

To be an indispensable partner in the journey of everyone
whose life we touch.



26 June 2014

Ms. Janet A. Encarnacion
Head, Disclosure Department
Philippine Stock Exchange
3/F PSE Plaza
Ayala Triangle Plaza
Ayala Ave., Makati City

Dear *Ms. Encarnacion*:

We are herewith submitting the Company's second quarter report for period ended 30 June 2014 (SEC 17-Q) in compliance with the Securities Regulation Code and Revised Disclosure Rules.

Thank you and warm regards.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Socorro Ermac Cabreros".

Atty. Socorro Ermac Cabreros
Corporate Secretary

HEAD OFFICE: Phoenix Bulk Depot, Lanang, Davao City 8000,
Philippines
Trunkline: +63 (82) 235-8888
Fax: +63 (82) 233-0168

MANILA OFFICE: 25/F Fort Legend Towers, 3rd Avenue corner 31st St.,
Fort Bonifacio Global City, Taguig City 1634, Philippines
Trunkline: +632-403-4013
Fax: +632-403-4009

CEBU OFFICE: Phoenix Maguikay Gasoline Station, M.C. Briones St.,
National Highway, Maguikay, Mandaue City, Cebu 6014,
Philippines
Tel. No.: +63 (32) 236-8168 / 236-8198

COVER SHEET

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S.E.C. Registration Number

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P-H-O-E-N-I-X Petroleum Philippines, Inc.
(Company's Full Name)

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(Business Address: No. Street City / Town / Province)

| |
|---------------------|
| Dennis A. Uy |
|---------------------|

Contact Person

| |
|-----------------------|
| (082) 233-0168 |
|-----------------------|

Company Telephone Number

| | |
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| 1 | 2 |
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Month
Fiscal Year Ending

| | |
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Day

SEC Form 17-Q
FORM TYPE

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Annual Meeting

last Friday
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Secondary License Type, if applicable

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Amended Articles Number/Section

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Total No. of Stockholders

| | | | | |
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| | | | | |
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Domestic

| | | | | |
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Foreign

Total Amount of Borrowings

To be accomplished by SEC Personnel Concerned

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SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q, AS AMENDED

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES
REGULATION CODE AND SRC RULE 17(2)(b) THEREUNDER

1. For the quarterly period ended: 30 June 2014
2. SEC identification number: A200207283
3. BIR Tax Identification No. 006-036-274
4. Exact name of issuer as specified in its charter **P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC.**
5. Province, country or other jurisdiction of incorporation or organization Davao City, Philippines.
6. Industry Classification Code: (SEC Use Only)
7. Address of issuer's principal office: Stella Hizon Reyes Road, Bo.
Pampanga, Lanang, Davao City
Postal Code: 8000
8. Issuer's telephone number, including area code: (082) 233-0168
9. Former name, former address and former fiscal year, if changed since last report: Not Applicable
10. Securities registered pursuant to Sections 8 and 12 of the Code, or Sections 4 and 8 of the RSA

| Title of each class | Number of Shares Outstanding |
|---------------------|------------------------------|
| COMMON | 1,428,777,232.00 |
| PREFERRED | 10,000,000.00 |

Amount of Debt Outstanding as of 30 June 2014: Php 14,680,244,368.00

11. Are any or all of the securities listed on the Stock Exchange? Yes [] No []

If yes, state the name of such Stock Exchange and the class/es of securities listed therein:

Philippine Stock Exchange

12. Check whether the issuer has:

(a) has filed all reports required to be filed by Section 17 of the SRC and SRC Rule 17.1 thereunder or Sections 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding twelve (12) months (or for such shorter period the registrant was required to file such reports): Yes [] No []

(b) has been subject to such filing requirements for the past ninety (90) days: Yes [] No []

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P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
JUNE 30, 2014 AND DECEMBER 31, 2013
(Amounts in Philippine Pesos)

