Beacon Electric Asset Holdings, Inc.

Financial Statements
December 31, 2012 and 2011

and

Independent Auditors' Report

SyCip Gorres Velayo & Co.

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BOA/PRC Reg. No. 0001,
December 28, 2012, valid until December 31, 2015
SEC Accreditation No. 0012-FR-3 (Group A),
November 15, 2012, valid until November 16, 2015

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
Beacon Electric Asset Holdings, Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Beacon Electric Asset Holdings, Inc., which comprise the statements of financial position as at December 31, 2012 and 2011, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Beacon Electric Asset Holdings, Inc. as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

Report on the Supplementary Information Required Under Revenue Regulations 19-2011 and 15-2010

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required under Revenue Regulations 19-2011 and 15-2010 in Notes 18 and 19 to the financial statements, respectively, is presented for purposes of filing with the Bureau of Internal Revenue and is not a required part of the basic financial statements. Such information is the responsibility of the management of Beacon Electric Asset Holdings, Inc. The information has been subjected to the auditing procedures applied in our audit of the basic financial statements. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.

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PTR No. 3669694, January 2, 2013, Makati City

February 27, 2013

BEACON ELECTRIC ASSET HOLDINGS, INC.
STATEMENTS OF FINANCIAL POSITION
(Amounts in Millions)

	December 31	
	2012	2011
ASSETS		
Current Assets		
Cash and cash equivalents (Notes 4, 14 and 15)	**₱2,146.1**	₱1,472.3
Receivables (Notes 5, 14 and 15)	**1.1**	54.5
Other current assets	**2.2**	1.0
Total Current Assets	**2,149.4**	1,527.8
Noncurrent Assets		
Investment in Meralco (Notes 6 and 8)	**113,940.0**	104,091.9
Other noncurrent assets (Note 8)	–	51.7
Total Noncurrent Assets	**113,940.0**	104,143.6
	₱116,089.4	₱105,671.4
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and other current liabilities (Notes 7, 8, 14 and 15)	**₱918.4**	₱469.9
Current portion of long-term debt (Notes 8, 14 and 15)	**374.2**	506.5
Liability for contingent consideration (Note 6)	–	2,781.7
Deferred purchase liability (Notes 6, 14 and 15)	–	7,313.0
Total Current Liabilities	**1,292.6**	11,071.1
Noncurrent Liabilities		
Long-term debt - net of current portion (Notes 8, 14 and 15)	**32,895.7**	21,225.2
Due to related parties (Note 9)	**972.6**	972.9
Total Noncurrent Liabilities	**33,868.3**	22,198.1
Equity (Note 10)		
Capital stock	**4,583.0**	4,313.0
Additional paid-in capital	**70,200.5**	65,071.9
Other comprehensive loss (Note 6)	**(217.6)**	(224.5)
Retained earnings	**6,362.6**	3,241.8
Total Equity	**80,928.5**	72,402.2
	₱116,089.4	₱105,671.4

See accompanying Notes to Financial Statements.

BEACON ELECTRIC ASSET HOLDINGS, INC.
STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in Millions)

	Years Ended December 31	
	2012	2011
REVENUE		
Equity share in net earnings of Meralco (Note 6)	**₱7,358.4**	₱5,015.5
EXPENSES		
Professional and other service fees	**10.8**	4.5
Taxes and licenses	**6.9**	6.0
	17.7	10.5
OTHER INCOME (EXPENSES)		
Interest expense (Notes 6 and 8)	**(2,570.5)**	(1,932.2)
Interest income (Note 4)	**94.4**	36.8
Gain on disposal of investment in available-for-sale (AFS) financial assets (Note 6)	**77.4**	–
Amortization of debt issue costs (Note 8)	**(43.3)**	(26.4)
Loss on re-measurement of liability for contingent consideration (Note 6)	–	(317.3)
Gain on derecognition of liability for contingent consideration (Note 6)	–	91.7
Miscellaneous (Notes 7 and 8)	**(496.1)**	(0.1)
	(2,938.1)	(2,147.5)
NET INCOME	**4,402.6**	2,857.5
OTHER COMPREHENSIVE INCOME (LOSS) (Note 6)	**6.9**	(224.5)
TOTAL COMPREHENSIVE INCOME	**₱4,409.5**	₱2,633.0

See accompanying Notes to Financial Statements.

BEACON ELECTRIC ASSET HOLDINGS, INC.

STATEMENTS OF CHANGES IN EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

(Amounts in Millions)

	Preferred Stock (Note 10)	Common Stock (Note 10)	Additional Paid-in Capital (Note 10)	Other Comprehensive Loss (Note 6)	Retained Earnings (Note 10)	Total
Balances at January 1, 2012	**₱2,000.0**	**₱2,313.0**	**₱65,071.9**	**(₱224.5)**	**₱3,241.8**	**₱72,402.2**
Shares issued	–	**270.0**	**5,128.6**	–	–	**5,398.6**
Net income	–	–	–	–	**4,402.6**	**4,402.6**
Other comprehensive income	–	–	–	**6.9**	–	**6.9**
Total comprehensive income	–	–	–	**6.9**	**4,402.6**	**4,409.5**
Dividends declared	–	–	–	–	**(1,281.8)**	**(1,281.8)**
Balances at December 31, 2012	**₱2,000.0**	**₱2,583.0**	**₱70,200.5**	**(₱217.6)**	**₱6,362.6**	**₱80,928.5**
Balances at January 1, 2011	₱801.0	₱2,313.0	₱51,140.9	₱–	₱664.7	₱54,919.6
Shares issued	1,199.0	–	13,931.0	–	–	15,130.0
Net income	–	–	–	–	2,857.5	2,857.5
Other comprehensive loss	–	–	–	(224.5)	–	(224.5)
Total comprehensive income	–	–	–	(224.5)	2,857.5	2,633.0
Dividends declared	–	–	–	–	(280.4)	(280.4)
Balances at December 31, 2011	₱2,000.0	₱2,313.0	₱65,071.9	(₱224.5)	₱3,241.8	₱72,402.2

See accompanying Notes to Financial Statements.

BEACON ELECTRIC ASSET HOLDINGS, INC.

STATEMENTS OF CASH FLOWS

(Amounts in Millions)

	Years Ended December 31	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**₱4,402.6**	₱2,857.5
Adjustments for:		
Equity share in net earnings of Meralco (Note 6)	**(7,358.4)**	(5,015.5)
Interest expense (Notes 6 and 8)	**2,570.5**	1,932.2
Pretermination fees and transactions cost (Notes 7 and 8)	**214.0**	–
Write-down of capitalized debt issue costs (Note 8)	**158.5**	–
Interest income (Note 4)	**(94.4)**	(36.8)
Gain on disposal of investment in AFS financial assets (Note 6)	**(77.4)**	–
Amortization of debt issue costs (Note 8)	**43.3**	26.4
Loss on re-measurement of liability for contingent consideration (Note 6)	**–**	317.3
Gain on derecognition of liability for contingent consideration (Note 6)	**–**	(91.7)
Operating loss before working capital changes	**(141.3)**	(10.6)
Increase in:		
Other current assets	**(1.2)**	(0.6)
Accounts payable and other current liabilities	**84.1**	41.4
Net cash generated from (used for) operations	**(58.4)**	30.2
Interest received	**94.7**	36.6
Net cash provided by operating activities	**36.3**	66.8
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of investment in Meralco (Notes 6 and 17)	**(17,344.3)**	(22,490.0)
Dividends received from Meralco	**4,437.2**	3,892.8
Proceeds from disposal of investment in AFS financial assets (Note 6)	**282.9**	–
Net cash used in investing activities	**(12,624.2)**	(18,597.2)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from:		
Long-term debt (Note 8)	**12,000.0**	5,800.0
Issuance of capital stock (Note 10)	**5,400.0**	15,136.0
Payments for:		
Interest on loans	**(2,242.9)**	(1,704.6)
Dividends declared (Note 10)	**(1,281.8)**	(280.4)
Long-term debt (Note 8)	**(540.0)**	–
Debt issue costs (Note 8)	**(71.9)**	(173.3)
Capital stock issuance costs (Note 10)	**(1.4)**	(6.0)
Increase (decrease) in due to related parties	**(0.3)**	84.5
Net cash provided by financing activities	**13,261.7**	18,856.2
NET INCREASE IN CASH AND CASH EQUIVALENTS	**673.8**	325.8
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**1,472.3**	1,146.5
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱2,146.1**	₱1,472.3

See accompanying Notes to Financial Statements.

1. **Corporate Information**

Beacon Electric Asset Holdings, Inc. (the Company or Beacon) was incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on February 10, 2010 with the sole purpose of consolidating the respective ownership interests in Manila Electric Company (Meralco) of Metro Pacific Investments Corporation (MPIC) and PLDT Communications and Energy Ventures, Inc. (PCEV), formerly Pilipino Telephone Corporation. The Company is a joint venture between MPIC and PCEV, with equity interests in the form of shares and share entitlements in the Company divided equally between them.

MPIC is 59.0% owned by Metro Pacific Holdings, Inc. (MPHI). MPHI is a Philippine corporation whose stockholders are Enterprise Investment Holdings, Inc. (EIH) (60.0%), Intalink B.V. (26.7%) and First Pacific International Limited (13.3%). First Pacific Company Limited (FPC), a company incorporated in Bermuda and listed in Hong Kong, through its subsidiaries, 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 FPC Group of Companies in Hong Kong.

PCEV is 99.8% owned by Smart Communications, Inc. (Smart). Smart is wholly owned and controlled by Philippine Long Distance Telephone Company (PLDT), a company incorporated in the Philippines.

On March 1, 2010, Beacon, MPIC and PCEV entered into an Omnibus Agreement (OA) to set out their mutual agreement in respect of, among others, the capitalization, organization, conduct of business and the extent of their participation in the management of the affairs of Beacon.

On the same date, Beacon's Board of Directors (BOD) approved the following resolutions:

(i) to change the name of the Company from Rightlight Holdings Inc. to Beacon Electric Asset Holdings, Inc. This was subsequently approved by SEC on March 11, 2010.

(ii) to increase its authorized capital stock to ₱5,000.0 million consisting of 3.0 billion common shares with par value of ₱1 per share and 2.0 billion preferred shares with par value of ₱1 per share. Such increase in authorized capital stock was approved by the SEC on April 29, 2010.

(iii) to amend the Company's Articles of Incorporation and By-Laws consistent with the provisions in the OA among Beacon, MPIC and PCEV.

Beacon, PCEV and MPIC have also agreed on certain corporate governance matters, including BOD composition, election of officers, shareholders' action, representation to the Meralco BOD, nomination of the Meralco BOD Committees and nomination of Meralco officers.

The registered office address of the Company is 10th Floor, MGO Building, Legaspi corner Dela Rosa Streets, Legaspi Village, Makati City.

The accompanying financial statements as at December 31, 2012 and 2011 were approved and authorized for issue by the BOD on February 27, 2013.

2. Summary of Significant Accounting Policies

Basis of Preparation
The accompanying financial statements have been prepared under the historical cost basis. The financial statements are presented in Philippine peso, which is the Company's functional and presentation currency. All values are rounded to the nearest million, except when otherwise indicated.

Statement of Compliance
The accompanying financial statements have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS include statements named PFRS and Philippine Accounting Standards (PAS), and Philippine interpretations based on equivalent interpretations of International Financial Reporting Interpretations Committee (IFRIC) issued by the Philippine Financial Reporting Standards Council (FRSC).

Changes in Accounting Policies
The accounting policies adopted are consistent with those of the previous financial year, except for the adoption of the following amended PFRS that became effective beginning January 1, 2012. Except as otherwise indicated, adoption of the amended PFRS has no impact on the Company's financial statements.

- PAS 12, *Income Taxes - Recovery of Underlying Assets*

  The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in PAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in PAS 16 always be measured on a sale basis of the asset.

