlement occurs in cash and payable on demand.

Total compensation and benefits of key management personnel of the Company consist of:

	2016	2015	2014
Compensation	₱264,218	₱237,908	₱198,607
Pension costs	11,743	11,628	9,597
Short-term benefits	7,424	7,285	7,823
	₱283,385	₱256,821	₱216,027



15. Income Taxes

Provision for current income tax represents the total of RCIT for both Parent Company and Phil Hydro in 2016 and 2014, and the combination of RCIT for the Parent Company and MCIT for Phil Hydro in 2015. Prior to 2016, RCIT for the Parent Company is computed only for miscellaneous income not covered by ITH (see Note 20).

The components of the net deferred tax assets of the Company as at December 31, 2016 and 2015 shown in the consolidated statements of financial position are as follows:

	2016	2015
Deferred tax assets:		
Accrued expenses	₱453,214	₱836,519
Service concession assets - net	499,633	1,031,947
Pension liability and unamortized past service cost	43,990	117,656
Unamortized debt issuance costs	31,318	119,280
Allowance for inventory obsolescence	6,885	19,049
Unearned revenue	-	16,754
Allowance for doubtful accounts	-	428
	1,035,040	2,141,633
Deferred tax liabilities -		
Unrealized foreign exchange gain	(2,846)	(2,059)
Deferred tax assets - net	₱1,032,194	₱2,139,574

The components of the net deferred tax liabilities of the Phil Hydro as at December 31, 2016 shown in the consolidated statement of financial position are as follows:

	2016
Deferred tax assets:	
Unearned revenue	₱16,129
Accrued expenses	2,331
Pension liability and unamortized past service cost	142
	18,602
Deferred tax liabilities:	
Service concession assets - net	47,189
Unamortized debt issuance costs	298
	47,487
Deferred tax liabilities - net	₱28,885

In 2015, the Parent Company has the following deductible temporary differences for which no deferred tax assets have been recognized since management believes that it is not probable that these will be realized in the near future:

	2015
Impairment loss on AFS financial assets	₱78,197
Pension liability and unamortized past service cost	40,953
Share-based payment	40,199
	₱159,349



Service concession assets consist of concession fees and property, plant and equipment. For income tax purposes, concession fees are amortized using UOP method while property, plant and equipment are depreciated on a straight-line basis over the estimated useful lives or remaining concession period, whichever is shorter.

The reconciliation of provision for income tax computed at the statutory income tax rate to provision for (benefit from) income tax as shown in the consolidated statements of income is summarized as follows:

	2016	2015	2014
Income tax at statutory tax rate of 30%	₱2,999,561	₱2,885,377	₱2,467,385
Add (deduct) the tax effects of:			
Deduction under OSD method	(1,407,531)	–	–
Foregone benefit under itemized deduction method	1,216,392	–	–
Derecognition of deferred tax assets relating to accrued expenses	214,169	414,913	–
Change in income tax rate for using OSD	244,460	–	–
Change in unrecognized net deferred tax assets	(47,805)	(817,109)	(380,601)
Interest income already subjected to final tax	(35,976)	(40,468)	(24,385)
Net taxable income under ITH (see Note 20)	–	(2,405,872)	(2,077,981)
Other nondeductible items and others	67,095	30,456	(15,088)
Provision for (benefit from) income tax	₱3,250,365	₱67,297	(₱30,670)

16. Employee Benefits

LTIP

In 2013, the Parent Company approved an LTIP for its managers and executives which is based on profit targets for the covered Performance Cycle.

The total cost of the LTIP amounted to ₱181.1 million, ₱149.8 million and ₱130.9 million in 2016, 2015 and 2014, respectively, which are presented as part of “Salaries, wages and benefits” account in the consolidated statements of income. Accrued LTIP amounting to ₱181.1 million as at December 31, 2016 and ₱429.0 million as at December 31, 2015 were respectively presented as part of “Other noncurrent liabilities” account and “Trade and other payables” account in the consolidated statements of financial position.

Pension Plan

Maynilad

The Parent Company has a funded, noncontributory and actuarially computed pension plan covering all regular and permanent employees. The benefits are based on years of service and compensation during the last year of employment.

In line with its strategic goal to improve operational efficiency, the Parent Company offered a Redundancy and Right-Sizing Program in 2014. The redundancy program offered a separation package based on the number of years, or fractions thereof, on a pro-rated basis, of service with



the Company plus monetary equivalent of some benefits. This resulted to a curtailment gain of ₱257.3 million.