| | <u>Notes</u> | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|---|--------------|-------------------------|--------------------------|
| | | (Unaudited) | (Audited) |
| <u>A S S E T S</u> | | | |
| CURRENT ASSETS | | | |
| Cash and cash equivalents | 6 | P 755,011,783 | P 357,220,520 |
| Trade and other receivables - net | 7 | 4,374,753,376 | 7,343,793,926 |
| Inventories | 8 | 4,145,175,423 | 3,812,532,673 |
| Land held for sale and land development costs | 9 | 494,495,368 | 503,672,474 |
| Due from related parties | 24 | 1,948,494 | 2,747,994 |
| Restricted deposits | 10 | 49,490,630 | 95,419,646 |
| Input value-added tax - net | | 585,777,479 | 448,838,093 |
| Other current assets | 11 | 594,621,734 | 489,913,177 |
| Total Current Assets | | 11,001,274,287 | 13,054,138,503 |
| NON-CURRENT ASSETS | | | |
| Installment contract receivable | | 34,766,254 | - |
| Land held for future development | 13 | 295,260,682 | 297,942,281 |
| Investment in Associate | 23.9 | 2,250,000 | 2,250,000 |
| Property and equipment - net | 12 | 9,643,373,101 | 8,628,490,469 |
| Goodwill | 15 | 84,516,663 | 84,516,663 |
| Other non-current assets | 14 | 347,564,325 | 270,215,050 |
| Total Non-current Assets | | 10,407,731,025 | 9,283,414,463 |
| TOTAL ASSETS | | P 21,409,005,312 | P 22,337,552,966 |
| <u>LIABILITIES AND EQUITY</u> | | | |
| CURRENT LIABILITIES | | | |
| Interest-bearing loans and borrowings | 16 | P 6,884,420,793 | P 8,207,229,484 |
| Trade and other payables | 17 | 1,833,491,100 | 1,570,427,327 |
| Due to related parties | 24 | - | 64,161,243 |
| Total Current Liabilities | | 8,717,911,892 | 9,841,818,054 |
| NON-CURRENT LIABILITIES | | | |
| Interest-bearing loans and borrowings | 16 | 5,580,029,952 | 5,544,509,333 |
| Deferred Tax Liability | | 154,423,083 | 76,530,691 |
| Other non-current liabilities | 18 | 227,879,440 | 376,789,584 |
| Total Non-current Liabilities | | 5,962,332,475 | 5,997,829,608 |
| Total Liabilities | | 14,680,244,368 | 15,839,647,662 |
| EQUITY | | | |
| Common stock* | 25 | 1,428,777,232 | 1,428,777,232 |
| Preferred stock | 25 | 5,000,000 | 5,000,000 |
| Additional paid-in capital | 25 | 3,367,916,774 | 3,367,916,774 |
| Revaluation reserves | 25 | 271,161,579 | 272,621,771 |
| Other reserves | | (622,952,239) | (622,952,239) |
| Retained earnings | 25 | 2,278,857,598 | 2,046,541,766 |
| Total Equity | | 6,728,760,945 | 6,497,905,304 |
| TOTAL LIABILITIES AND EQUITY | | P 21,409,005,312 | P 22,337,552,966 |

See Notes to Consolidated Financial Statements.

P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE PERIOD ENDED JUNE 30, 2014 & 2013
(Amounts in Philippine Pesos)

| | <i>Notes</i> | YTD (January-June) Unaudited | | 2nd Quarter (April-June) Unaudited | |
|--|--------------|------------------------------|-----------------------|------------------------------------|-----------------------|
| | | 2014 | 2013 | 2014 | 2013 |
| REVENUES | | | | | |
| Sale of goods - NET | | 18,332,113,166 | 21,708,613,280 | 9,876,496,429 | 11,525,156,422 |
| Fuel service, storage income and other revenue | | 182,715,860 | 123,414,154 | 110,824,306 | 54,832,406 |
| | | 18,514,829,026 | 21,832,027,433 | 9,987,320,735 | 11,579,988,828 |
| COST AND EXPENSES | | | | | |
| Cost of sales and services | 19 | 16,887,866,438 | 20,227,958,056 | 9,207,155,675 | 10,752,249,454 |
| Selling and administrative expenses | 20 | 901,229,739 | 907,547,927 | 439,121,520 | 506,628,877 |
| | | 17,789,096,177 | 21,135,505,983 | 9,646,277,195 | 11,258,878,331 |
| OTHER INCOME (CHARGES) | | | | | |
| Finance costs - net | | (312,415,161) | (285,571,915) | (151,286,817) | (134,607,471) |
| Others | | 1,133,448 | (26,761,664) | 7,398,198 | (34,066,549) |
| | | (311,281,713) | (312,333,580) | (143,888,620) | (168,674,020) |
| PROFIT BEFORE TAX | | | | | |
| | | 414,451,136 | 384,187,871 | 197,154,921 | 152,436,478 |
| TAX INCOME (EXPENSE) | | | | | |
| | | (12,617,925) | (11,920,691) | (7,193,033) | (4,771,255) |
| NET PROFIT | | | | | |
| | | 401,833,211 | 372,267,180 | 189,961,888 | 147,665,223 |
| Earnings Per Share | | 0.27 | 0.24 | | |

See Notes to Consolidated Financial Statements.