- PFRS 7, *Financial Instruments: Disclosures - Enhanced Derecognition Disclosure Requirements*

  The amendment requires additional disclosure about financial assets that have been transferred but not derecognized to enable the user of the Company's financial statements to understand the relationship with those assets that have not been derecognized and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognized assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognized assets.

Future Changes in Accounting Standards
The Company will adopt the following standards and interpretations enumerated below when these become effective. Except as otherwise indicated, the Company does not expect the adoption of these new and amended standards and interpretations to have significant impact on its financial statements.

Effective in 2013

- PAS 1, *Financial Statement Presentation - Presentation of Items of Other Comprehensive Income* (effective for annual periods beginning on or after July 1, 2012)

  The amendments to PAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has therefore no impact on the Company's financial position or performance.

- PAS 19, *Employee Benefits* (Amendment) (effective for annual periods beginning on or after January 1, 2013)

  Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording.

- PAS 27, *Separate Financial Statements (as revised in 2011)* (effective for annual periods beginning on or after January 1, 2013)

  As a consequence of the new PFRS 10, *Consolidated Financial Statements*, and PFRS 12, *Disclosure of Interests in Other Entities*, what remains of PAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements.

- PAS 28, *Investments in Associates and Joint Ventures (as revised in 2011)* (effective for annual periods beginning on or after January 1, 2013)

  As a consequence of the new PFRS 11, *Joint Arrangements*, and PFRS 12, PAS 28 has been renamed PAS 28, *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates.

- PFRS 7, *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities* (effective for annual periods beginning on or after January 1, 2013, with retrospective application)

  These amendments require an entity to disclose information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set-off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32. The amendments require entities to disclose, in a tabular format unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the reporting period:

  a) The gross amounts of those recognized financial assets and recognized financial liabilities
  b) The amounts that are set-off in accordance with the criteria in PAS 32 when determining the net amounts presented in the statement of financial position
  c) The net amounts presented in the statement of financial position
  d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:

   i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32
   ii. Amounts related to financial collateral (including cash collateral)

e) The net amount after deducting the amounts in (d) from the amounts in (c) above

The amendment affects disclosures only and has no impact on the Company's financial position or performance.

- PFRS 10, *Consolidated Financial Statements* (effective for annual periods beginning on or after January 1, 2013)

  PFRS 10 replaces the portion of PAS 27, *Consolidated and Separate Financial Statements,* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12, *Consolidation - Special Purpose Entities*. PFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by PFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in PAS 27.

  As at December 31, 2012, the Company assessed that it does not have control over Meralco, thus the Company expects that it will continue to account its investment in Meralco as an investment in associate using the equity method of accounting. The Company will continuously assess its control over Meralco and determine whether future events and circumstances will result to Beacon obtaining control over Meralco and thus require the Company to consolidate Meralco.

- PFRS 11, *Joint Arrangements* (effective for annual periods beginning on or after January 1, 2013)

  PFRS 11 replaces PAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly-controlled Entities - Non-monetary Contributions by Venturers*. PFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method.

- PFRS 12, *Disclosure of Interests in Other Entities* (effective for annual periods beginning on or after January 1, 2013)

  PFRS 12 includes all of the disclosures that were previously in PAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in PAS 31 and PAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required.

- PFRS 13, *Fair Value Measurement* (effective for annual periods beginning on or after January 1, 2013)

  PFRS 13 establishes a single source of guidance under PFRS for all fair value measurements. PFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS when fair value is required or permitted. The Company is currently assessing the impact that this standard will have on its financial position and performance.

- Philippine Interpretation IFRIC 20, *Stripping Costs in the Production Phase of a Surface Mine* (effective for annual periods beginning on or after January 1, 2013)

  This interpretation applies to waste removal costs ("stripping costs") that are incurred in surface mining activity during the production phase of the mine ("production stripping costs"). If the benefit from the stripping activity will be realized in the current period, an entity is required to account for the stripping activity costs as part of the cost of inventory. When the benefit is the improved access to ore, the entity should recognize these costs as a noncurrent asset, only if certain criteria are met ("stripping activity asset"). The stripping activity asset is accounted for as an addition to, or as an enhancement of, an existing asset. After initial recognition, the stripping activity asset is carried at its cost or revalued amount less depreciation or amortization and less impairment losses, in the same way as the existing asset of which it is a part. This interpretation is not applicable to the Company and has no impact on its financial position or performance.

Improvements to PFRS
Improvements to PFRS, an omnibus of amendments to standards, deal primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies but did not have any impact on the financial position or performance of the Company. The improvements to PFRS are effective for annual periods beginning on or after January 1, 2013, with retrospective application.

- PFRS 1, *First-time Adoption of PFRS - Borrowing Costs*

  The amendment clarifies that, upon adoption of PFRS, an entity that capitalized borrowing costs in accordance with its previous generally accepted accounting principles, may carry forward, without any adjustment, the amount previously capitalized in its opening statement of financial position at the date of transition. Subsequent to the adoption of PFRS, borrowing costs are recognized in accordance with PAS 23, *Borrowing Costs*. The amendment does not apply to the Company as it is not a first-time adopter of PFRS.

- PAS 1, *Presentation of Financial Statements - Clarification of the Requirements for Comparative Information*

  The amendments clarify the requirements for comparative information that are disclosed voluntarily and those that are mandatory due to retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The additional comparative period does not need to contain a complete set of financial statements. On the other hand, supporting notes for the third balance sheet (mandatory when there is a retrospective application of an accounting policy, or retrospective restatement or reclassification of items in the financial statements) are not required. The amendments affect disclosures only and have no impact on the Company's financial position or performance.

- PAS 16, *Property, Plant and Equipment - Classification of Servicing Equipment*

  The amendment clarifies that spare parts, stand-by equipment and servicing equipment should be recognized as property, plant and equipment when they meet the definition of property, plant and equipment and should be recognized as inventory if otherwise. The amendment will not have any significant impact on the Company's financial position or performance.

- PAS 32, *Financial Instruments: Presentation - Tax Effect of Distribution to Holders of Equity Instruments*

  The amendment clarifies that income taxes relating to distributions to equity holders and to transaction costs of an equity transaction are accounted for in accordance with PAS 12, *Income Taxes*. The Company expects that this amendment will not have any impact on its financial position or performance.

- PAS 34, *Interim Financial Reporting - Interim Financial Reporting and Segment Information for Total Assets and Liabilities*

  The amendment clarifies that the total assets and liabilities for a particular reportable segment need to be disclosed only when the amounts are regularly provided to the chief operating decision maker and there has been a material change from the amount disclosed in the entity's previous annual financial statements for that reportable segment. The amendment affects disclosures only and has no impact on the Company's financial position or performance.

Effective Subsequent to 2013

- PAS 32, *Financial Instruments: Presentation - Offsetting Financial Assets and Financial Liabilities* (effective for annual periods beginning on or after January 1, 2014, with retrospective application)

  These amendments to PAS 32 clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. While the amendment is expected not to have any impact on the net assets of the Company, any changes in offsetting is expected to impact leverage ratios and regulatory capital requirements. The Company is currently assessing impact of the amendments to PAS 32.

- PFRS 9, *Financial Instruments: Classification and Measurement* (effective for annual periods beginning on or after January 1, 2015)

  PFRS 9, as issued, reflects the first phase on the replacement of PAS 39 and applies to the classification and measurement of financial assets and liabilities as defined in PAS 39, *Financial Instruments: Recognition and Measurement*. In subsequent phases, hedge accounting and impairment of financial assets will be addressed with the completion of this project.

  The Company has made an evaluation of the impact of the adoption of this standard. The Company decided not to early adopt PFRS 9 for the 2012 reporting ahead of its effectivity date on January 1, 2015, therefore, the financial statements as at and for the year ended December 31, 2012 do no reflect the impact of said standard.

  Only financial assets and liabilities will be affected by the standard and based on this evaluation, loans and receivables (consisting of cash and cash equivalents and receivables) and financial liabilities (consisting of accounts payable and other current liabilities and long-term debt) which are carried at amortized cost will not be significantly affected. Upon adoption, these financial assets and liabilities will continue to be carried at their amortized cost, thus, will have no significant impact to the Company's financial position and performance.

The Company shall conduct another impact evaluation in 2013 using the financial statements as at and for the year ended December 31, 2012.

- Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*

  This interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11, *Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion. The SEC and FRSC have deferred the effectivity of this interpretation until the final revenue standard is issued by International Accounting Standards Board and an evaluation of the requirements of the final revenue standard against the practices of the Philippine real estate industry is completed.

The Company continues to assess the impact of the above new, amended and improved accounting standards and interpretations effective subsequent to December 31, 2012 on its financial statements in the period of initial application. Additional disclosures required by these amendments will be included in the Company's financial statements when these amendments are adopted.

<u>Cash and Cash Equivalents</u>
Cash comprises cash in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, with original maturities of three months or less from dates of acquisition and are subject to an insignificant risk of change in value.

<u>Financial Instruments</u>

Date of Recognition. The Company recognizes a financial asset or a financial liability in the statement of financial position when it becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognized on the trade date. Regular way purchases and sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Initial Recognition. Financial instruments are recognized initially at fair value, which is the fair value of the consideration given (in case of an asset) or received (in case of a liability). The fair value of the consideration given or received is determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market interest rates for similar instruments with similar maturities. The initial measurement of financial instruments, except for financial instruments at fair value through profit or loss (FVPL), includes transaction costs.

Classification of Financial Instruments. Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity, net of any related income tax benefits.

The classification depends on the purpose for which the instruments were acquired and whether they are quoted in an active market. Management determines the classification of its instruments at initial recognition and, where allowed and appropriate, re-evaluates such classification at each financial year-end.

Financial instruments are further classified into the following categories: financial assets at FVPL, loans and receivables, held-to-maturity (HTM) investments, available-for-sale (AFS) financial assets, financial liabilities at FVPL, other financial liabilities and derivatives designated as hedging instruments in an effective hedge, as appropriate.

The Company has no financial assets or liabilities at FVPL, HTM investments, AFS financial assets and derivative instruments as at December 31, 2012 and 2011.

Determination of Fair Value. The fair value of financial instruments traded in active markets at the end of reporting period is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction is used since it provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models.

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

As at December 31, 2012 and 2011, the Company has no financial instruments carried and measured based on the three levels of fair value hierarchy.

Classification of Financial Instruments Between Debt and Equity
A financial instrument is classified as debt 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 Company's preferred stock is classified as equity instruments.

Financial Assets
The Company's financial assets consist of loans and receivables.

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 as financial assets at FVPL, HTM investments or AFS financial assets. After initial measurement, loans and receivables are subsequently measured at amortized cost using the effective interest rate (EIR) method, less any allowance for impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortization is included in interest income in the statement of comprehensive income. The losses arising from impairment are recognized in the statement of comprehensive income. Loans and receivables are included in current assets if maturity is within 12 months after the end of reporting period, otherwise these are classified as noncurrent assets.

The Company's cash and cash equivalents and receivables are classified as loans and receivables (see Note 15).

Financial Liabilities
The Company's financial liabilities consist of other financial liabilities.

Other Financial Liabilities. Financial liabilities are classified in this category if they are not held for trading or not designated as at FVPL upon the inception of the liability. Other financial liabilities which include loans and borrowings are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the EIR method. Amortized cost is calculated by taking into account any related issue costs, discount or premium. Gains or losses are recognized in profit or loss when the liabilities are derecognized, as well as through the amortization process. Other financial liabilities are included in current liabilities if maturity is within 12 months from the reporting date. Otherwise, these are classified as noncurrent liabilities.

The Company's accounts payable and other current liabilities, deferred purchase liability and long-term debt are classified as other financial liabilities (see Note 15).

Impairment of Financial Assets
The Company assesses at each end of reporting period whether a financial asset or group of financial assets is impaired.

Assets Carried at Amortized Cost. The Company first assesses whether objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) of impairment exists individually for financial assets that are individually significant 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 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 EIR (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the statement of comprehensive income. The assets, together with the associated allowance, are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Company. If a write-off is later recovered, the amount recovered is credited to the statement of comprehensive income.