Changes in the funded pension liability in 2016 are as follows:

	Present value of defined benefit obligation	Fair value of plan assets	Pension liability
At December 31, 2015	₱1,020,456	₱604,880	₱415,576
Pension cost in the consolidated statement of income:			
Current service cost	88,530	–	88,530
Net interest cost	48,495	32,976	15,519
	137,025	32,976	104,049
Benefits paid	(17,735)	(17,735)	–
			(192,000
Actual contributions	–	192,000)
Remeasurements in other comprehensive income:			
Interest income (excluding amount included in net interest)	–	(15,003)	15,003
Actuarial changes due to experience adjustment	25,517	–	25,517
Actuarial changes arising from changes in demographic assumptions	(2,252)	–	(2,252)
Actuarial changes arising from changes in financial assumptions	(48,981)	–	(48,981)
	(25,716)	(15,003)	(10,713)
At December 31, 2016	₱1,114,030	₱797,118	₱316,912

Changes in funded pension liability in 2015 are as follows:

	Present value of defined benefit obligation	Fair value of plan assets	Pension liability
At January 1, 2015	₱893,364	₱612,327	₱281,037
Pension cost in the consolidated statement of income:			
Current service cost	81,136	–	81,136
Net interest cost	39,576	27,126	12,450
	120,712	27,126	93,586
Benefits paid	(16,653)	(16,653)	–
Remeasurements in other comprehensive income:			
Interest income (excluding amount included in net interest)	–	(17,920)	17,920
Actuarial changes due to experience adjustment	64,226	–	64,226
Actuarial changes arising from changes in financial assumptions	(41,193)	–	(41,193)
	23,033	(17,920)	40,953
At December 31, 2015	₱1,020,456	₱604,880	₱415,576



The components of pension cost (income) included under “Salaries, wages and benefits” account in the consolidated statements of income for 2016, 2015 and 2014 are as follows:

	2016	2015	2014
Current service cost	₱88,530	₱81,136	₱87,799
Net interest cost	15,519	12,450	13,636
Curtailment gain	-	-	(257,341)
	₱104,049	₱93,586	(₱155,906)

The fair value of plan assets by each class as at the end of the reporting period are as follows:

	2016	2015
Investments in:		
Government securities	₱386,404	₱273,937
Equity securities	323,408	226,292
Unit trust funds	36,629	17,195
Cash and cash equivalents	46,903	2,110
Loans/notes receivable	960	2,970
Receivables and others	2,815	82,376
	₱797,119	₱604,880

The plan asset’s carrying amount approximates its fair value since the plan assets are short-term in nature or marked-to-market. Investments held have quoted prices in active market. The remaining plan assets which are short term in nature, do not have quoted market prices in an active market.

The plan assets have diverse investments and do not have any concentration risk.

As at December 31, 2016, the plan assets consist of the following:

- Investments in government securities consist primarily of fixed-rate treasury notes and retail treasury bonds that bear interest ranging from 2.13% to 9.5% per annum and have maturities from 2017 to 2035.
- Investments in equity securities are composed of investment in shares of various listed entities. The carrying amounts of investments in equity securities also approximate their fair values since they are marked-to-market.
- Unit trust funds include mutual funds invested in quoted shares.
- Loans and notes receivables include unsecured fixed-rate notes of a related party and unsecured notes of an unaffiliated company which bear interest at 6.26%.
- Cash and cash equivalents include regular savings and time deposits, which bear interest ranging from 1.60% to 5.50% per annum.
- Receivables and others include certificate of deposit with a term of 7 years and bear interest at 5.25%.



The cost of defined benefit pension plans and other post-employment benefits as well as the present value of the pension obligation are determined using actuarial valuations. The actuarial valuation involves making various assumptions. The principal assumptions used in determining pension cost and present value of defined benefit obligation are shown below:

	2016	2015
Discount rate	5.40%	4.86%
Salary increase rate	4.00%	4.00%
Turnover rate	2.76%	0.78%

Sensitivity analysis below has been determined based on reasonably possible changes of each significant assumption on the defined benefit obligation as at the end of the reporting period, assuming all other assumptions were held constant:

	2016	
	Increase (decrease) in Basis Points	Increase (decrease) in Amount
Discount rate	100	(₱80,812)
	(100)	94,188
Salary increase rate	100	101,238
	(100)	(88,289)
Turnover rate	100	(3,465)
	(100)	3,283
	2015	
	Increase (decrease) in Basis Points	Increase (decrease) in Amount
Discount rate	100	(₱86,880)
	(100)	102,676
Salary increase rate	100	97,507
	(100)	(84,141)
Turnover rate	100	(10,293)
	(78)	8,376

Shown below are the maturity analyses of the undiscounted benefit payments:

	2016		
	Normal Retirement	Other than Normal Retirement	Total
Less than one year	₱43,086	₱22,916	₱66,002
More than one year to five years	458,152	112,280	570,432
More than 5 years to 10 years	641,177	124,361	765,538
More than 10 years to 15 years	267,538	116,683	384,221
More than 15 years to 20 years	214,022	152,688	366,710
More than 20 years	2,514,176	449,602	2,963,778
	₱4,138,151	₱978,530	₱5,116,681



	2015		Total
	Normal Retirement	Other than Normal Retirement	
Less than one year	₱37,216	₱7,992	₱45,208
More than one year to five years	315,305	49,396	364,701
More than 5 years to 10 years	732,021	71,902	803,923
More than 10 years to 15 years	387,308	67,192	454,500
More than 15 years to 20 years	198,938	66,644	265,582
More than 20 years	3,137,143	258,263	3,395,406
	₱4,807,931	₱521,389	₱5,329,320

Actual contributions to the defined benefit pension plan amounted to ₱192.0 million and nil in 2016 and 2015, respectively.

The Parent Company expects to contribute ₱170.8 million to the defined benefit pension plan in 2017.