P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC. AND SUBSIDIARIES
(A Subsidiary of P-H-O-E-N-I-X Petroleum Holdings, Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE QUARTER ENDED JUNE 30, 2014 AND 2013
(Amounts in Philippine Pesos)

| | <u>Notes</u> | <u>June 30, 2014</u> <u>(Unaudited)</u> | <u>June 30, 2013</u> <u>(Unaudited)</u> |
|---|--------------|--|--|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit before tax | | 414,451,136 | 384,187,871 |
| Adjustments for: | | | |
| Interest expense | | 325,441,451 | 289,673,974 |
| Depreciation and amortization | 12 | 274,148,421 | 243,518,015 |
| Interest income | | (1,001,713) | (4,102,058) |
| Impairment losses | | 600,000 | 1,800,000 |
| Operating income before working capital changes | | 1,013,639,295 | 915,077,802 |
| Increase in trade and other receivables | | 2,968,440,551 | (540,939,222) |
| Decrease (increase) in inventories | | (332,642,750) | (453,319,027) |
| Decrease (increase) in restricted deposits | | 45,929,016 | (1,578,920) |
| Increase in input value-added tax | | (136,939,386) | (186,812,935) |
| Increase in other current assets | | (104,708,557) | (82,603,240) |
| Decrease (increase) in Installment Receivable | | (34,766,254) | - |
| Decrease (Increase) in land held for sale and development costs | | 9,177,106 | 721,970 |
| Increase (Decrease) in trade and other payables | | 263,063,773 | 2,055,678,405 |
| Cash generated from (used in) operations | | <u>3,691,192,793</u> | <u>1,706,224,832</u> |
| Provision for Taxes | | <u>(12,617,925)</u> | <u>(11,920,691)</u> |
| Net Cash From (Used in) Operating Activities | | <u>3,678,574,868</u> | <u>1,694,304,141</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Net acquisitions of property and equipment | 12 | (1,289,031,054) | (940,638,266) |
| Increase in land held for future development | | 2,681,599 | (1,719,633) |
| Net increase in other non-current assets | | (77,349,275) | (333,201,624) |
| Interest received | | 1,001,713 | 4,102,058 |
| (Payment) Collections from related parties | | <u>799,500</u> | <u>6,897,765</u> |
| Net Cash From (Used) in Investing Activities | | <u>(1,361,897,517)</u> | <u>(1,264,559,699)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Net (Decrease) increase in loans and borrowings | | (1,287,288,072) | (1,092,692,920) |
| Interest paid | | (325,441,451) | (289,673,974) |
| Borrowings (payments) to/from related parties | 24 | (64,161,243) | - |
| Increase (Decrease) in non-current liabilities | | (71,017,752) | 43,178,097 |
| Additional/Adjustment during the year | 25 | | |
| Payments of cash dividends | 25 | (163,502,723) | (132,355,942) |
| Net Proceeds in the Issuance of New Common Stocks | 25 | | 1,187,893,514 |
| Prior Period adjustments | | (6,014,655) | |
| Increase (Decrease) on Other reserves | | <u>(1,460,192)</u> | <u>-</u> |
| Net Cash From (Used) Financing Activities | | <u>(1,918,886,088)</u> | <u>(283,651,224)</u> |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | 397,791,263 | 146,093,218 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 6 | <u>357,220,520</u> | <u>438,510,937</u> |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | 6 | <u>755,011,783</u> | <u>584,604,155</u> |

See Notes to Consolidated Financial Statements.

P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC. AND SUBSIDIARIES
(A Subsidiary of P-H-O-E-N-I-X Petroleum Holdings, Inc.)
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE QUARTERS ENDED JUNE 30, 2014 AND 2013
(Amounts in Philippine Pesos)