If, in a subsequent year, the amount of the impairment loss decreases because of 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 statement of comprehensive income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Derecognition of Financial Assets and Financial Liabilities

Financial Asset. A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Company has transferred its right to receive cash flows from the asset, or 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 rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Company has transferred its rights to receive cash flows from an asset or has entered into a "pass-through arrangement", and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control 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 the 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 statement of comprehensive income.

Offsetting of Financial Instruments
Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented at gross amounts in the statement of financial position.

Investment in Meralco
Investment in Meralco, an associate, where the Company has the ability to exercise significant influence since date of acquisition, is accounted for using the equity method. The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other companies, are considered when assessing whether a company has significant influence. If the conversion or the potential voting rights results to significant influence, equity accounting is applied from the date on which the investee becomes an associate.

Under the equity method, investments are carried in the statement of financial position at cost plus post-acquisition changes in the Company's share in net assets of the associate, less any dividends declared and impairment loss. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized nor individually tested for impairment. The statement of comprehensive income reflects the Company's share in the results of operations of the associate. Where there has been a change recognized directly in equity of the associate, the Company recognizes its share of any changes and discloses this in the other comprehensive income account in the statement of comprehensive income and changes in equity. Unrealized gains arising from transactions with associates are eliminated to the extent of the Company's interest in the associate, against the respective investment account. When potential voting rights exist, the investor's share of profit or loss of the investee and of changes in the investee's equity is determined on the basis of present ownership interests and does not reflect the possible exercise or conversion of potential voting rights.

The share of profits and losses of the associate is shown on the face of the statement of comprehensive income. This is the profit or loss, attributable to equity holders of the associate and, therefore, is the profit or loss, after tax and net of non-controlling interest in the subsidiaries of the associate. The Company's reporting date and that of its associate is identical and the associate's accounting policies conform to those used by the Company for like transactions and events in similar circumstances. Where necessary, adjustments are made to bring such accounting policies in line with those of the Company.

When the Company's share in the losses of the associate equals or exceeds the carrying amount of the investment, the Company provides for additional losses to the extent that the Company has incurred obligations or made payments on behalf of the associate to satisfy the obligations of the associate that the Company has guaranteed or otherwise committed.

After the application of the equity method, the Company determines whether it is necessary to recognize an additional impairment loss on its investment in Meralco.

Impairment of Investment in Meralco
The Company assesses at the end of each reporting period whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the

carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the statement of comprehensive income.

The Company determines at the end of each reporting period whether there is any objective evidence that the Company's investment in Meralco is impaired. If this is the case, the amount of impairment is calculated as the difference between the recoverable amount of the investment in Meralco, and its carrying amount. The amount of impairment loss is recognized in the statement of comprehensive income.

Foreign Currency Transactions

Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the end of reporting period. All differences are taken to the statement of comprehensive income. For income tax purposes, exchange gains or losses are treated as taxable income or deductible expenses in the period such are realized.

Capital Stock and Additional Paid-in Capital

Preferred and common stocks are 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/or fair value of considerations received in excess of par value are recognized as additional paid-in capital.

Cost of registering and issuing securities is recognized as a reduction from the proceeds of the securities issued, thus recognized as reduction from additional paid-in capital.

Retained Earnings

Retained earnings include profit attributable to the Company's equity holders. Retained earnings may also include effect of changes in accounting policy as may be required by the standard's transitional provisions. Retained earnings represent the Company's accumulated earnings, net of dividends declared.

Other Comprehensive Loss

Other comprehensive loss comprises items of income and expense that is not recognized in profit or loss as required or permitted by other PFRS. This account also includes share of the Company in the post-acquisition changes in net assets of the associate recognized directly in equity of the associate.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of revenue can be reliably measured.

Interest Income. Interest income is recognized as it accrues using the EIR method.

Income Tax

Current Tax. Current tax assets and liabilities for the current and prior period are measured at the amount expected to be recovered from or paid to the tax authority. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of reporting period.

Deferred Tax. Deferred tax is provided, using the liability method, on all temporary differences at the end of reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences, carry-forward benefits of unused tax credits from excess minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT) and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry-forward benefits of unused tax credits from MCIT and NOLCO can be utilized. Deferred tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred tax assets is reviewed at each end of reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are measured at each end of reporting period and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be recovered.

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

Deferred taxes relating to items recognized outside profit or loss are recognized in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred tax assets and liabilities are offset, 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 tax 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 obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are made 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.

Where the Company expects some or all of a provision to be reimbursed, 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 statement of comprehensive income, net of any reimbursement.

Contingencies

Contingent liabilities are not recognized in the financial statements but are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the financial statements but are disclosed in the notes to financial statements when an inflow of economic benefits is probable.

Events After the Reporting Period
Post year-end events that provide additional information about the Company's financial position at the end of reporting period (adjusting events), if any, are reflected in the Company's financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the financial statements when material.

3. Significant Accounting Judgment, Estimates and Assumptions

The preparation of the financial statements in compliance with PFRS requires management to make judgment, estimates and assumptions that affect certain reported amounts and disclosures. In preparing the financial statements, management has made its best estimates and assumptions of certain amounts, giving due consideration to materiality. The judgment, estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from those estimates, and such estimates will be adjusted accordingly.

Judgment, estimates and assumptions include expectations of future events that are believed to be reasonable under the circumstances.

The Company believes that the following represent a summary of the significant judgment, estimates and assumptions, related impact and associated risks in the financial statements.

Judgment

Classification of Financial Instruments. The Company exercises judgments in classifying a financial instrument on initial recognition either as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial asset, a financial liability or an equity instrument. The substance of a financial instrument, rather than its legal form, governs its classification in the statement of financial position.

In addition, the Company classifies financial assets by evaluating, among others, whether the asset is quoted or not in an active market.

Based on the Company's evaluation, the Company classified its preferred shares as equity instruments.

Estimates and Assumptions

Determination of Fair Value of Financial Instruments. Entities are required to disclose for each class of financial assets and liabilities the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the Company's statement of financial position, which requires the use of accounting judgment and estimates. Significant components of fair value measurement are determined using verifiable objective evidence (i.e., interest rates, volatility rates), and timing and amount of changes in fair value would differ with the valuation methodology used. Any changes in fair value of these financial assets and liabilities would affect the disclosures made by management.

The fair value of the Company's financial assets and liabilities are disclosed in Note 15.

Realizability of Deferred Tax Assets. The Company reviews its deferred tax assets at each reporting date and reduces their carrying amounts to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Company's assessment of the recognition of deferred tax assets is based on the projected taxable income in the following years. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be recovered.

Unrecognized deferred tax assets amounted to ₱1,777.2 million and ₱1,070.6 million as at December 31, 2012 and 2011, respectively (see Note 11).

Impairment of Investment in Meralco. The Company assesses impairment of its investment in Meralco whenever events or changes in circumstances indicate that the carrying amount of these assets 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.

An impairment loss is recognized whenever the carrying amount of an asset exceeds its estimated recoverable amount. The estimated recoverable amount is the higher of an asset's fair value less costs to sell and value in use. The value in use is the present value of estimated future cash flows expected to arise from holding on to the investment in the form of dividends and from its disposal.

In determining the present value of estimated future cash flows expected to be generated from the investment, the Company is required to make estimates and assumptions that can materially affect the financial statements.

No impairment loss was recognized in 2012 and 2011. The fair values of Meralco shares based on its quoted price is higher than its carrying value as at December 31, 2012 and 2011 (see Note 6). The carrying values of investment in Meralco, subjected to impairment testing, amounted to ₱113,940.0 million and ₱104,091.9 million as at December 31, 2012 and 2011, respectively (see Note 6).

4. Cash and Cash Equivalents

This account consists of:

	2012	2011
	(In Million Pesos)	
Cash in banks	**₱2.7**	₱1.0
Short-term deposits	**2,143.4**	1,471.3
	₱2,146.1	₱1,472.3

Cash in banks earn interest at the prevailing bank deposit rates. Short-term deposits are made for varying periods of up to three months depending on the immediate cash requirements of the Company and earn interest at the prevailing short-term deposit rates.

Interest earned from cash in banks and short-term deposits amounted to ₱94.4 million and ₱36.8 million in 2012 and 2011, respectively.

5. Receivables

This account consists of:

	2012	2011
	(In Million Pesos)	
Interest receivable	**₱1.1**	₱1.4
Dividends receivable	–	53.1
	₱1.1	₱54.5

Receivables are noninterest-bearing financial assets which are normally collected within one year.

6. Investment in Meralco

The movements in the carrying value of investment in Meralco for the years ended December 31 are as follows:

	2012	2011
	(In Million Pesos)	
Acquisition cost:		
Balance at beginning of year	**₱102,846.2**	₱73,395.3
Acquisitions	**10,035.0**	14,310.0
Transfer of Meralco shares from PCEV	–	15,287.9
Derecognition of contingent consideration	–	(147.0)
Balance at end of year	**112,881.2**	102,846.2
Accumulated equity in net earnings:		
Balance at beginning of year	**1,245.7**	(109.6)
Equity share in net earnings	**7,358.4**	5,015.5
Dividends	**(7,552.2)**	(3,435.7)
Share in other comprehensive income (loss)	**6.9**	(224.5)
Balance at end of year	**1,058.8**	1,245.7
	₱113,940.0	₱104,091.9

Meralco is the largest electric power distribution company and the largest private sector utility in the Philippines. It is incorporated in the Philippines and is subject to the rate-making regulations and regulatory policies of the Philippine Energy Regulatory Commission (ERC). Its subsidiaries are mainly engaged in engineering, construction and consulting services, information systems and technology, real estate, insurance and other electricity-related services.

A pledge on the Company's investment in Meralco shares secures the Company's loan facilities with a syndicate of various financial institutions (see Note 8).

Dividend income from Meralco amounted to ₱7,552.2 million (including property dividends of ₱3,168.1 million, discussed under "Property Dividends" section) and ₱3,435.7 million in 2012 and 2011, respectively.

Transfer of Meralco Shares from MPIC and PCEV
Under the OA, Beacon agreed to purchase 163.6 million and 154.2 million Meralco shares (the Transferred Shares) from MPIC and PCEV, respectively, for a consideration of ₱150 per share or a total of ₱24,540.4 million for the MPIC Meralco shares and ₱23,130.0 million for the PCEV Meralco shares.

The purchase of the Transferred Shares by Beacon from MPIC and PCEV were completed on March 30, 2010 and May 12, 2010, respectively. The transfer of legal title involving the Meralco shares was implemented through a special block sale/cross sale in the Philippine Stock Exchange (PSE).

Also under the OA, MPIC assigned its right to acquire the Call Option, over 74.7 million Meralco common shares held by FPHC (the Option Shares) to Beacon. As a result of this assignment, Beacon and First Philippine Holdings Corporation (FPHC) executed an Option Agreement dated March 1, 2010, pursuant to which FPHC granted the Call Option over the Option Shares to Beacon, which was exercised on March 30, 2010 for a cash consideration of ₱22,410.0 million.

On October 19, 2011, the Company's BOD approved the purchase of PCEV's remaining investment in 68.8 million Meralco common shares for a total cash consideration of ₱15,136.0 million with transaction costs of ₱151.9 million. The transfer of the Meralco shares was implemented through a cross sale in the PSE on October 25, 2011.

Property Dividends
With respect to the approximately 317.8 million Transferred Shares, the 74.7 million Option Shares, the 68.8 million Meralco common shares transferred by PCEV to Beacon and the 30.0 million Meralco common shares purchased from First Philippine Utilities Corporation (FPUC), FPHC has the benefit of being assigned certain property dividends that may be declared by Meralco.

In March 2010, Beacon recognized a liability for contingent consideration amounting to ₱2,372.5 million for such property dividends, which is re-measured at the end of each reporting period. In 2011, Beacon derecognized a portion of the liability for contingent consideration amounting to ₱238.7 million which resulted to a gain on derecognition of liability for contingent consideration amounting to ₱91.7 million in the 2011 statement of comprehensive income.