Phil Hydro

Phil Hydro recognized pension liability amounting to ₱0.4 million and ₱0.7 million in 2016 and 2015, respectively, in the consolidated statements of financial position determined in accordance with Republic Act No. 7641. Pension cost (income) included under “Salaries, wages and benefits” account in the consolidated statements of income amounted to nil, (₱0.1 million) and ₱0.8 million in 2016, 2015 and 2014, respectively.

17. Interest Expense and Other Financing Charges

	2016	2015	2014
Bank loans (see Note 10)	₱1,257,103	₱1,346,163	₱1,453,080
Accretion on service concession obligation payable to MWSS (see Note 12)	533,037	622,425	696,904
Accretion of customers’ deposits	10,816	6,030	6,897
Amortization of debt issuance costs (see Note 10)	9,619	8,670	6,595
	₱1,810,575	₱1,983,288	₱2,163,476



18. Basic/Diluted Earnings Per Share

	2016	2015	2014
Net income (a)	₱6,748,172	₱9,550,627	₱8,255,288
Weighted average number of shares at beginning of year	4,436,963	4,460,428	4,472,762
Less weighted average number of treasury shares (see Note 13)	3,858	23,465	12,334
Weighted average number of shares at end of year for basic earnings per share (b)	4,433,105	4,436,963	4,460,428
Add weighted average potential dilutive shares from ESOP (see Note 13)	-	1,981	-
Weighted average number of shares at end of year for diluted earnings per share (c)	4,433,105	4,438,944	4,460,428
Basic earnings per share (a/b)	₱1,522.22	₱2,152.51	₱1,850.78
Diluted earnings per share (a/c)	₱1,522.22	₱2,151.55	₱1,850.78

19. Contingent Liabilities

Following are the significant contingent liabilities of the Company as at December 31, 2016 and 2015:

- a. Additional Tranche B Concession Fees and interest penalty are being claimed by MWSS in excess of the amount recommended by the Receiver. Such additional charges being claimed by MWSS (in addition to other miscellaneous claims) amounted to ₱5.1 billion as at December 31, 2016 and 2015. The Rehabilitation Court has resolved to deny and disallow the said disputed claims of MWSS in its December 19, 2007 Order, upholding the recommendations of the Receiver on the matter. Following the termination of the Parent Company's rehabilitation proceedings, the Parent Company and MWSS sought to resolve this matter in accordance with the dispute requirements of the TCA (see Note 12).
- b. On October 13, 2005, the Parent Company and Manila Water (the "Concessionaires") were jointly assessed by the Municipality of Norzagaray, Bulacan for real property taxes on certain common purpose facilities purportedly due from 1998 to 2005 amounting to ₱357.1 million. It is the position of the Concessionaires that it is the Republic of the Philippines that owns these properties, and is therefore, exempt from real property taxes.

The supposed joint liability of the Concessionaires for real property tax, including interests, amounted to about ₱1.0 billion as at December 31, 2016 and 2015.

After the Local Board of Assessment Appeals (LBAA) ruled in favor of the Municipality of Norzagaray, Bulacan, the Concessionaires elevated the ruling of the LBAA to the Central Board of Assessment Appeals (CBAA) by filing separate appeals. As at February 27, 2017, the case is still pending resolution.

- c. The Parent Company is a party to various civil and labor cases relating to breach of contracts with damages, illegal dismissal of employees, and nonpayment of backwages, benefits and performance bonus, among others.



20. Registration with the Board of Investments (BOI)

The Parent Company is registered with the BOI under Executive Order No. 226, as amended, as a new operator of water supply and sewerage system for the West Service Area on a pioneer status.

The registration entitles the Parent Company to incentives which include, among others, an ITH for a period of six years beginning on Commencement Date or from actual start of commercial operations, whichever comes first.

On April 16, 2008, the BOI granted the request of the Parent Company for the extension of the period for the ITH availment from August 2001 - July 2007 to January 2003 - December 2008.

On October 20, 2008, the Parent Company filed an application for an ITH bonus year. The application was for the extension of the availment of the ITH incentive by the Parent Company for one (1) year or for the period January 1, 2009 to December 31, 2009. The BOI approved the Parent Company's application on December 22, 2008.

On December 3, 2009, the Parent Company was issued with BOI Certificate of Registration No. 2009-171 as a new operator of the 200 million liters per day (MLD) Bulk Water Supply and Distribution Project (Putatan, Muntinlupa). On December 16, 2009, Certificates of Registration Nos. 2009-188 and 2009-189 as a new operator of the 1,500 MLD and 900 MLD Bulk Water Supply and Distribution Projects pertaining to the La Mesa Treatment Plants 1 and 2, respectively, were likewise issued by the BOI. The registrations entitle the Parent Company to incentives which include an ITH for six years commencing on January 2010 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration. Commercial operations of the 1,500 MLD and 900 MLD Bulk Water Supply and Distribution Projects started on January 1, 2010 while the 200 MLD Project started on January 1, 2011. The ITH for all these projects has expired on December 31, 2015. The ITH incentives were limited to the sales/revenue generated from the operation of the three plants which substantially covered the total capacity of the Parent Company. ITH incentive enjoyed by the Company amounted to ₱2,405.9 million and ₱2,078.0 million in 2015 and 2014, respectively (see Note 15).