| | Note | <u>June 30, 2014</u> <u>(Unaudited)</u> | <u>June 30, 2013</u> <u>(Unaudited)</u> |
|-----------------------------------|------|--|--|
| COMMON STOCK | 25 | | |
| Balance at beginning of year | | P 1,428,777,232 | P 906,059,416 |
| Stock dividends | | | 329,717,816 |
| Issuance during the period | | <u>-</u> | <u>130,000,000</u> |
| Balance at end of year* | | <u>1,428,777,232</u> | <u>1,365,777,232</u> |
| PREFERRED STOCK | 25 | | |
| Balance at beginning of year | | <u>5,000,000</u> | <u>P 5,000,000</u> |
| Balance at end of period | | <u>P 5,000,000</u> | <u>5,000,000</u> |
| ADDITIONAL PAID-IN CAPITAL | 25 | | |
| Balance at beginning of year | | 2,051,723,794 | 2,051,723,794 |
| Additions | | <u>1,316,192,980</u> | <u>1,057,892,980</u> |
| Balance at end of period | | <u>3,367,916,774</u> | <u>3,109,616,774</u> |
| Revaluation Reserves | 25 | <u>271,161,579</u> | <u>294,152,102</u> |
| Other Reserves | 25 | <u>(622,952,239)</u> | <u>(622,952,239)</u> |
| RETAINED EARNINGS | | | |
| Balance at beginning of year | | 2,046,541,766 | 1,866,468,238 |
| Net profit | | 401,833,211 | 372,267,180 |
| Stock Dividend | | | (329,717,816) |
| Adjustments from Prior year | 25 | (6,014,656) | |
| Cash dividends | 25 | <u>(163,502,723)</u> | <u>(132,355,942)</u> |
| Balance at end of period | | <u>2,278,857,598</u> | <u>1,776,661,660</u> |
| TOTAL EQUITY | | <u>P 6,728,760,945</u> | <u>P 5,928,255,529</u> |

See Notes to Consolidated Financial Statements.

P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2014 AND DECEMBER 31, 2013
(Amounts in Philippine Pesos)

1. CORPORATE INFORMATION

1.1 Incorporation and Operations

P-H-O-E-N-I-X Petroleum Philippines, Inc. (the Parent Company) was incorporated in the Philippines on May 8, 2002. On 11 January 2004, the Company amended its Articles of Incorporation changing its name from Oilink Mindanao Distribution, Inc. to "Davao Oil Terminal Services Corp." On August 7, 2006, the Philippine Securities and Exchange Commission (the "Commission") approved the Amended Articles of Incorporation of the Company changing its name from Davao Oil Terminal Services Corp. to "P-H-O-E-N-I-X Petroleum Philippines, Inc." The Company is 41.22% owned by P-H-O-E-N-I-X Petroleum Holdings, Inc. (PPHI), a company likewise incorporated and organized under the laws of the Republic of the Philippines.

On July 11, 2007, the Company had its Initial Public Offering (IPO) with the Philippine Stock Exchange (the "Exchange"), making available twenty-five per cent (25%) of its total outstanding shares to the public. The Company, thus, became the first petroleum company to list in the Exchange after the enactment of the Republic Act (RA) 8479 in 1998. The aforementioned law encourages petroleum companies to be listed with the Exchange

The Company's operations consist of Trading, Terminaling and Hauling Services. Under its trading operations, the Company offers its refined petroleum products (including Jet A1) and lubricants to retailers and commercial/industrial customers. The retail service stations are classified as Company-Owned, Company-Dealer-Operated (CODO) or Dealer-Owned, Dealer-Operated (DODO). As of 30 June 2014, the Parent Company has a total of 405 operating service stations with 130 service stations in Luzon, 55 in the Visayas and 220 in Mindanao and a total of 57 service stations under construction as of June 30, 2014.

On the other hand, the Company's terminaling and hauling services operations involve leasing of storage space in its terminal depot, hauling and into-plane services (hauling of Jet A1 fuels to airports and refueling of aircraft) in Davao City, Cagayan de Oro City, Butuan City, General Santos City, Cotabato City, Ozamis City, Pagadian City, Zamboanga City and Cebu City of its major client, Cebu Pacific Air. Starting 2008, Cebu Pacific designated the Company as its exclusive logistics partner in all its Mindanao operations.

The Company's storage tanks and facilities in Davao City were registered with the Board of Investments (BOI) effective November 16, 2005 as a New Industry Participant with New Investments in storage, marketing and distribution of petroleum products under Republic Act (RA) 8479 (Downstream Oil Industry Deregulation Act of 1998). Under its registration, the Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investment Code of 1987. The Company is also entitled to certain tax and non-tax incentives to include Income Tax Holiday (ITH) for five (5) years from its registration.