As at and for the year ended December 31, 2011, the carrying value of the liability for contingent consideration and the re-measurement loss amounted to ₱2,781.7 million and ₱317.3 million, respectively.

On February 27, 2012, Meralco's BOD declared its common shareholdings in Rockwell as property dividend to shareholders of record as at March 23, 2012, payable five days after the approval by the SEC of such property dividend, which approval was issued on April 25, 2012. Thereafter, Beacon recognized the property dividend received from Meralco amounting to ₱3,168.1 million as "Investment in AFS financial assets" account in the 2012 statement of financial position (see Note 17). On June 27, 2012, Beacon sold its investment in 140.7 million Rockwell common shares, arising from Meralco shares acquired from the market, to FPHC and FPHC Pension Fund for a cash consideration of ₱2.01 per share or an aggregate amount ₱282.9 million, thus, recognizing a gain on disposal of investment amounting to ₱77.4 million for the difference between the consideration and the value of the property dividend. On June 27 and 28, 2012, Beacon transferred its investment in 1,384.6 million Rockwell common shares, arising from Meralco shares acquired from PCEV, MPIC, FPHC and FPUC, to FPHC through a crossed sale at the PSE. With the transfer, Beacon derecognized the outstanding balance of its liability for contingent consideration. As a result of the sale and transfer transactions, the "Investment in AFS financial assets" account amounted to nil as at December 31, 2012.

Goodwill Arising from Acquisition of Meralco Shares
As previously discussed, in March 2010, Beacon acquired approximately 392.5 million Meralco shares from MPIC, PCEV and FPHC, representing approximately 34.8% ownership in Meralco, comprising approximately 317.8 million Transferred Shares and 74.7 million Option Shares.

Total goodwill arising from the acquisitions in 2010, based on the final purchase price allocation, amounted to ₱47,757.4 million.

On various dates in 2011, Beacon acquired from the market approximately 49.9 million Meralco shares, representing approximately 4.4% beneficial ownership in Meralco, at an aggregate cost of ₱14,310.0 million.

Out of the said acquisitions from third parties, 31.2 million Meralco shares were purchased at a deferred payment scheme amounting to ₱8,980.5 million, with the outstanding liability recorded under "Deferred purchase liability" account in the 2011 statement of financial position. The liability is payable in installments of ₱936.3 million each in May and July 2011, with final payment amounting to ₱7,490.2 million made in July 2012. Related interest expense, resulting from the amortization at EIR of the related liability, amounted to ₱177.2 million and ₱205.1 million in 2012 and 2011, respectively.

Total goodwill, arising from acquisitions of Meralco shares in 2011, based on the final purchase price allocation, amounted to ₱20,745.4 million, comprising goodwill amounting to ₱10,675.4 million arising from 49.9 million Meralco shares acquired from third parties and goodwill amounting to ₱10,070.0 million arising from the 68.8 million Meralco shares transferred from PCEV, as previously discussed.

On January 31, 2012, Beacon acquired 30.0 million Meralco shares from FPUC, representing approximately 2.7% effective ownership in Meralco, at an aggregate cost of ₱9,103.8 million (including recognized contingent consideration amounting to ₱180.9 million). FPUC will retain certain property dividends that may be declared on such shares. The acquisition was funded through an equity infusion an aggregate amount of ₱5,400.0 million from MPIC and PCEV equally, and a ₱5,000.0 million corporate notes facility arranged by First Metro Investment Corporation (FMIC) and PNB Capital and Investment Corporation (PNB Capital) (see Notes 8 and 10).

On November 29, 2012, Beacon acquired additional 3.2 million Meralco shares from the market, representing approximately 0.3% effective ownership in Meralco, at an aggregare cost of ₱841.7 million.

On December 21, 2012, Beacon acquired additional 0.3 million Meralco shares from the market, representing approximately 0.04% effective ownership in Meralco, at an aggregate cost of ₱89.5 million.

Total goodwill arising from acquisitions of Meralco shares in 2012, based on provisional purchase price allocation, amounted to ₱7,543.6 million.

As at December 31, 2012, Beacon effectively owns 544.8 million Meralco shares, representing approximately 48.3% effective ownership in Meralco, with a carrying value of ₱113,940.0 million and market value of ₱141,970.9 million based on quoted price of approximately ₱260.60 per share. As at December 31, 2011, Beacon beneficially owns 511.2 million Meralco shares, representing approximately 45.4% beneficial ownership in Meralco, with a carrying value of ₱104,091.9 million and market value of ₱126,379.2 million based on quoted price of approximately ₱247.20 per share.

A summary of Meralco's audited financial information as at and for the years ended December 31 is shown below:

	2012	2011
	(In Million Pesos)	
Consolidated Statements of Financial Position		
Noncurrent assets	**₱124,671**	₱116,259
Current assets	**92,243**	75,780
Assets of discontinued operations	**–**	18,349
Equity	**67,727**	68,501
Noncurrent liabilities	**89,828**	83,331
Current liabilities	**59,359**	49,443
Liabilities of discontinued operations	**–**	9,113
Consolidated Statements of Income		
Revenues	**₱285,270**	₱259,139
Expenses	**269,090**	246,379
Income from discontinued operations	**978**	966
Net income attributable to equity holders of Meralco	**17,016**	13,227

Beacon restated the investment properties of Meralco to align with its accounting policy of carrying investment property at fair value since Meralco accounts for its investment properties at cost. As at December 31, 2011, the restatement resulted in a net gain of ₱362.8 million, in which Beacon recognized its share of ₱158.4 million. Meralco's investment properties are included under noncurrent assets in the table above.

7. Accounts Payable and Other Current Liabilities

This account consists of:

	2012	2011
	(In Million Pesos)	
Accounts payable	**₱0.1**	₱45.2
Accrued expenses:		
Interest	**575.1**	424.7
Pretermination fees and transaction cost (see Note 8)	**214.0**	–
Withholding taxes	**123.5**	–
Others	**5.7**	–
	₱918.4	₱469.9

Accounts payable and accrued expenses are noninterest-bearing financial liabilities that are generally settled within one year.

Accrual for pretermination fees and transaction cost pertain to the Company's estimated retroactive gross receipt tax adjustment on cumulative interests paid on the loans and fixed upfront fee on refinancing involving the early redemption of its long-term debt (see Note 8).

Accrual for withholding taxes pertains to taxes imposed to the Company's creditors which were shouldered by the Company. This is presented as part of "Miscellaneous" account in the 2012 statement of comprehensive income.

Others include accruals for legal and professional fees.

8. **Long-term Debt**

The account consists of:

	2012	2011
	(In Million Pesos)	
Principal	**₱33,460.0**	₱22,000.0
Less unamortized debt issue cost	**190.1**	268.3
	33,269.9	21,731.7
Less current portion of long-term debt - net of unamortized debt issue cost: 2012 - ₱65.8 million; 2011 - ₱33.5 million	**374.2**	506.5
	₱32,895.7	₱21,225.2

The movements in unamortized debt issue cost are as follows:

	2012	2011
	(In Million Pesos)	
Balance at beginning of year	**₱268.3**	₱173.1
Capitalized debt issue costs	**123.6**	121.6
Amortization (including write-down in 2012 amounting to ₱158.5 million charged to miscellaneous expenses)	**(201.8)**	(26.4)
Balance at end of year	**₱190.1**	₱268.3

Future repayments of principal are as follows:

	2012	2011
	(In Million Pesos)	
Within one year	**₱22,680.0***	₱540.0
After one year but not more than five years	**3,300.0**	6,100.0
After five years	**7,480.0**	15,360.0
	₱33,460.0	₱22,000.0

**Includes principal on loan facilities to be refinanced in 2013.*

The Company's loan facilities are discussed below:

a. ₱18,000.0 Million Corporate Notes

On March 22, 2010, the Company entered into an ₱18,000.0 million 10-year Corporate Notes Facility with FMIC and PNB Capital as joint lead arrangers and various local financial institutions as noteholders. The loan facility is divided into two tranches with the first tranche amounting to ₱11,800.0 million (the Fixed Rate Tranche) and the second tranche amounting to ₱6,200.0 million (the Floating Rate Tranche) in which both tranches have a term of ten years payable with semi-annual interest payments and principal repayments with final repayment on March 30, 2020.

On March 30, 2010, the Company made its first drawdown amounting to ₱16,200.0 million, which was used to partially finance the acquisition of Meralco shares pursuant to its exercise of the Call Option, while the remaining balance of ₱1,800.0 million was drawn on May 26, 2011, which was drawn to finance the first installment payment of the 31.2 million Meralco shares acquired under a deferred payment scheme.

Interest rate of the Fixed Rate Tranche is based on a spread of 2.5% over the 10-year Philippine Dealing System Treasury Fixing (PDST-F) rate while the Floating Rate Tranche is based on a spread of 2.75% over the 6-month PDST-F rate.

As at December 31, 2012 and 2011, the outstanding balance of the ₱18,000.0 million loan facility amounted to ₱17,441.1 million (net of unamortized debt issue cost of ₱18.9 million) and ₱17,834.8 million (net of unamortized debt issue cost of ₱165.2 million), respectively.

b. ₱11,000.0 Million Fixed Corporate Notes

On May 24, 2011, the Company entered into an ₱11,000.0 million 10-year Fixed Corporate Notes Facility with FMIC and PNB Capital as joint lead arrangers and various local financial institutions as noteholders. The term of the loan is ten years payable in semi-annual fixed interest payments and principal repayments with final repayment on May 26, 2021.

On May 26, 2011, the Company made its first drawdown amounting to ₱4,000.0 million, the proceeds of which were partially used to finance the acquisition of 49.9 million Meralco shares. The remaining ₱7,000.0 million was drawn on July 9, 2012 which was used for the payment of the deferred purchase made in May 2011. Commitment fees amounting to ₱11.4 million, relative to the undrawn balance of the loan facility, recorded under "Other noncurrent assets" account in the 2011 statement of financial position, was subsequently reclassified as part of debt issue costs upon full drawdown of the loan.

Interest rate is based on a spread of 1.5% over the 10-year PDST-F rate.

As at December 31, 2012 and 2011, the outstanding balance of the loan amounted to ₱10,856.2 million (net of unamortized debt issue cost of ₱143.8 million) and ₱3,896.9 million (net of unamortized debt issue cost of ₱103.1 million), respectively.

c. ₱5,000.0 Million Corporate Notes

On November 9, 2011, the Company entered into a ₱5,000.0 million 10-year Corporate Notes Facility with FMIC and PNB Capital as joint lead arrangers and various local financial institutions as noteholders. The loan comprises Fixed Rate Tranches, amounting to

₱550.0 million (the Tranche A) and ₱3,450.0 million (the Tranche B), and Floating Rate Tranche amounting to ₱1,000.0 million. Arranger's fees amounting to ₱40.3 million, relative to the undrawn balance of the loan facility, recorded under "Other noncurrent assets" account in the 2011 statement of financial position, was subsequently reclassified as part of debt issue costs upon full drawdown of the loan on February 1, 2012. The proceeds were used to finance the acquisition of 30.0 million Meralco shares from FPUC in January 2012.

The fixed interest rate of Tranche A is based on a spread of 1.5% over the 10-year PDST-F rate while Tranche B is based on a spread of 1.5% over the 5-year PDST-F rate subject to repricing after 5 years. The interest rate of the Floating Rate Tranche is based on a spread of 2.25% over the 6-month PDST-F rate.

As at December 31, 2012, the outstanding balance of the facility amounted to ₱4,972.6 million (net of unamortized debt issue cost of ₱27.4 million).

Amortization of debt issue costs from the Company's loan facilities amounted to ₱43.3 million and ₱26.4 million in 2012 and 2011, respectively. Interest incurred on the loan facilities amounted to ₱2,393.3 million and ₱1,727.1 million in 2012 and 2011, respectively.