21. Significant Contracts with Manila Water (East Concessionaire)

In relation to the Concession Agreement, the Parent Company entered into the following contracts with the East Concessionaire:

- a. Interconnection Agreement wherein the two Concessionaires shall form an unincorporated joint venture that will manage, operate, and maintain interconnection facilities. The terms of the agreement provide, among others, the cost and the volume of water to be transferred between zones; and
- b. Common Purpose Facilities Agreement that provides for the operation, maintenance, renewal, and, as appropriate, decommissioning of the Common Purpose Facilities, and performance of other functions pursuant to and in accordance with the provisions of the Concession Agreement and performance of such other functions relating to the Concession (and the Concession of the East Concessionaire) as the Parent Company and the East Concessionaire may choose to delegate to the Joint Venture, subject to the approval of MWSS.



22. Commitments

Concession Agreement

Significant commitments under the Concession Agreement follow:

- a. To pay Concession Fees (see Note 7)
- b. To post Performance Bond (see Note 6)

Under Section 6.9 of the Concession Agreement, the Parent Company is required to post a performance bond to secure the performance of its obligations under certain provisions of the Concession Agreement. The aggregate amount drawable in one or more installments under such performance bond during the Rate Rebasing Period to which it relates is set out below.

Rate Rebasing Period	Aggregate Amount Drawable Under Performance Bond
	<i>(In Millions)</i>
First (August 1, 1997 – December 31, 2002)	US\$120.0
Second (January 1, 2003 – December 31, 2007)	120.0
Third (January 1, 2008 – December 31, 2012)	90.0
Fourth (January 1, 2013 – December 31, 2017)	80.0
Fifth (January 1, 2018 – May 6, 2022)	60.0

Within 30 days from the commencement of each renewal date, the Parent Company shall cause the performance bond to be reinstated to the full amount applicable to the rate rebasing period as set forth above.

In connection with the extension of the term of the Concession Agreement (see Note 1), certain adjustments to the obligation of the Parent Company to post the performance bond under Section 6.9 of the Concession Agreement have been approved and summarized as follows:

- The aggregate amount drawable in one or more installments under each performance bond during the Rate Rebasing Period to which it relates has been adjusted to US\$30.0 million until the Expiration Date.
 - The amount of the Performance Bond for the period covering 2023 to 2037 shall be mutually agreed upon in writing by the MWSS and the Parent Company consistent with the provisions of the Concession Agreement.
 - The Parent Company posted the Surety Bond for the amount of US\$90.0 million issued by Prudential Guarantee and Assurance, Inc. (the Surety) in favor of MWSS, as security for the Parent Company's proper and timely performance of its obligations under the Concession Agreement. On December 6, 2012, the Parent Company renewed the Surety Bond for the amount of US\$80.0 million issued by the Surety in favor of MWSS. The liability of the Surety under this bond will expire on December 31, 2017 (see Note 6).
- c. To pay half of MWSS and MWSS-RO's budgeted expenditures for the subsequent years, provided the aggregate annual budgeted expenditures do not exceed ₱200.0 million, subject to CPI adjustments. As a result of the extension of the life of the Concession Agreement, the annual budgeted expenditures shall increase by 100%, subject to CPI adjustments, effective January 2010 (see Notes 1 and 7).



- d. To meet certain specific commitments in respect to the provision of water and sewerage services in the West Service Area, unless modified by the MWSS-RO due to unforeseen circumstances.
- e. To operate, maintain, renew and, as appropriate, decommission facilities in a manner consistent with the National Building Standards and best industrial practices so that, at all times, the water and sewerage system in the West Service Area is capable of meeting the service obligations (as such obligations may be revised from time to time by the MWSS-RO following consultation with the Parent Company).
- f. To repair and correct, on a priority basis, any defect in the facilities that could adversely affect public health or welfare, or cause damage to persons or third-party property.
- g. To ensure that at all times the Parent Company has sufficient financial, material and personnel resources available to meet its obligations under the Concession Agreement.
- h. To prevent incurrence of debt or liability that would mature beyond the term of the Concession Agreement, without prior notice to MWSS.

Failure of the Parent Company to perform any of its obligations under the Concession Agreement of a kind or to a degree which, in a reasonable opinion of the MWSS-RO, amounts to an effective abandonment of the Concession Agreement and which failure continues for at least 30 days after written notice from the MWSS-RO, may cause the Concession Agreement to be terminated.

Operating Lease Commitments

The Company leases the office space and branches, where service outlets are located, several equipment and service vehicles, renewable under certain terms and conditions to be agreed upon by the parties. Total rent expense for the above operating leases amounted to ₱143.7 million, ₱150.6 million and ₱167.7 million in 2016, 2015 and 2014, respectively (see Note 23).

Future minimum operating lease payments as at December 31 are as follows:

<u>Period Covered</u>	<u>2016</u>	<u>2015</u>
	<i>(In Millions)</i>	
Not later than one year	₱125.55	₱94.83
More than one year and not later than five years	334.81	207.53
More than five years	154.85	169.48

23. Assets Held in Trust

Materials and Supplies

The Parent Company has the right to use any items of inventory owned by MWSS in carrying out its responsibility under the Concession Agreement, subject to the obligation to return the same at the end of the concession period, in kind or in value at its current rate, subject to CPI adjustments.