The Company was also registered with the BOI on February 26, 2010 as New Industry Participant With New Investments in storage, marketing and distribution of petroleum products under RA 8479 (Downstream Oil Industry Deregulation Act) for its storage tanks in various locations. Under its registration, the Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987. Like its previous registration, these storage tanks found in various locations are likewise entitled to tax and non-tax incentives, details of which are as follows:

| Location of Project | Date of Registration | Income Tax Holiday Period | Income Tax Holiday Expiry |
|----------------------------|-----------------------------|----------------------------------|----------------------------------|
| Calaca, Batangas | February 26, 2010 | 5 years | February 25, 2015 |
| Davao Expansion | May 14, 2010 | 5 years | May 13, 2015 |
| Zamboanga | November 25, 2010 | 5 years | November 24, 2015 |
| Phividec (CDO) Depot | May 10, 2012 | 5 years | 09-May-2017 |
| Bacolod Depot | May 10, 2012 | 5 years | 09-May-2017 |

PPHI was incorporated in the Philippines on May 31, 2006. PPHI's primary purpose is to provide management, investment and technical advice for commercial, industrial, manufacturing and other kinds of enterprises. PPHI's registered office is located at Stella Hizon Reyes Road, Barrio Pampang, Davao City.

The ultimate parent is Udenna Corporation, which is primarily organized to purchase, acquire, take over and manage all or any part of the rights, assets, business and property; undertake and assume the liabilities of any person, firm, association, partnership, syndicate of corporation; and to engage in the distribution, selling, importation, installation of pollution control devices, units and services, and all other pollution control related products and emission test servicing. The ultimate parent company's registered office is located at Stella Hizon Reyes Road, Barrio Pampang, Davao City.

1.2 Subsidiaries, Associate and their Operations

The Parent Company holds ownership interests in the following entities as of June 30, 2014 and December 31, 2013 (the Parent Company and the subsidiaries are collectively referred to as "the Group"):

| | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|--|-----------------------------|---------------------------------|
| P-F-L Petroleum Management, Inc. (PPMI) | 100% | 100% |
| P-H-O-E-N-I-X Global Mercantile, Inc. (PGMI) | 100% | 100% |
| Phoenix Petroterminals & Industrial Park Corp. (PPIPC) | 100% | 100% |

| | | |
|--|------|------|
| Subic Petroleum Trading and Transport Phils., Inc. (SPTT) | 100% | 100% |
| Chelsea Shipping Corp. (CSC) | 100% | 100% |
| Bunkers Manila, Inc. (BMI)* | 100% | 100% |
| Michael, Inc. (MI)* | 100% | 100% |
| PNX – Chelsea Shipping Corp. (PNX – Chelsea)* | 100% | 100% |
| Chelsea Ship Management Marine Services Corp. (CSMMSC)* | 100% | 100% |
| Fortis Tugs Corp. (FTC)* | 100% | - |
| Norse/Phil Marine Services Corp. (NPMSC)** | 45% | - |

* *Wholly-owned subsidiaries of CSC*

** *Associate of CSC*

All the subsidiaries were organized and incorporated in the Philippines.

PPMI is primarily engaged in organizing, managing, administering, running and supervising the operations and marketing of various kinds of services-oriented companies such as petroleum service stations. PPMI was registered with the Securities and Exchange Commission (SEC) on January 31, 2007.

PGMI was registered with the SEC on July 31, 2006 to engage in the manufacture, production and creation of all kinds of motor, and all other transportation lubricants, fluids and additives of all kinds and other petroleum products purposely for motor vehicles and other transportation. PGMI has temporarily ceased its operation since 2008.

PPIPC is engaged in real estate development. PPIPC was registered with the SEC on March 7, 1996. PPIPC is also registered with the Housing and Land Use Regulatory Board (HLURB) under Executive Order No. 648 and was granted to sell parcels of land on the Group's project, the Phoenix Petroleum Industrial Park (the Park).

SPTT was registered with the SEC on February 20, 2007 and is engaged in buying and selling, supply and distribution, importation and exportation, storage and delivery of all types of petroleum for industrial, marine, aviation and automotive use. It does not carry any inventory at any given time.

CSC was incorporated in the Philippines on July 17, 2006 and started commercial operations on January 1, 2007. It is engaged in maritime trade through conveying, carrying, loading, transporting, discharging and storing of petroleum products, goods and merchandise of every kind, over waterways in the Philippines.

Under CSC, the Shipping Company, the following are its subsidiaries:

BMI was registered with the SEC on March 7, 2000 to serve the growing demand of marine fuel (bunker) of foreign vessels calling on the ports of the Philippines. Aside from international bunkering, BMI also ventures into hauling of marine fuel and petroleum products for major oil companies.

MI, which was registered with the SEC on December 26, 1957 and whose corporate life was approved to be extended for another 50 years by the SEC on May 6, 2008, is engaged in the business of acquiring and operating floating equipment for charter or hire and for the conveyance and carriage of goods, wares, and merchandise of every

description in the Philippines coastwise traffic without any fixed schedule. MI is also engaged in the trading of fuel oil.