Refinancing of ₱18,000.0 Million Corporate Notes
On December 18, 2012, Beacon's BOD authorized the refinancing of its outstanding long-term debt involving the ₱18,000.0 million and the ₱5,000.0 million corporate notes facilities through the execution of a ₱17,000.0 million ten-year corporate notes facility.

On February 6, 2013, Beacon entered into a ₱17,000 million ten-year Corporate Notes Facility with FMIC and PNB Capital as joint lead arrangers and various local financial institutions as noteholders. The proceeds will be used to refinance the outstanding balance of the ₱18,000 million ten-year Corporate Notes Facility under a Facility Agreement dated March 22, 2010. The loan facility is divided into two tranches with the first tranche amounting to ₱2,285.0 million (the Tranche A) and the second tranche amounting to ₱14,715.0 million (the Tranche B). Both tranches have a term of ten years with semi-annual interest payments starting June 27, 2013 and semi-annual unequal principal repayments starting December 27, 2013.

The Tranche A will bear a fixed interest rate based on the ten-year PDST-F plus a spread, subject to a floor rate. The Tranche B will bear a fixed interest rate for the first 5 years from the drawdown date based on the 5-year PDST-F plus a spread, subject to a floor rate. For the next five years, the fixed interest rate for Tranche B will be repriced based on the 5-year PDST-F on the business day immediately preceding the repricing date plus a spread, provided that such interest rate shall not be lower than the applicable interest rate for the first 5 years.

Also on February 6, 2013, the required consents from Beacon's existing noteholders to prepay the ₱18,000.0 million notes facility have been obtained. On February 21, 2013, Beacon issued a notice to prepay the outstanding amounts of the ₱18,000.0 million notes facility on March 27, 2013. For the year ended December 31, 2012, the capitalized debt issue cost amounting to ₱158.5 million, involving the ₱18,000.0 million and the ₱5,000.0 million notes facilities, was written down in 2012 based on the revised expected future cash flows and was recorded as expense under "Miscellaneous" account in the 2012 statement of comprehensive income. In addition, ₱214.0 million estimated retroactive gross receipt tax adjustment on cumulative interests paid on the loans and refinancing costs were charged to "Miscellaneous" account in the 2012 statement of comprehensive income with a corresponding credit to "Pretermination fees and transaction cost" under "Accounts payable and other current liabilities" account in the 2012 statement of financial position (see Note 7).

Loan Security
The loans are secured by a pledge on Meralco shares owned by the Company and shall, from the date of the pledge over the Meralco shares, maintain the loan to value ratio at 50% (see Note 6). The loan agreements also contain provisions for the maintenance of a Debt Service Account (DSA) to be used by the Company to service interest payments and principal repayments, maintenance of debt to equity ratio, debt service coverage ratio and loan to value ratio, continuity of/change in business, distribution of quarterly unaudited and annual audited financial statements to noteholders, payment of indebtedness as they fall due, sale of assets, maintenance of ownership in Meralco, issuance of preferred shares, declaration and payment of dividends, additional indebtedness and guarantees, negative pledge, prepayments, additional investments, arm's length transactions, change in ownership, redemption of preferred shares, and loans or advances to directors, officers and stockholders.

As at December 31, 2012 and 2011, Beacon is in compliance with all the requirements stipulated in the loan agreements.

9. Related Party Transactions

Enterprises and individuals that directly, or indirectly through one or more intermediaries, control, or are controlled by, or under common control with the Company, including holding companies, subsidiaries and fellow subsidiaries are related parties of the Company. Associates and individuals owning, directly or indirectly, an interest in the voting power of the Company that gives them significant influence over the enterprise, key management personnel, including directors and officers of the Company and close members of the family of these individuals and companies associated with these individuals also constitute related parties. In considering each possible related entity relationship, attention is directed to the substance of the relationship, and not merely the legal form.

Details of due to related parties are as follows:

Related Party	Relationship	Year	Amount of transaction	Due to Related Parties	Terms	Conditions
MPIC	Venturer	**2012**	**(₱0.3)**	**₱756.2**	Noninterest-bearing	Unsecured
		2011	0.2	756.5	Noninterest-bearing	Unsecured
PCEV	Venturer	**2012**	–	**216.4**	Noninterest-bearing	Unsecured
		2011	84.3	216.4	Noninterest-bearing	Unsecured
		2012		**₱972.6**		
		2011		972.9		

As at December 31, 2012 and 2011, the Company's outstanding liability to MPIC primarily comprises PSE crossing charges on the transferred shares in March 2010, expenses relating to the Option Shares, professional and legal fees paid on behalf of the Company involving the Company's acquisition of Meralco shares from the market.

As at December 31, 2012 and 2011, the Company's outstanding liability to PCEV primarily comprises PSE crossing charges on the transferred shares in March 2010 and October 2011.

The Company is in the process of drawing up the repayment terms of these advances.

10. **Equity**

The details of the Company's capital stock as at December 31 are as follow:

	2012		2011	
	Number of Shares	**Amount**	Number of Shares	Amount
		(In Million Pesos)		*(In Million Pesos)*
Authorized common shares - ₱1 par value per share	**3,000,000,000**	**₱3,000.0**	3,000,000,000	₱3,000.0
Authorized preferred shares - ₱1 par value per share	**2,000,000,000**	**2,000.0**	2,000,000,000	2,000.0
	5,000,000,000	**₱5,000.0**	5,000,000,000	₱5,000.0
Issued - common shares:				
Balance at beginning of year	**2,313,025,000**	**₱2,313.0**	2,313,025,000	₱2,313.0
Issuances	**270,000,000**	**270.0**	–	–
Balance at end of year	**2,583,025,000**	**2,583.0**	2,313,025,000	2,313.0
Issued - preferred shares:				
Balance at beginning of year	**2,000,000,000**	**2,000.0**	801,044,415	801.0
Issuances	–	–	1,198,955,585	1,199.0
Balance at end of year	**2,000,000,000**	**2,000.0**	2,000,000,000	2,000.0
	4,583,025,000	**₱4,583.0**	4,313,025,000	₱4,313.0

Authorized Capital Stock
Beacon was incorporated with original authorized capital stock of 100,000 common shares having par value of ₱1 per share. On March 1, 2010, Beacon's BOD approved a resolution to increase its authorized capital stock to ₱5,000.0 million consisting of 3.0 billion common shares with par value of ₱1 per share and 2.0 billion preferred shares with par value of ₱1 per share which was subsequently approved by SEC on April 29, 2010.

The preferred shares of Beacon are non-voting, non-convertible to common shares or any shares of any class of Beacon, have no pre-emptive rights to subscribe to any share or convertible debt securities or warrants issued or sold by Beacon. The preference shareholder is entitled to liquidation preference and yearly cumulative dividends at the rate of 7% of the issue value subject to: (a) availability of unrestricted retained earnings; and (b) dividend payment restrictions imposed by Beacon's bank creditors.

Issued Shares
Under the OA, each of MPIC and PCEV agreed to subscribe to 1,156.5 million common shares of Beacon, for a subscription price of ₱20 per share or a total of ₱23,130.0 million. MPIC and PCEV also agreed that their resulting equity after such subscriptions and PCEV's purchase from MPIC of 12,500 Beacon common shares will be 50% each of the outstanding common shares of Beacon.

MPIC additionally agreed to subscribe to 801.0 million shares of Beacon's preferred stock for a subscription price of ₱10 per share or a total of ₱8,010.4 million.

The completion of the subscription of MPIC and PCEV to 1,156.5 million common shares each and subscription of MPIC to 801.0 million preferred shares of Beacon were subject to the same conditions discussed in Note 6.

The subscription price of MPIC's and PCEV's subscription to Beacon shares was offset in part (in the case of MPIC) and in full (in the case of PCEV) against the consideration for the transfer of Meralco shares held by MPIC and PCEV as described in Note 6.

In addition, MPIC settled its remaining balance of ₱6,600.0 million in cash. On May 12, 2010, PCEV also completed the purchase from MPIC of 12,500 shares or 50 percent of the 25,000 Beacon common shares originally owned by MPIC.

On October 20, 2011, PCEV agreed to subscribe to 1,199.0 million preferred shares of Beacon, for a subscription price of approximately ₱12.62 per share or a total of ₱15,136.0 million as approved by MPIC BOD on October 19, 2011. As a result of the transaction, the Company incurred ₱6.0 million stock issuance costs.

On January 20, 2012, MPIC and PCEV subscribed to an additional 135.0 million common shares each at the price of ₱20 per common share, or aggregate subscription price of ₱5,400.0 million. Capital stock issuance costs relative to the transaction amounted to ₱1.4 million.

<u>Dividends Declared</u>
The Company declared cash dividends at the rate of 7% of the issue value of each preferred share in favor of its preferred shareholder amounting to:

(i) ₱140.2 million on March 28, 2011 in favor of holders of record as at March 31, 2011 which was paid on March 31, 2011.

(ii) ₱46.7 million on April 26, 2011 in favor of holders of record as at April 30, 2011 which was paid on April 30, 2011.

(iii) ₱93.5 million on June 30, 2011 in favor of holders of record as at June 30, 2011 which was paid on June 30, 2011.

(iv) ₱471.7 million on March 21, 2012 in favor of holders of record as at December 31, 2011 which was paid on March 30, 2012.

(v) ₱810.1 million on August 9, 2012 in favor of holders of record as at June 30, 2012 which was paid on August 31, 2012.

As at December 31, 2012, total cumulative dividends on preferred shares not yet declared by the Company amounted to ₱810.1 million.

11. **Income Taxes**

The reconciliation between the provision for income tax at the applicable statutory tax rate and the actual provision for income tax for the year ended December 31 is as follows:

	2012	2011
	(In Million Pesos)	
Provision for income tax at statutory tax rate	**₱1,320.8**	₱857.3
Tax effects of:		
Equity share in net earnings of Meralco	**(2,207.5)**	(1,504.7)
Nondeductible expenses/losses	**231.6**	66.1
Income already subjected to final tax	**(28.3)**	(11.0)
Income already subjected to stock transaction tax	**(23.2)**	–
Movement in unrecognized deferred tax assets	**706.6**	592.3
Actual provision for income tax	**₱–**	₱–

The Company's deferred income tax assets have not been recognized in the statements of financial position as it is not probable that future taxable income will be sufficient against which these can be utilized. The deductible temporary differences for which no deferred tax assets have been recognized as at December 31 are as follows:

	2012	2011
	(In Million Pesos)	
NOLCO	**₱5,710.0**	₱3,012.6
Accrual for pretermination fees and transaction cost	**214.0**	–
Loss on re-measurement of liability for contingent consideration	**–**	556.2
	₱5,924.0	₱3,568.8

Unutilized NOLCO which can be deducted against future taxable income is as follows:

Date Incurred	Expiry Date	Amount
December 31, 2010	December 31, 2013	₱1,263.7
December 31, 2011	December 31, 2014	1,748.9
December 31, 2012	December 31, 2015	2,697.4
		₱5,710.0

12. **Contingencies of Meralco**

The following are the contingent assets and liabilities of Meralco as at December 31, 2012. The equity share in net earnings to be recognized by Beacon in the future will be affected by the ultimate resolution of these contingencies.

Overpayment of Income Tax related to Supreme Court (SC) Refund
With the decision of the SC for Meralco to refund ₱0.167 per kilowatt (kWh) to covered customers during the billing period February 1994 to May 2003, Meralco overpaid income tax in the amount of ₱7,107 million for taxable years 1994 to 1998 and 2000 to 2001. Accordingly, Meralco filed a claim on November 27, 2003 for the recovery of such excess income taxes paid.

After examination of the books of Meralco for the covered periods, the BIR determined that Meralco had in fact overpaid income taxes in the amount of ₱6,690 million. However, the BIR also maintained that Meralco is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001, claiming that the period for filing a claim had prescribed in respect of the difference between Meralco's overpayment and the refund amount Meralco is entitled to.

The BIR then approved the refund of ₱894 million for issuance of tax credit certificates (TCCs), proportionate to the actual refund of claims to utility customers. The BIR initially issued TCCs amounting to ₱317 million corresponding to actual refund to customers as at August 31, 2005.