Facilities

The Parent Company has been granted the right to operate, maintain in good working order, repair, decommission and refurbish the movable property required to provide the water and sewerage services under the Concession Agreement. MWSS shall retain legal title to all movable property in existence at the Commencement Date. However, upon expiration of the useful life of any such movable property as may be determined by the Parent Company, such movable property



shall be returned to MWSS in its then-current condition at no charge to MWSS or the Parent Company (see Note 7).

The Concession Agreement also provides the Parent Company and the East Concessionaire to have equal access to MWSS facilities involved in the provision of water supply and sewerage services in both West and East Service Areas including, but not limited to, the MWSS management information system, billing system, telemetry system, central control room and central records.

The net book value of the facilities transferred to the Parent Company on Commencement Date based on MWSS' closing audit report amounted to ₱7.3 billion with a sound value of ₱13.8 billion.

Beginning at the Commencement Date, MWSS' corporate headquarters were made available for a one-year lease to the Parent Company and the East Concessionaire, subject to yearly renewal with the consent of the parties concerned. As at December 31, 2016, the lease has been renewed for another year. Rent expense amounted to ₱38.0 million in 2016, 2015 and 2014 (see Note 22).

24. Financial Risk Management Objectives and Policies

The Company's principal financial instruments are its debts to the local banks and concession fees payable to MWSS per Concession Agreement. Other financial instruments of the Company are cash and cash equivalents, short-term investments, and trade and other receivables. The main purpose of those financial instruments is to finance the Company's operations.

The main risks arising from the Company's principal financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk.

The BOD reviews and approves the policies for managing the Company's financial risks. The Company monitors risks arising from all financial instruments and regularly reports financial management activities and the results of these activities to the BOD.

Interest Rate Risk

Interest rate risk is the risk that the future cash flows of financial instruments will fluctuate because of the changes in market interest rates. The Company's exposure to market risk for changes in interest rates relates primarily to the Company's interest-bearing loans.

The Company maintains a mix of floating and fixed rate interest-bearing loans, at a ratio of 12% floating and 88% fixed, and 8% floating and 92% fixed in 2016 and 2015, respectively, per abovementioned loan agreements. The floating rate interest-bearing loans will increase to a higher portion over time because of future drawdowns in connection to the MWMP loan agreement.



The following table shows the Company's significant financial liabilities that are exposed to cash flow interest rate risk:

₱21.2 billion Term Loan	Fixed rate benchmark+0.75% (5.75%, March 25, 2013 to March 25, 2018)
₱5.0 billion Corporate Notes (1 st drawdown)	Fixed rate benchmark+0.75% (5.75%, April 29, 2013 to April 29, 2018)
₱5.0 billion Corporate Notes (2 nd drawdown)	Fixed rate benchmark+0.75% (5.75%, October 29, 2013 to October 29, 2018)
US\$137.5 million Loan (US\$67.5 million drawdown)	Floating rate benchmark+1.25% (3.12%, November 15, 2016 to May 15, 2017)
₱5.2 billion Corporate Notes (1 st drawdown)	Fixed rate benchmark (6.00%, March 2, 2015 to March 2, 2035)
₱5.2 billion Corporate Notes (2 nd drawdown)	Fixed rate benchmark (6.00%, October 4, 2016 to March 2, 2035)
Peso-denominated Bank Loan	Fixed rate benchmark (5.50%, June 29, 2015 to June 29, 2025)

Interest on financial liabilities classified as fixed rate is fixed until the maturity of the instrument.

The following tables show information about the Company's financial assets and financial liabilities that are exposed to cash flow and fair value interest rate risks.

	2016	
	Within 1 Year	Total
Short-term cash investments:		
Cash and cash equivalents (1-90 days)*	₱5,011,855	₱5,011,855
Short-term investments (91-364 days)	3,041,000	3,041,000
	₱8,052,855	₱8,052,855

*Excludes cash on hand amounting to ₱12,899.

	2016			
	Within 1 Year	More than 1 Year	Total (In US\$)	Total (In ₱)
Liabilities:				
Interest-bearing loans:				
Interest rate	5.75%	5.75%, 3.12%, 6.00% and 5.50%		
Current - local	₱1,808,101	–	–	₱1,808,101
Noncurrent - foreign	–	\$66,857	\$66,857	3,324,117
Noncurrent - local	–	₱21,555,638	–	21,555,638
				26,687,856
Service concession obligation payable to MWSS:				
Interest rate	8.16%			
Current - foreign	\$11,128	–	\$11,128	₱553,289
Current - local	₱775,689	–	–	775,689
Noncurrent - foreign	–	\$73,626	73,626	3,660,698
Noncurrent - local	–	₱2,839,433	–	2,839,433
				7,829,109
				₱34,516,965



	2015	
	Within 1 Year	Total
Short-term cash investments:		
Cash and cash equivalents (1-90 days)*	₱3,069,280	₱3,069,280
Short-term investments (91-364 days)	6,088,541	6,088,541
	₱9,157,821	₱9,157,821

*Excludes cash on hand amounting to ₱23,732.