PNX – Chelsea was incorporated on February 2, 2011 and is engaged in the ownership and operation of vessels for domestic trade for the purpose of conveyance or carriage of petroleum products, goods, wares and merchandise of every kind and description. As of December 31, 2012, PNX - Chelsea has not yet started commercial operations.

CSMMSC was incorporated on March 30, 2012 to carry on the business of ship management and to act as agent, broker, ship Chandler or representative of foreign/domestic shipping corporations and individuals for the purpose of managing, operating, supervising, administering and developing the operation of vessels.

FTC was incorporated on April 8, 2013 and started commercial operations on November 8, 2013. It is engaged in the towage and salvage of marine vessels and other crafts including their cargoes upon seas, lakes, rivers, canals, bays, harbours, and other waterways between the various ports of the Philippines, and to acquire by purchase, charter, lease or modes recognized by law of obtaining title to or use of such equipment and properties, real or personal, which may be necessary to achieve such purpose.

NPMSC was incorporated on January 30, 2013 to engage in the business of providing technical ship services and to act as agent, broker, ship handler or representative of foreign/domestic shipping corporations and individuals for the purpose of operating, supervising, administering and developing the operation of vessels belonging to or which are or may be leased or operated by said shipping corporations and individuals, and to equip any and all kinds of ships, barges and vessels of every class and description owned by any shipping corporation. NPMSC started commercial operations on June 10, 2013.

PPMI's registered office is located at Penthouse, Valero Tower, 122 Valero Street, Salcedo Village, Makati City and its principal place of business is located at Stella Hizon Reyes Road, Barrio Pampang, Davao City.

The registered office of PGMI, CSC, BMI, MI and PNX – Chelsea, which is also their principal place of business, is located at Stella Hizon Reyes Road, Barrio Pampang, Davao City.

PPIPC's registered office is located at 4th Floor, Phinma Plaza, 39 Plaza Drive, Rockwell Center, Makati City and its principal place of business is located at 26th Floor, The Fort Legend Tower, 3rd Avenue corner 31st Street, The Fort Global City, Taguig City.

The registered office of SPTT, which is also its principal place of business, is located at Units 113 and 115 Subic International Hotel, Alpha Building, Rizal Highway, Subic Bay Freeport Zone, Zambales.

The registered address of CSMMSC and FTC, which is also their principal place of business, is located at the 26/F, Fort Legend Towers, 3rd Ave. corner 31st St., Bonifacio Global City, Taguig City.

The registered office of NPMSC, which is also its principal place of business, is located at 2/F Harbor Centre II Bldg., Railroad and Delgado Sts., South Harbor, Port Area, Manila.

1.3 Acquisition of CSC

On September 6, 2012, CSC became a wholly owned subsidiary of the Parent Company upon the approval of the Parent Company's stockholders of the acquisition of the 100% of CSC's outstanding shares from Udenna Management Resources Corp. (UMRC), a related party under common ownership. The acquisition was initially approved by the Parent Company's Board of Directors (BOD) on July 6, 2012.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been used in the preparation of these consolidated financial statements are summarized below and in the succeeding pages. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of Preparation of Consolidated Financial Statements

(a) Statement of Compliance with Philippine Financial Reporting Standards

The consolidated financial statements of the Group have been prepared in accordance with Philippine Financial Reporting Standards (PFRS). PFRS are adopted by the Financial Reporting Standards Council from the pronouncements issued by the International Accounting Standards Board (IASB).

The consolidated financial statements have been prepared using the measurement bases specified by PFRS for each type of assets, liabilities, income and expense. The measurement bases are more fully described in the accounting policies that follow.

(b) Presentation of Financial Statements

The consolidated financial statements are presented in accordance with Philippine Accounting Standards (PAS) 1, *Presentation of Financial Statements*. The Group presents all items of income and expenses in a single consolidated statement of comprehensive income.

The Group presents a third statement of financial position as at the beginning of the preceding period when it applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the statement of financial position at the beginning of the preceding period. The related notes to the third statement of financial position are not required to be disclosed.

(c) Functional and Presentation Currency

These consolidated financial statements are presented in Philippine pesos, the Group's functional and presentation currency, and all values represent absolute amounts except when otherwise indicated.

Items included in the consolidated financial statements of the Group are measured using its functional currency, the currency of the primary economic environment in which the Group operates.