As at December 31, 2012 and 2011, the amount of unissued TCCs of ₱577 million out of the ₱894 million refund entitlement is presented as part of "Other noncurrent assets" account in Meralco's consolidated statements of financial position.

Meralco filed a Petition with the Court of Tax Appeals (CTA) assailing the denial by the BIR of its income tax refund claim of ₱5,796 million for the years 1994 - 1998 and 2000, arising from the SC decision (net of ₱894 million as approved by the BIR for taxable year 2001). In a decision dated December 6, 2010, the CTA's Second Division granted Meralco's claim and ordered the BIR to refund or to issue tax credit certificate in favor of Meralco in the amount of ₱5,796 million in proportion to the tax withheld on the total amount that has been actually given or credited to its customers.

On appeal by the BIR to the CTA En Banc, Meralco's petition was dismissed on the ground of prescription in the Decision of the CTA En Banc dated May 8, 2012. On Motion for Reconsideration by Meralco of the said dismissal, the CTA En Banc partly granted Meralco's motion and issued an Amended Decision dated November 13, 2012, ruling that Meralco's claim was not yet barred by prescription and remanding the case back to the CTA Second Division for further reception of evidence.

The BIR filed a Motion for Reconsideration of the above Amended Decision, while Meralco filed its Motion for Partial Reconsideration or Clarification of Amended Decision. Both parties already filed their respective Comments to the said motions, and these are now submitted for resolution at the CTA En Banc.

Overpayment of Income Tax Related to Change in Tax Basis
On February 4, 2008, the SC denied with finality a motion for reconsideration filed by the Commissioner of Internal Revenue (CIR), against Meralco, with respect to the issue on excess income tax paid by the latter. The SC affirmed a Court of Appeals' (CA) decision and ordered the CIR to refund or issue a TCC in favor of Meralco for ₱107 million representing overpaid income taxes for taxable years 1987 and 1988. The overpayment is in accordance with the effectivity of Executive Order No. 72, which subjected Meralco to regular corporate income tax instead of 2% franchise tax based on gross receipts it was previously liable for. On February 5, 2013, Meralco filed a Motion for Issuance of a Writ of Execution with the CTA to enforce the judgment of the SC. On February 14, 2013, the CTA promulgated a Resolution ordering the CIR and the Office of the Solicitor General (OSG) to comment on the Motion filed by Meralco. As at February 25, 2013, the Motion is still pending with the CTA.

Local Franchise Tax (LFT) Assessments of Municipalities
Certain municipalities have served assessment notices on Meralco for LFT. As provided in the Local Government Code (LGC), only cities and provincial governments may impose taxes on establishments doing business in their localities. On the basis of the foregoing, Meralco and its legal counsel believe that Meralco is not subject or liable for such assessments.

Real Property Tax (RPT) Assessments
Six Local Government Units (LGUs) assessed Meralco for deficiency RPTs on certain assets of Meralco. The assets include electric poles, wires, insulators, and transformers, collectively referred to as transformers, wires, insulators, poles (TWIP). Of these LGUs, one has secured a favorable decision from the CA. Such decision was appealed by Meralco to the SC for the benefit of Meralco customers, where it is now submitted for resolution. The cases of the other LGUs are pending with their respective administrative bodies or government offices.

Meralco also filed a case against the City of Manila before Regional Trial Court (RTC)-Pasig branch or RTC-Pasig, to enjoin the collection of RPT on Meralco's TWIP and nullify RPT assessments made thereon based on the argument that these are not within the ambit of the definition of real property under the LGC. The case is set for mediation after the City of Manila filed its comment on Meralco's petition.

In the event that the assessments are sustained by the SC and payment is warranted or appropriate, Meralco will file for the recovery of any resulting real estate tax payments from customers in the relevant LGU through separate application with the Energy Regulatory Commission (ERC).

Mediation with National Power Corporation (NPC)
The NPC embarked on a Power Development Program, which consisted of contracting generating capacities and the construction of its own, as well as private sector, generating plants, following a crippling power supply crisis. To address the concerns of the creditors of NPC, namely, Asian Development Bank and the World Bank, the Department of Energy (DOE) required that Meralco enter into a long-term supply contract with the NPC.

Accordingly, on November 21, 1994, Meralco entered into a 10-year Contract for Sale of Electricity (CSE), with NPC to commence on January 1, 1995. The CSE and the rates and amounts charged to Meralco therein were approved by the BOD of NPC and the then Energy Regulatory Board, respectively.

Separately, the DOE further asked Meralco to provide a market for half of the output of the Camago-Malampaya gas field to enable its development and production of natural gas, which was to generate significant revenues for the Philippine Government and equally significant foreign exchange savings for the country to the extent of the fuel imports, which the domestic volume of natural gas will displace.

Meralco's actual purchases from NPC exceeded the contract level in the first seven years of the CSE. However, the 1997 Asian crisis resulted in a significant curtailment of energy demand.

While the events were beyond the control of Meralco, NPC did not honor Meralco's good faith notification of its off-take volumes. A dispute ensued and both parties agreed to enter into mediation.

The mediation resulted in the signing of a Settlement Agreement (SA), between the parties on July 15, 2003. The SA was approved by the respective BODs of NPC and Meralco. The net settlement amount of ₱14,320 million was agreed upon by NPC and Meralco and manifested before the ERC through a Joint Compliance dated January 19, 2006. The implementation of the SA is subject to the approval of ERC.

Subsequently, the OSG filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between NPC and Meralco." As a result, Meralco sought judicial clarification with the RTC-Pasig. Pre-trials were set which

Meralco complied with and attended. However, the OSG refused to participate in the pre-trial and opted to seek a Temporary Restraining Order (TRO) from the CA.

In a Resolution dated December 1, 2010, the CA issued a TRO against RTC-Pasig, Meralco and NPC restraining the respondents from further proceeding with the case. Subsequently, in a Resolution dated February 3, 2011, the CA issued a writ of preliminary injunction enjoining the RTC-Pasig from conducting further proceedings pending resolution of the Petition. In a Decision dated October 14, 2011, the CA resolved to deny the Petition filed by the OSG and lifted the injunction previously issued. The said Decision likewise held that the RTC-Pasig committed no error in finding the OSG in default due to its failure to participate in the proceedings. The RTC-Pasig was thus ordered to proceed to hear the case ex-parte, as against the OSG, and with dispatch. The OSG has filed a motion for reconsideration which was denied by the CA in its Resolution dated April 25, 2012. The OSG filed a Petition for Review of the Certiorari with the SC. In a Resolution dated July 25, 2012, the SC required Meralco to file a Comment. Meralco's Comment was filed on October 29, 2012. The SC then issued a Resolution dated November 26, 2012 requiring the OSG to file a Reply. On February 19, 2013, the OSG filed a motion for extension to file a consolidated reply. Meralco has yet to receive the OSG's consolidated reply.

With the dismissal of the petition filed by the OSG with the CA, Meralco filed a motion for the reception of its evidence ex-parte with the RTC-Pasig pursuant to the ruling of the CA. In a Decision dated May 29, 2012, the RTC-Pasig declared the SA, independent of the pass-through for the Settlement amount which is reserved for the ERC, valid and binding. The OSG has filed a Notice of Appeal with the RTC-Pasig on June 19, 2012. Meralco is awaiting receipt of OSG's appeal brief.

Sucat-Araneta-Balintawak Transmission Line
The Sucat-Araneta-Balintawak transmission line is a two-part transmission line, which completed the 230kV-line loop within Metro Manila. The two main parts are the Araneta to Balintawak leg and the Sucat to Araneta leg, which cuts through Dasmariñas Village, Makati City.

On March 10, 2000, certain residents along Tamarind Road, Dasmariñas Village, Makati City or plaintiffs, filed a case against NPC with the RTC-Makati, enjoining NPC from further installing high voltage cables near the plaintiffs' homes and from energizing and transmitting high voltage electric current through said cables because of the alleged health risks and danger posed by the same. Following its initial status quo Order issued on March 13, 2000, RTC-Makati granted on April 3, 2000 the preliminary injunction sought for by the plaintiffs. The decision was affirmed by the SC on March 23, 2006, which effectively reversing a decision of the CA to the contrary. The RTC-Makati subsequently issued a writ of execution based on the order of the SC. Meralco, in its capacity as an intervenor, was constrained to file an Omnibus Motion to maintain status quo because of the significant effect of a de-energization of the Sucat-Araneta line to the public and economy. Shutdown of the 230-kV line will result in widespread and rotating brownouts within Meralco's franchise area with certain power plants unable to run at their full capacities.

On September 8, 2009, the RTC-Makati granted the motions for intervention filed by intervenors Meralco and National Grid Corporation of the Philippines (NGCP) and dissolved the Writ of Preliminary Injunction issued, upon the posting of the respective counter bonds by defendant NPC, intervenors, Meralco and NGCP, subject to the condition that NPC and intervenors pay all damages, which the plaintiffs may incur as a result of the Writ of Preliminary Injunction.

Thereafter, the plaintiffs questioned the RTC-Makati order before the CA. As at February 25, 2013, this case remains pending for resolution in the CA.

Moreover, in its Order dated February 5, 2013, the RTC-Makati granted plaintiffs' motion and directed the re-raffle of the case to another court after the judicial dispute resolution failed.

Petition for Dispute Resolution
On September 9, 2008, Meralco filed a Petition for Dispute Resolution, against Philippine Electricity Market Corporation (PEMC), TransCo, NPC and Power Sector Assets and Liabilities Management Corporation (PSALM) with the ERC as a result of the congestion in the transmission system of TransCo arising from the outages of the San Jose-Tayabas 500kV Line 2 on June 22, 2008, and the 500kV 600 Mega volt-ampere Transformer Bank No. 2 of TransCo's San Jose, Bulacan substation on July 11, 2008. The Petition seeks to, among others, direct PEMC to adopt the NPC - Time of Use (TOU) rate or the new price determined through the price substitution methodology of PEMC as approved by the ERC, as basis for its billing during the period of the congestion and direct NPC and PSALM to refund the transmission line loss components of the line rentals associated with NPC/PSALM bilateral transactions from the start of Wholesale Electricity Spot Market (WESM) operation on June 26, 2006.

In a Decision dated March 10, 2010, the ERC granted Meralco's petition and ruled that there is double charging of the Transmission Line Costs billed to Meralco by NPC for the Transition Supply Contract (TSC) quantities to the extent of 2.98% loss factor, since the start of the TSC in November 2006. Thus, NPC was directed to refund/collect line rental adjustment to/from Meralco. In the meantime, the ERC issued an Order on May 4, 2011 directing PEMC to submit an alternative methodology for the segregation of line rental into congestion cost and line losses from the start of the WESM. PEMC has filed its compliance submitting its alternative methodology.

On September 8, 2011, Meralco received a copy of PEMC's compliance to ERC's directive and on November 11, 2011, Meralco filed a counter-proposal which effectively simplifies PEMC's proposal.

On November 11, 2011, Meralco filed its Motion to Implement the Decision dated March 10, 2010 By Immediately Effecting the Refund/(Collection) of Line Rental Adjustments to Consumers. On December 21, 2011, PSALM filed its comment on Meralco's said Motion. Then, in an Order dated January 24, 2012, the ERC directed PEMC, Transco and NPC to submit their respective comments on Meralco's motion within five days from receipt.

In an Order of the ERC dated June 27, 2012, Meralco was directed to submit its computation of the amount of the double charging of line loss on a per month basis from June 26, 2006 up to the present. On July 4, 2012, Meralco filed its Compliance to the said Order. Thereafter, the ERC issued an Order directing the parties to comment on Meralco's submissions.

Hearings were then conducted on October 2 and 16, 2012, to discuss the parties' proposals and comments. Meralco has filed its Comment thereon and is awaiting the resolution of the ERC.

PSALM versus PEMC and Meralco
Due to the unusually large increases in WESM prices during the 3rd and 4th months of the WESM operations, Meralco raised concerns with the PEMC to investigate whether WESM rules were breached or if anti-competitive behavior had occurred.