	2015			
	Within 1 Year	More than 1 Year	Total (In US\$)	Total (In ₱)
Liabilities:				
Interest-bearing loans:				
Interest rate	5.75%	5.75%, 2.40%, 6.00% and 5.50%		
Current - local	₱1,742,164	–	–	₱1,742,164
Noncurrent - foreign	–	\$42,084	\$42,084	1,980,458
Noncurrent - local	–	₱21,356,717	–	21,356,717
				25,079,339
Service concession obligation payable to MWSS:				
Interest rate	8.21%			
Current - foreign	\$9,244	–	\$9,244	435,008
Current - local	₱922,697	–	–	922,697
Noncurrent - foreign	–	\$85,617	85,617	4,029,148
Noncurrent - local	–	₱2,708,009	–	2,708,009
				8,094,862
				₱33,174,201

The following table demonstrates the sensitivity of the Company's profit before tax to a reasonably possible change in interest rates for the years ended December 31, 2016 and 2015, with all variables held constant (through the impact on floating rate borrowings). The estimates are based on the management's annual financial forecast. There is no impact on the Company's equity other than those already affecting income.

	2016	
	Increase/ Decrease in Basis Points	Effect on Income Before Tax
Floating rate borrowings	+50	(₱16,621)
	-50	16,621
	2015	
	Increase/ Decrease in Basis Points	Effect on Income Before Tax
Floating rate borrowings	+50	(₱9,902)
	-50	9,902

Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future value of financial instruments will fluctuate because of changes in foreign exchange rates.



The Company's foreign currency risk arises primarily from movements of the Philippine Peso against the United States Dollar, Euro and Japanese Yen. The servicing of foreign currency denominated loans of MWSS is among the requirements of the Concession Agreement. Revenues are generated in Philippine Peso. However, there is a mechanism in place as part of the Concession Agreement wherein the Company (or the end consumers) can recover currency fluctuations through the FCDA that is approved by the Regulatory Office.

Information on the Company's foreign currency-denominated monetary assets and liabilities and the Philippine Peso equivalent of each as at December 31, 2016 and 2015 is presented as follows:

	2016			Total Peso Equivalent
	US Dollar	Euro	JPY	
Asset				
Cash and cash equivalents, short-term investments and sinking fund	\$4,623	€-	¥-	₱229,847
Liabilities				
Interest-bearing loans	(\$66,857)	€-	¥-	(₱3,324,117)
Service concession obligation payable to MWSS	(82,081)	(19)	(312,776)	(4,213,987)
	(148,938)	(19)	(312,776)	(7,538,104)
Net foreign currency denominated liabilities	(\$144,315)	(€19)	(¥312,776)	(₱7,308,257)

The spot exchange rates used were ₱49.72:US\$1, ₱51.84:EUR1, and ₱0.43:JPY1 as at December 31, 2016.

	2015			Total Peso Equivalent
	US Dollar	Euro	JPY	
Asset				
Cash and cash equivalents, short-term investments and sinking fund	\$6,346	€-	¥-	₱298,664
Liabilities				
Interest-bearing loans	(\$42,084)	€-	¥-	(₱1,980,458)
Service concession obligation payable to MWSS	(84,589)	(33)	(1,228,775)	(4,464,156)
	(126,673)	(33)	(1,228,775)	(6,444,614)
Net foreign currency denominated liabilities	(\$120,327)	(€33)	(¥1,228,775)	(₱6,145,950)

The spot exchange rates used were ₱47.06:US\$1, ₱51.74:EUR1, and ₱0.39:JPY1 as at December 31, 2015.



The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates, with all variables held constant, of the Company's profit before tax (due to changes in the fair value of monetary assets and liabilities) and equity as at December 31, 2016 and 2015. The estimates in the movement of the foreign exchange rates were based on the management's annual financial forecast.

	Increase/Decrease in Peso and U.S Dollar, Euro and JPY Exchange Rates	Foreign Exchange Rate	Effect on Income Before Income Tax
2016			
U.S Dollar	+1%	49.72	(P71,753)
Euro	+1%	51.84	(10)
JPY	+1%	0.43	(1,345)
U.S Dollar	-1%	49.72	71,753
Euro	-1%	51.84	10
JPY	-1%	0.43	1,345
	Increase/Decrease in Peso and U.S Dollar, Euro and JPY Exchange Rates	Foreign Exchange Rate	Effect on Income Before Income Tax
2015			
U.S Dollar	+1%	47.06	(P56,626)
Euro	+1%	51.74	(17)
JPY	+1%	0.39	(4,792)
U.S Dollar	-1%	47.06	56,626
Euro	-1%	51.74	17
JPY	-1%	0.39	4,792

The Company recognized net foreign exchange loss of P510.8 million and P152.7 million in 2016 and 2015, respectively, mainly arising from the translation of the Company's cash and cash equivalents, short-term investments, deposits, interest-bearing loans and service concession obligation payable to MWSS. However, the net foreign exchange gain or loss on interest-bearing loans and service concession obligation payable to MWSS is subject to foreign exchange recovery mechanisms under the Concession Agreement (see Note 2).

Credit Risk

Credit risk is the risk that a counter party will not meet its obligations under a financial instrument or customer contract, leading to a financial loss.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that except for connection fees and other highly meritorious cases, it does not offer credit terms to its customers. Because of the basic need service it provides, historical collections of the Company are relatively high. Credit exposure is widely dispersed. Receivable balances are monitored on an ongoing basis.