2.2 Adoption of New and Amended PFRS

(a) Effective in 2013 that are Relevant to the Group

In 2013, the Group adopted for the first time the following new PFRS and revisions, amendments and improvements thereto that are relevant to the Group and effective for consolidated financial statements for the annual period beginning on or after July 1, 2012 or January 1, 2013:

| | | |
|--|---|--|
| PAS 1 (Amendment) | : | Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income |
| PAS 19 (Revised) | : | Employee Benefits |
| PFRS 7 (Amendment) | : | Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities |
| PFRS 10 | : | Consolidated Financial Statements |
| PFRS 11 | : | Joint Arrangements |
| PFRS 12 | : | Disclosure of Interests in Other Entities |
| PAS 27 (Revised) | : | Separate Financial Statements |
| PAS 28 (Revised) | : | Investments in Associate and Joint Venture |
| PFRS 10, 11 and PFRS 12 (Amendment) | : | Amendments to PFRS 10, 11 and 12 – Transition Guidance to PFRS 10, 11 and 12 |
| PFRS 13 | : | Fair Value Measurement |
| Annual Improvements | : | Annual Improvements to PFRS (2009-2011 Cycle) |

Discussed below and in the succeeding pages are the relevant information about these amended standards.

- (i) PAS 1 (Amendment), *Financial Statements Presentation – Presentation of Items of Other Comprehensive Income* (effective from July 1, 2012). The amendment requires an entity to group items presented in other comprehensive income into those that, in accordance with other PFRS: (a) will not be reclassified subsequently to profit or loss and (b) will be reclassified subsequently to profit or loss when specific conditions are met. The amendment has been applied retrospectively; hence, the presentation of other comprehensive income has been modified to reflect the changes.

- (ii) PAS 19 (Revised), *Employee Benefits* (effective from January 1, 2013). The revision made a number of changes as part of the improvements throughout the standard. The main changes relate to defined benefit plans as follows:
- eliminates the corridor approach under the existing guidance of PAS 19 and requires an entity to recognize all actuarial gains and losses arising in the reporting period;
 - streamlines the presentation of changes in plan assets and liabilities resulting in the disaggregation of changes into three main components of service costs, net interest on net defined benefit obligation or asset, and remeasurement; and,
 - enhances disclosure requirements, including information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.
- (iii) PFRS 7 (Amendment), *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2013). The amendment requires entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement. This amendment did not have a significant impact on the Group's consolidated financial statements as the Group is not setting off financial instruments in accordance with PAS 32 and does not have relevant offsetting arrangements.
- (iv) Consolidation, Joint Arrangements, Associates and Disclosures

In 2013, the Group has adopted the following consolidation standards that are relevant to the Group and effective as of January 1, 2013:

- PFRS 10 (Amendment), *Consolidated Financial Statements*, changes the definition of control focusing on three elements which determines whether the investor has control over the investee such as the (a) power over the investee, (b) exposure or rights to variable returns from involvement with the investee; and (c) ability to use such power to affect the returns. This standard also provides additional guidance to assist in determining controls when this is difficult to assess, particularly in situation where an investor that owns less than 50% of the voting rights in an investee may demonstrate control to the latter.
- PFRS 11 (Amendment), *Joint Arrangements*, deals with how a joint arrangement is classified and accounted for based on the rights and obligations of the parties to the joint arrangement by considering the structure, the legal form of the arrangements, the contractual terms agreed by the parties to the arrangement, and, when relevant, other facts and circumstances. The option of using proportionate consolidation for

arrangement classified as jointly controlled entities under the previous standard has been eliminated. This new standard now requires the use of equity method in accounting for arrangement classified as joint venture.

- PFRS 12 (Amendment), *Disclosures of Interest in Other Entities*, integrates and makes consistent the disclosure requirements for entities that have interest in subsidiaries, joint arrangements, associates, special purpose entities and unconsolidated structured entities. In general, this requires more extensive disclosure about the risks to which an entity is exposed from its involvement with structured entities.
- PAS 27 (Revised), *Separate Financial Statements*, deals with the requirements solely to separate financial statements while PAS 28 (revised), *Investments in Associates and Joint Ventures*, includes the requirements for joint ventures, as well as for associates, to be accounted for using the equity method.

Subsequent to the issuance of these standards, amendments to PFRS 10, PFRS 11 and PFRS 12 were issued to clarify certain transitional guidance for the first-time application of the standards. The guidance clarifies that an entity is not required to apply PFRS 10 retrospectively in certain circumstances and clarifies the requirements to present adjusted comparatives. The guidance also made changes to PFRS 10 and PFRS 12 which provide similar relief from the presentation or adjustment of comparative information for periods prior to the immediately preceding period. Further, it provides relief by removing the requirements to present comparatives for disclosure relating to unconsolidated structure entities for any period before the first annual period for which PFRS 12 is applied.