While resolutions were initially issued by the PEMC directing adjustments of WESM settlement amounts, a series of exchanges and appeals with the ERC ensued. ERC's decision directing the WESM settlement price for the 3rd and 4th billing months to be NPC-TOU rates prompted PSALM to file a Motion for Reconsideration with the CA, which was denied on November 6, 2009. In December 2009, PSALM filed a Petition for Review on Certiorari with the SC.

As at February 25, 2013, PSALM's petition for review is pending resolution by the SC.

Petition for Dispute Resolution with NPC on Premium Charges
On June 2, 2009, Meralco filed a Petition for Dispute Resolution against NPC and PSALM with respect to NPC's imposition of premium charges for the alleged excess energy it supplied to Meralco covering the billing periods May 2005 to June 2006. The premium charges amounting to ₱315 million during the May-June 2005 billing periods have been paid but are the subject of a protest by Meralco, and premium charges of ₱318 million during the November 2005, February 2006 and April to June 2006 billing periods are being disputed and withheld by Meralco. Meralco believes that there is no basis for the imposition of the premium charges. The hearings on this case have been completed and Meralco is now awaiting the resolution of the ERC on the petition.

Others
Management and its internal and external counsels believe that the probable resolution of these issues will not materially affect the Meralco Group's financial position and results of operations.

13. Significant Contracts and Commitments of Meralco

The significant contracts and commitments of Meralco as at December 31, 2012 are as follows:

NPC
Meralco and NPC entered into a TSC, effective the earlier of five years from November 16, 2006 up to December 25, 2011 or one year after the introduction of Open Access, should Retail Competition and Open Access (RCOA) be in place within the five-year contract period. Two addenda for additional contracted volumes were signed, the most recent being in 2010. The adjusted contracted volume was for a total of more than 40,000 GWh up to 2011.

On December 26, 2011, the TSC with NPC was extended until December 25, 2012 or three months after the implementation of the RCOA, whichever comes first.

As a result of the extension of the TSC, the Customer Choice Program (CCP), which is a joint program of NPC and Meralco aimed at providing NPC-TOU, benefits to qualified customers, has also been extended to be co-terminus with the TSC. The CCP program expired on December 25, 2012.

With respect to the TSC, Meralco, NPC and PSALM then executed a Memorandum of Agreement which further extended the TSC until June 25, 2013 or the turnover of the Angat Hydroelectric Power Plant to the winning bidder, whichever comes earlier, with a contracted monthly energy volume ranging from 112.846 GWh to 159.966 GWh.

Assignment of TSC Volume to Successor Generating Companies
From 2008 to 2009, NPC privatized a number of its generating assets and Independent Power Producers (IPP) contracts in favor of the successful bidders. As a result, the contracted energy volume under the original TSC between Meralco and NPC was assigned by NPC to the respective new owners and Independent Power Plant Administrators (IPPAs). Following are the privatized plants and IPP contracts:

Year	Power Plant	Successor Owner/IPPAs	% of Total Volume
2008	Masinloc coal-fired power plant – 600 MW	Masinloc Power Partners Co. Ltd. (Masinloc Power)	21.3
2009	Tiwi-Makban geothermal power plants – 289 MW	Aboitiz Power Renewable, Inc. (Aboitiz Power)	8.1
	Pagbilao power plan –735 MW	Therma Luzon Inc. (Therma Luzon)	25.0
	Sual coal-fired power plant – 1,000 MW	San Miguel Energy Corporation (SMEC)	8.6
	Coal-fired Calaca power plant – 600 MW	Sem-Calaca Power Corporation or Sem-Calaca	10.4
2010	Combined cycle gas turbine, natural gas-fired Ilijan power plant – 1,200 MW	South Premier Power Corporation (SPPC)	15.2

NPC/PSALM remains the contracting party of record for the supply of power to Meralco. Payments of the contracted volume are made based on the billing instructions from NPC/PSALM received by Meralco.

PSAs with Successor Generating Companies
Meralco entered into separate Power Supply Agreement (PSAs) with SPPC, Masinloc Power and Sem-Calaca on December 12, 20 and 21, 2011, respectively. Also, a PSA with Therma Luzon was executed on February 29, 2012. These PSAs are for a period of seven years, extendable for three years upon agreement of the parties.

In March 2012, the application for approval of the PSAs was filed with the ERC. On June 26, 2012, Meralco BOD approved the grant of authority to Meralco to enter into a PSA with SMEC for a period of seven years, extendable for three years upon agreement of the parties.

On March 16, 2012, MPower signed a new PSA with Masinloc Power for 30MW of contracted capacity from the Masinloc coal-fired power plant in Zambales for seven years, extendable for three years upon agreement of the parties.

On April 26, 2012, the BOD approved the PSA with Pangea Green Energy Philippines, Inc. (PGEP), a biogas power plant located in Payatas, Quezon City using methane gas extracted from the Payatas Landfill as its fuel. Its plant will have a total nominal generating capacity of 1,236 kW.

In separate Decisions dated December 17, 2012, the ERC approved with modifications the PSAs of Meralco with Masinloc Power, SPPC, Sem-Calaca, Therma Luzon and SMEC.

Motions for Reconsideration were filed regarding the ERC decisions on the PSAs with SPPC, Sem-Calaca and SMEC. The motions are set for decision by the ERC upon the submission of the Formal Offer of Evidence and other documents requested by the ERC.

With respect to the motion for reconsideration of the Decision on the PSA of Sem-Calaca, hearings have been scheduled.

On December 27, 2012, Meralco executed the PSAs with Therma Luzon and Aboitiz Power to cover the volume needed by Meralco during the six-month transition period before the start of the commercial operations of RCOA. Under the PSAs with Therma Luzon and Aboitiz Power, Meralco will procure power from Therma Luzon and Aboitiz Power from the expiration of the TSC until June 25, 2013 conditioned upon ERC approval. The said PSAs had been submitted to the ERC for approval on January 2, 2013. The hearings on both PSAs have already been terminated and are already submitted for decision.

Under the PSAs, fixed capacity fees and fixed operating maintenance fees are recognized monthly based on their contracted capacities. The annual projection of these payments are shown in the table below:

Year	Contracted Capacity	Fixed Payment Amount
	(In Megawatt)	*(In Million Pesos)*
2013	2,850	₱33,214
2014	2,850	33,992
2015	2,850	35,570
2016	2,880	37,560
2017	2,880	38,101
2018	2,880	38,626
2019	2,460	33,140

First Gas Power Corp. (*FGPC) and FGP Corp. (FGP)*
In compliance with the DOE's program to create a market for Camago-Malampaya gas field and enable its development, Meralco was committed to contract 1,500-MW of the 2,700 MW output of the Malampaya gas field.

Accordingly, Meralco entered into separate 25-year PPAs with FGPC (March 14, 1995) and FGP (July 22, 1999) for a minimum number of kWh of the net electrical output of the Sta. Rita and San Lorenzo power plants, respectively, from the start of their commercial operations. The PPA with FGPC terminates on August 17, 2025, while that of FGP ends on October 1, 2027.

On January 7, 2004, Meralco, FGP and FGPC signed an Amendment to their respective PPAs. The negotiations resulted in certain new conditions including the assumption of FGP and FGPC of community taxes at current tax rate, and subject to certain conditions increasing the discounts on excess generation, payment of higher penalties for non-performance up to a capped amount, recovery of accumulated deemed delivered energy until 2011 resulting in the non-charging of Meralco of excess generation charge for such energy delivered beyond the contracted amount but within a 90% capacity quota. The amended terms under the respective PPAs of FGP and FGPC were approved by the ERC on May 31, 2006.

Under the respective PPAs of FGP and FGPC, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity tested and proven, which is usually conducted on a semi-annual basis.

Meralco entered into a PPA with Quezon Power (Philippines) Limited Company (QPPL) on August 12, 1994, which was subsequently amended on December 1, 1996. Under the terms of the amended PPA, Meralco is committed to purchase a specified volume of electric power and energy from QPPL, subject to certain terms and conditions. The PPA is for a period of 25 years from the start of commercial operations up to July 12, 2025.

In a Letter Agreement signed on February 21, 2008, the amount billable by QPPL included a transmission line charge reduction in lieu of a previous rebate program. The Letter Agreement also provides that Meralco make advances to QPPL of $2.85 million per annum for 10 years beginning 2008 to assist QPPL in consideration of the difference between the transmission line charge specified in the Transmission Line Agreement and the ERC-approved transmission line charge in March 2003. QPPL shall repay Meralco the same amount at the end of the 10-year period in equal annual payments without adjustment. However, if Meralco is able to dispatch QPPL at a plant capacity factor of no less than 86% in any particular year, Meralco shall not be required to pay the $2.85 million in that year. This arrangement did not have any impact on the rates to be charged to consumers and hence, would not require any amendment in the PPA, as approved by ERC.

Committed Energy Volume to be Purchased
The following are forecasted purchases/payments to FGPC, FGP and QPPL corresponding to the Minimum Energy Quantity (MEQ), provisions of the contracts. The forecasted fixed payments include capacity charge and fixed operation and maintenance cost escalated using the US and Philippine Consumer Price Index (CPI).

Year	MEQ	Equivalent Amount
	(In Million Kilowatt-Hours)	*(In Million Pesos)*
2013	14,656	₱20,167
2014	14,656	20,346
2015	14,656	20,530
2016	14,556	20,524
2017	14,556	20,928
2018-2025	116,450	152,788

Montalban Methane Power Corporation (MMPC)
MMPC operates an 8 MW (designed capacity of 11 MW) renewable energy generating facility, which utilizes landfill gas.

On May 13, 2009, Meralco filed an application for the approval of the CSE with MMPC with the ERC. On June 9, 2009, ERC issued an order dated June 1, 2009 provisionally approving the CSE subject to the following conditions: (i) any amendments to the CSE shall be filed with the ERC for approval and the implementation shall be prospective; and (ii) in the event the rates approved are higher than the final rates, the amount corresponding to the excess shall be refunded by Meralco to its customers by crediting the same in their electric bills.

On June 11, 2009, MMPC began delivering energy to Meralco under a two year CSE. The CSE is a “take and pay” arrangement, without a minimum energy volume. Energy is billed to Meralco on an hourly basis at the ERC-approved NPC-TOU rate plus certain pre-agreed cost components. Being an embedded renewable energy generator, purchases from MMPC are VAT zero-rated. Energy deliveries from MMPC are exempt from power delivery service charge.

After a series of negotiations, on May 23, 2011, Meralco and MMPC signed a Letter Agreement extending the CSE. Said Agreement likewise contained minor amendments to the CSE that were intended to benefit the consumers. On June 3, 2011, Meralco filed a Manifestation with Motion with the ERC seeking the approval of the Letter Agreement, pursuant to the condition contained in the ERC Order dated June 1, 2009. On February 19, 2013, the ERC issued its Decision approving the application.

BEI
Meralco signed a CSE with BEI on November 12, 2010. BEI owns and operates a 4MW renewable energy generation facility powered by landfill gas in San Pedro, Laguna.
The terms of the CSE with BEI are similar to that signed with MMPC. Purchases from BEI, an embedded renewable energy generator, are VAT zero-rated and exempt from power delivery service charge. Meralco filed an application for the approval of the CSE with the ERC, for the provisional implementation of the contract on December 15, 2010. In an order dated January 31, 2011, the ERC provisionally approved the said application which extended the implementation indefinitely. The said case is pending decision by the ERC.

Interconnection Agreement with Alternergy Philippine Holdings Corporation (Alternergy)
On March 1, 2012, Meralco signed an Interconnection Agreement with Alternergy for their 90MW Wind Farm Renewable Energy plant in Pililla, Rizal, which is an interconnection at Meralco's Malaya-Teresa 115kV line, Altenergy is thus an embedded generator. Alternergy shall construct at its own cost, operate and maintain the new 115kV line. Aside from supporting renewable energy, technical benefits of the interconnection agreement are slight lowering of loading of Dolores Delivery Point Substation power transformers resulting in additional spare capacity, and slight improvement in the voltage at the 115kV and 34.5kV busses.