With respect to credit risk arising from the other financial assets of the Company, consisting of cash and cash equivalents, short-term cash investments, deposits and sinking fund and miscellaneous deposits, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments. The Company transacts only with institutions or banks which have demonstrated financial soundness for the past five years.



The Company has no significant concentrations of credit risk.

The table below shows the maximum exposure to credit risk for the components of the consolidated statements of financial position as at December 31, 2016 and 2015:

	2016	2015
Cash and cash equivalents* (see Note 4)	₱5,011,855	₱3,069,280
Short-term investments (see Note 4)	3,041,000	6,088,541
Trade and other receivables - net (see Note 5)	2,492,645	2,428,812
Deposits and sinking fund (see Note 6)	1,928,175	1,914,093
Miscellaneous deposits**	319,980	220,016
Total credit risk exposure	₱12,793,655	₱13,720,742

*Excludes cash on hand amounting to ₱12,899 and ₱23,732 as at December 31, 2016 and 2015, respectively.

**Included as part of "Other noncurrent assets" in the consolidated statements of financial position.

As at December 31, 2016 and 2015, the credit quality per class of financial assets that were neither past due nor impaired are as follows:

	2016				Total
	Neither Past Due nor Impaired		Past Due but not Impaired	Impaired	
	High Grade	Standard			
Cash and cash equivalents*	₱5,011,855	₱-	₱-	₱-	₱5,011,855
Short-term investments	3,041,000	-	-	-	3,041,000
Trade and other receivables	2,338,887	31,188	122,570	953,772	3,446,417
Deposits and sinking fund	1,928,175	-	-	-	1,928,175
Miscellaneous deposits**	-	319,980	-	-	319,980
	₱12,319,917	₱351,168	₱122,570	₱953,772	₱13,747,427

	2015				Total
	Neither Past Due nor Impaired		Past Due but not Impaired	Impaired	
	High Grade	Standard			
Cash and cash equivalents*	₱3,069,280	₱-	₱-	₱-	₱3,069,280
Short-term investments	6,088,541	-	-	-	6,088,541
Trade and other receivables	2,166,300	160,752	101,760	1,030,624	3,459,436
Deposits and sinking fund	1,914,093	-	-	-	1,914,093
Miscellaneous deposits**	-	220,016	-	-	220,016
	₱13,238,214	₱380,768	₱101,760	₱1,030,624	₱14,751,366

*Excludes cash on hand amounting to ₱12,899 and ₱23,732 as at December 31, 2016 and 2015, respectively.

**Included as part of "Other noncurrent assets" in the consolidated statements of financial position.

Past due accounts amounting to ₱122.6 million and ₱101.8 million as at December 31, 2016 and 2015, respectively, are not impaired since based on the Company's experience, these receivables are normally collected the following year.

The credit quality of the financial assets was determined as follows:

Cash and cash equivalents, short-term investments, and deposits and sinking fund are placed in various banks. These are held by large prime financial institutions that have good reputation and low probability of insolvency. Management assesses the quality of these financial assets as high grade.

For trade and other receivables, high grade relates to those which are consistently collected before the maturity date, normally seven days from bill delivery. Standard grade includes receivables from customers that are collectible beyond seven days from bill delivery even without an effort from the Company to follow them up, or those advances from officers and employees that are



collected through salary deduction. For miscellaneous deposits, standard grade consists of meter and security deposits that are normally refundable upon termination of service.

Liquidity Risk

Liquidity risk is the potential for not meeting the obligations as they become due because of an inability to liquidate assets or obtain adequate funding.

The Company monitors its risk to a shortage of funds using a recurring liquidity planning. Cash planning considers the maturity of both its financial investments and financial assets (e.g., trade and other receivables, other financial assets) and projected cash flows from operations.

The Company's objective is to maintain a balance between continuity of funding and flexibility through the use of bank drafts, bank loans and debentures.

The tables below summarize the maturity profile of the Company's financial liabilities as at December 31, 2016 and 2015 based on contractual undiscounted payments.

	2016				Total
	On Demand	Due Within 3 Months	Due Between 3 and 12 Months	Due after 12 Months	
Interest-bearing loans*	₱-	₱1,129,031	₱1,026,171	₱24,879,755	₱27,034,957
Trade and other payables**	601,454	2,660,299	1,941,696	4,566,705	9,770,154
Service concession obligation payable to MWSS	-	-	1,328,978	6,500,131	7,829,109
Customers' deposits	-	-	-	911,338	911,338
	₱601,454	₱3,789,330	₱4,296,845	₱36,857,929	₱45,545,558

*Principal plus interest payment

**Excludes taxes payable and interest payable

	2015				Total
	On Demand	Due Within 3 Months	Due Between 3 and 12 Months	Due after 12 Months	
Interest-bearing loans*	₱-	₱1,100,226	₱972,157	₱23,337,175	₱25,409,558
Trade and other payables**	1,045,691	2,804,270	2,222,174	4,649,417	10,721,552
Service concession obligation payable to MWSS	-	-	1,357,705	6,737,157	8,094,862
Customers' deposits	-	-	-	828,077	828,077
	₱1,045,691	₱3,904,496	₱4,552,036	₱35,551,826	₱45,054,049

*Principal plus interest payment

**Excludes taxes payable and interest payable

The table below shows the maturity profile of the Company's financial assets based on contractual undiscounted cash flows as at December 31, 2016 and 2015:

	2016				Total
	On Demand	Due Within 3 Months	Due Between 3 and 12 Months	Due after 12 Months	
Cash and cash equivalents	₱977,357	₱4,047,397	₱-	₱-	₱5,024,754
Short-term investments	-	-	3,041,000	-	3,041,000
Trade and other receivables	2,233,358	188	259,099	-	2,492,645
Deposits and sinking fund	1,777,626	-	150,549	-	1,928,175
AFS financial assets	132,387	-	-	-	132,387
Miscellaneous deposits	-	-	-	319,980	319,980
	₱5,120,728	₱4,047,585	₱3,450,648	₱319,980	₱12,938,941



	2015				Total
	On Demand	Due Within 3 Months	Due Between 3 and 12 Months	Due after 12 Months	
Cash and cash equivalents	₱982,791	₱2,110,221	₱-	₱-	₱3,093,012
Short-term investments	-	-	6,088,541	-	6,088,541
Trade and other receivables	2,039,961	230	388,621	-	2,428,812
Deposits and sinking fund	1,773,843	-	140,250	-	1,914,093
AFS financial assets	132,387	-	-	-	132,387
Miscellaneous deposits	-	-	-	220,016	220,016
	₱4,928,981	₱2,110,452	₱6,617,412	₱220,016	₱13,876,861

Capital Management

The primary objective of the Company's capital management strategy is to ensure that it maintains a healthy capital structure in order to maintain a strong credit standing while it maximizes shareholder value.

The Company closely manages its capital structure vis-a-vis a certain target gearing ratio, which is net debt divided by total capital plus net debt. The Company's target gearing ratio is 75%. This target is to be maintained over the next five years by managing the Company's level of borrowings and dividend payments to shareholders.

For purposes of computing its net debt, the Company includes the outstanding balance of its long-term interest-bearing loans, service concession obligation payable to MWSS and trade and other payables, less the outstanding cash and cash equivalents, short-term investments, deposits and sinking fund. To compute its capital, the Company uses net equity.

	2016	2015
Interest-bearing loans and service concession obligation payable to MWSS (see Notes 10 and 12)	₱34,516,965	₱33,174,201
Trade and other payables (see Note 11)	10,892,909	11,327,222
Less cash and cash equivalents, short-term investments, deposits and sinking fund (see Notes 4 and 6)	(9,993,929)	(11,095,646)
Net debt (a)	35,415,945	33,405,777
Net equity	40,261,654	35,538,655
Net equity and debt (b)	₱75,677,599	₱68,944,432
Gearing ratio (a/b)	47%	48%

For purposes of monitoring debt ratio covenants, the Company computes using both interest-bearing debt and total liabilities. The Company closely monitors its debt covenants and maintains a capital expenditure program and dividend declaration policy that keeps the compliance of these covenants into consideration.



25. Financial Assets and Financial Liabilities

The following table summarizes the carrying values and fair values of the Company's financial assets and financial liabilities as at December 31, 2016 and 2015:

	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Loans and receivables -				
Miscellaneous deposits (included under "Other noncurrent assets" account)	₱319,980	₱270,064	₱220,016	₱171,339
Financial Liabilities				
Other financial liabilities:				
Interest-bearing loans	₱26,687,856	₱28,175,873	₱25,079,339	₱26,959,364
Service concession obligation payable to MWSS	7,829,109	9,302,022	8,094,862	9,569,586
Customers' deposits	279,363	312,192	244,434	271,883
	₱34,796,328	₱37,790,087	₱33,418,635	₱36,800,833

The following methods and assumptions were used to estimate the fair value of each class of financial assets and financial liabilities for which it is practicable to estimate such value:

Cash and Cash Equivalents, Short-term Investments, Trade and Other Receivables, Deposits and Sinking Fund, and Trade and Other Payables. Due to the short-term nature of these transactions, the carrying values approximate the fair values as at the reporting date.

AFS Financial Assets. Fair value is equivalent to the carrying value because the Company's AFS financial assets pertain to unquoted equity investments.

Interest-bearing Loans. For floating rate loans, the carrying value approximates the estimated fair value as at the reporting date due to quarterly repricing of interest rates. For fixed rate loans, the estimated fair value is based on the discounted value of future cash flows using the applicable rates for similar types of financial instruments.

Miscellaneous Deposits, Service Concession Obligation Payable to MWSS and Customers' Deposits. Estimated fair value is based on the discounted value of future cash flows using the applicable rates for similar types of financial instruments.

The fair values of fixed rate interest-bearing loans, miscellaneous deposits, service concession obligation payable to MWSS and customers' deposits are determined using Fair Value Hierarchy Level 3.

26. Supplemental Disclosure of Cash Flow Information

In 2015, the noncash operating activities pertain to unpaid concession fees amounting to ₱500.0 million and effect of change in rebased rate amounting to ₱632.3 million (see Note 7).

In 2016, the noncash operating activity pertains to MWSS loan drawdown for Angat Water Transmission Improvement Project (AWTIP) amounting to ₱92.4 million (see Note 7).



27. Events After the Reporting Period

On February 27, 2017, during the regular meeting, the Parent Company's BOD set and approved the declaration of cash dividends amounting to ¥3.0 billion to all shareholders.