14. **Financial Risk Management Objectives and Policies**

The Company's principal financial instruments consist mainly of borrowings from local financial institutions and short-term deposits, proceeds of which were used for the acquisition of investments and for financing operations. The Company has other financial assets and liabilities such as cash in banks, receivables and accounts payable and other current liabilities which arise directly from the Company's operations.

The main risks arising from the Company's financial instruments are interest rate risk, liquidity risk and credit risk from its use of financial instruments. The BOD reviews and approves policies of managing each of the risks and they are summarized below.

Interest Rate Risk
Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to market risk for changes in interest rates relate primarily to its long-term debt. The Company manages interest rate exposure by using a mix of fixed rate and variable rate debts.

Fixed rate debt is subject to fair value interest rate risk while variable rate debt is subject to cash flow interest rate risk. Repricing of variable rate debt is done on intervals of six months. Interest on fixed rate debt is fixed until maturity.

The following table sets forth the impact of a reasonably possible change in interest rates on the Company's income before income tax, with all other variables held constant. There is no impact on equity other than those already affecting income before income tax.

2012		2011	
Change in Interest Rates	**Sensitivity of Income Before Tax**	Change in Interest Rates	Sensitivity of Income Before Tax
100 bps (decrease)	**₱523.8**	100 bps (decrease)	₱217.2
100 bps increase	**(523.8)**	100 bps increase	(217.2)

Liquidity Risk

Liquidity risk is the risk of not meeting obligations as they become due because of an inability to liquidate assets or obtain funding. The Company's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans.

As part of the liquidity strategy, the Company sets aside cash to ensure that financial obligations will be met as they fall due. As at December 31, 2012 and 2011, the Company has cash and cash equivalents, which are short-term in nature, amounting to ₱2,146.1 million and ₱1,472.3 million, respectively. These are allocated to meet the Company's short-term liquidity needs.

The Company's liquidity and funding management process include the following:

- Managing the concentration and profile of debt maturities
- Maintaining debt financing plans
- Monitoring statement of financial position liquidity ratios against internal and regulatory requirements

The table below summarizes the maturity profile of the Company's financial assets and liabilities as at December 31 based on undiscounted contractual payments.

	2012						
	On Demand	**Within 1 Year**	**1–2 Years**	**2–3 Years**	**3–4 Years**	**More than 4 Years**	**Total**
				(In Million Pesos)			
Financial Assets							
Loans and receivables:							
Cash and cash equivalents:							
Cash in banks	**₱2.7**	**₱–**	**₱–**	**₱–**	**₱–**	**₱–**	**₱2.7**
Short-term deposits	–	**2,143.4**	–	–	–	–	**2,143.4**
Interest receivable	–	**1.1**	–	–	–	–	**1.1**
	2.7	**2,144.5**	–	–	–	–	**2,147.2**
Financial Liabilities							
Other financial liabilities:							
Accounts payable and other current liabilities:							
Accounts payable	–	**0.1**	–	–	–	–	**0.1**
Accrued interest	–	**575.1**	–	–	–	–	**575.1**
Accrued pretermination fees and transaction cost	–	**214.0**	–	–	–	–	**214.0**
Others	–	**5.7**	–	–	–	–	**5.7**
Long-term debt:							
Principal	–	**22,680.0**	**605.0**	**605.0**	**990.0**	**8,580.0**	**33,460.0**
Interest	–	**1,947.7**	**807.8**	**761.9**	**710.5**	**2,131.5**	**6,359.4**
	–	**25,422.6**	**1,412.8**	**1,366.9**	**1,700.5**	**10,711.5**	**40,614.3**
	₱–	**(₱23,278.1)**	**(₱1,412.8)**	**(₱1,366.9)**	**(₱1,700.5)**	**(₱10,711.5)**	**(₱38,467.1)**

	2011						
	On Demand	Within 1 Year	1–2 Years	2–3 Years	3–4 Years	More than 4 Years	Total
				(In Million Pesos)			
Financial Assets							
Loans and receivables:							
Cash and cash equivalents:							
Cash in banks	₱1.0	₱–	₱–	₱–	₱–	₱–	₱1.0
Short-term deposits	–	1,471.3	–	–	–	–	1,471.3
Receivables:							
Dividends receivables	–	53.1	–	–	–	–	53.1
Interest receivable	–	1.4	–	–	–	–	1.4
	1.0	1,525.8	–	–	–	–	1,526.8
Financial Liabilities							
Other financial liabilities:							
Accounts payable and other current liabilities:							
Accounts payable	–	45.2	–	–	–	–	45.2
Accrued interest	–	424.7	–	–	–	–	424.7
Deferred purchase liability	–	7,490.2	–	–	–	–	7,490.2
Long-term debt:							
Principal	–	540.0	800.0	1,120.0	2,020.0	17,520.0	22,000.0
Interest	–	1,871.5	1,806.3	1,729.8	1,615.5	5,041.5	12,064.6
	–	10,371.6	2,606.3	2,849.8	3,635.5	22,561.5	42,024.7
	₱1.0	(₱8,845.8)	(₱2,606.3)	(₱2,849.8)	(₱3,635.5)	(₱22,561.5)	(₱40,497.9)

Credit Risk

Credit risk is the risk that the Company will incur a loss arising from counterparties that fail to discharge their contracted obligations. The Company manages and controls credit risk by setting limits on the amount of risk that the Company is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

The Company's maximum exposure to credit risk is equal to the carrying amount of these instruments. The Company has no concentration of credit risk.

The aggregate cash and cash equivalents and receivables amounting to ₱2,147.2 million and ₱1,526.8 million as at December 31, 2012 and 2011, respectively, are all neither past due nor impaired. The Company classified the credit quality of its cash and cash equivalents and receivables as high grade since they are collectible on their due dates.

Capital Management

The primary objective of the Company's capital management is to ensure that the Company has sufficient funds in order to support its business, pay existing obligations and maximize shareholder value. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions. To manage or adjust the capital structure, the Company may obtain additional advances from stockholders, return capital to shareholders or issue new shares.

The Company monitors capital on the basis of debt-to-equity ratio. Debt-to-equity ratio is calculated as long-term debt over equity.

The Company's strategy is to maintain a sustainable debt-to-equity ratio. The debt-to-equity ratio as at December 31 is as follows:

	2012	2011
	(In Million Pesos)	
Long-term debt	**₱33,269.9**	₱21,731.7
Equity	**80,928.5**	72,402.2
Debt-to-equity ratio	**1:2.4**	1:3.3

15. **Financial Assets and Financial Liabilities**

The following tables set forth the carrying values and estimated fair values of the Company's financial assets and liabilities as at December 31, 2012 and 2011:

	2012		2011	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
		(In Million Pesos)		
Financial Assets				
Loans and receivables:				
Cash and cash equivalents:				
Cash in banks	**₱2.7**	**₱2.7**	₱1.0	₱1.0
Short-term deposits	**2,143.4**	**2,143.4**	1,471.3	₱1,471.3
Receivables:				
Interest receivable	**1.1**	**1.1**	1.4	1.4
Dividends receivable	**–**	**–**	53.1	53.1
	₱2,147.2	**₱2,147.2**	₱1,526.8	₱1,526.8
Financial Liabilities				
Other financial liabilities:				
Accounts payable and other current liabilities:				
Accounts payable	**₱0.1**	**₱0.1**	₱45.2	₱45.2
Accrued expenses:				
Interest	**575.1**	**575.1**	424.7	424.7
Pretermination fees and transaction cost	**214.0**	**214.0**	–	–
Others	**5.7**	**5.7**	–	–
Deferred purchase liability	**–**	**–**	7,313.0	7,313.0
Long-term debt	**33,269.9**	**35,465.2**	21,731.7	24,438.8
	₱34,064.8	**₱36,260.1**	₱29,514.6	₱32,221.7

Cash and Cash Equivalents, Receivables, Accounts Payable and Other Current Liabilities and Deferred Purchase Liability. Carrying values approximate their fair values at the end of the reporting period due to the relatively short-term nature of the transactions.

Long-term Debt. For both fixed rate and floating rate, estimated fair value is based on the discounted value of future cash flows using the prevailing credit rates ranging from 2.17% to 5.77% and 3.12% to 7.84% in 2012 and 2011, respectively.

16. **Event After the Reporting Date**

On February 25, 2013, Meralco declared cash dividends equivalent to ₱6.10 per share to all common stockholders of record as at March 26, 2013 payable on April 24, 2013.

17. **Supplemental Cash Flow Information**

	2012	2011
	(In Million Pesos)	
Noncash investing and financing activities:		
Property dividends received from Meralco (see Note 6)	**₱3,168.1**	₱–
Contingent consideration recognized as part of investment in Meralco (see Note 6)	**180.9**	–
Share in the other comprehensive income (loss) of Meralco (see Note 6)	**6.9**	(224.5)
Acquisition of 31.2 million Meralco shares under a deferred payment scheme (see Note 6)	–	7,313.0
Derecognition of liability for contingent consideration (see Note 6)	–	147.0
Direct acquisition costs recognized as due to related parties (see Notes 6 and 9)	–	84.3

18. **Supplementary Information Required Under Revenue Regulation (RR) 19-2011**

On December 9, 2011, RR 19-2011 became effective where it prescribes the new income tax forms to be used effective December 31, 2011. The Company is now required to include as part of the notes to the financial statements the schedules and information on taxable income and deductions.

Below is the additional information required by RR No. 19-2011. This information is presented for purposes of filing with the BIR and is not a required part of the basic financial statements.

In 2012, the Company does not have taxable gross income.

Itemized deductions for the year consist of (values rounded to the nearest peso):

Interest expense	₱2,354,283,734
Amortization of debt issue costs	43,338,457
Taxes and licenses	6,885,688
Professional fees	6,362,137
Other services	4,399,009
Commission	25,000
Insurance	1,122
Miscellaneous	282,139,508
	₱2,697,434,655

Taxes and Licenses
Taxes and licenses in 2012 pertain to business permit amounting to ₱6,885,688.

19. Supplementary Information Required Under RR 15-2010

On December 28, 2010, RR No. 15-2010 became effective and amended certain provisions of RR No. 21-2002 prescribing the manner of compliance with any documentary and/or procedural requirements in connection with the preparation and submission of financial statements and income tax returns. Section 2 of RR No. 21-2002 was further amended to include in the Notes to Financial Statements information on taxes, duties and license fees paid or accrued during the year in addition to what is mandated by PFRS.

Below is the additional information required by RR No. 15-2010. This information is presented for purposes of filing with the BIR and is not a required part of the basic financial statements.

The Company reported and/or paid the following types of taxes in 2012 (values rounded to the nearest peso):

VAT
The Company has no output VAT transactions during the year.

Input VAT arising from domestic purchases of goods and services for the year is detailed as follows:

Balance at January 1	₱901,595
Current year's domestic purchases/payments for:	
Services lodged under other accounts	1,254,349
	2,155,944
Claims for tax credit/refund and other adjustments	–
Balance at December 31	₱2,155,944

Withholding Taxes
In 2012, the Company remitted creditable withholding taxes and accrued final withholding taxes amounting to ₱77,381,538 and ₱123,499,595, respectively.

Other Taxes and Licenses
This includes all other taxes, local and national, including documentary stamp tax and licenses and permit fees, lodged under the "Taxes and licenses" account under the "Expenses" section in the Company's statement of comprehensive income.

Taxes and licenses paid by the Company in 2012 amounting to ₱6,885,688 pertain to business permits.

Documentary Stamp Taxes (DST)
Details of DST paid and incurred by the Company in 2012 are as follows:

DST on loans	₱60,000,000
DST on issuance of shares	1,350,000
	₱61,350,000

Tax Assessments and Cases
The Company has not received any Assessment Notice from the BIR as at December 31, 2012. Also, the Company has no pending tax cases, litigation and/or prosecution outside the administration of the BIR.