The Group has evaluated the various facts and circumstances related to its interests in other entities and have determined that the adoption of the foregoing standards had no material impact on the amounts recognized in the consolidated financial statements.

- (v) PFRS 13, *Fair Value Measurement* (effective from January 1, 2013). This new standard clarifies the definition of fair value and provides guidance and enhanced disclosures about fair value measurements. The requirements under this standard do not extend the use of fair value accounting but provide guidance on how it should be applied to both financial instrument items and non-financial items for which other PFRSs require or permit fair value measurements or disclosures about fair value measurements, except in certain circumstances. The amendment applies prospectively from annual period beginning January 1, 2013; hence, disclosure requirements need not be presented in the comparative information in the first year of operation. The application of this new standard had no significant impact on the amounts recognized in the consolidated financial statements.

(vi) 2009-2011 Annual Improvements to PFRS. Annual improvements to PFRS (2009-2011 Cycle) made minor amendments to a number of PFRS. Among those improvements, the following amendments are relevant to the Group but management does not expect a material impact on the Group's consolidated financial statements:

(a) PAS 1 (Amendment), *Presentation of Financial Statements – Clarification of the Requirements for Comparative Information*. The amendment clarifies that a statement of financial position at the beginning of the preceding period (third statement of financial position) is required when an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items that has a material effect on the information in the third statement of financial position. The amendment specifies that other than disclosures of certain specified information in accordance with PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, related notes to the opening statement of financial position are not required to be presented.

Consequent to the Group's adoption of PAS 19 (Revised) in the current year which resulted in retrospective restatement of the prior years' consolidated financial statements, the Group has presented a third consolidated statement of financial position as of January 1, 2012 without the related notes, except for the disclosure requirements of PAS 8.

(b) PAS 16 (Amendment), *Property, Plant and Equipment – Classification of Servicing Equipment*. The amendment addresses a perceived inconsistency in the classification requirements for servicing equipment which resulted in classifying servicing equipment as part of inventory when it is used for more than one period. It clarifies that items such as spare parts, stand-by equipment and servicing equipment shall be recognized as property, plant and equipment when they meet the definition of property, plant and equipment, otherwise, these are classified as inventory. This amendment had no impact on the Group's consolidated financial statements since it has been recognizing those servicing equipment in accordance with the recognition criteria under PAS 16.

(c) PAS 32 (Amendment), *Financial Instruments: Presentation – Tax Effect of Distributions to Holders of Equity Instruments*. The amendment clarifies that the consequences of income tax relating to distributions to holders of an equity instrument and to transaction costs of an equity transaction shall be accounted for in accordance with PAS 12, *Income Taxes*. Accordingly, income tax relating to distributions to holders of an equity instrument is recognized in profit or loss while income tax related to the transaction costs of an equity transaction is recognized in equity. This amendment had no effect on the Group's consolidated financial

statements as it did not make any distributions to holders of equity instruments.

(b) *Effective in 2013 that are not Relevant to the Group*

The following amendments and interpretation to PFRS are mandatory for accounting periods beginning on or after January 1, 2013 but are not relevant to the Group's consolidated financial statements:

| | |
|---|--|
| Annual Improvements 2009-2011 Cycle | |
| PAS 34 (Amendment) | : Interim Financial Reporting – Interim Financial Reporting and Segment Information for Total Assets and Liabilities |
| PFRS 1 (Amendments) | : First-time Adoption of PFRS – Government Loans, and Repeated Application of PFRS 1 and Borrowing Cost |
| Philippine Interpretation International Financial Reporting Interpretation Committee 20 Phase | : Stripping Costs in the Production of a Surface Mine |

(c) *Effective Subsequent to 2013 but not Adopted Early*

There are new PFRS, amendments and annual improvements to existing standards that are effective for periods subsequent to 2013. Management has initially determined the following pronouncements, which the Group will apply in accordance with their transitional provisions, to be relevant to its consolidated financial statements:

- (i) PAS 19 (Amendment), *Employee Benefits: Defined Benefit Plans - Employee Contributions* (effective from January 1, 2014). The amendment clarifies that if the amount of the contributions from employees or third parties is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method (i.e., either using the plan's contribution formula or on a straight-line basis) for the gross benefit. Management has initially determined that this amendment will have no impact on the Group's consolidated financial statements.
- (ii) PAS 32 (Amendment), *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities* (effective from January 1, 2014). The amendment provides guidance to address inconsistencies in applying the criteria for offsetting financial assets and financial liabilities. It clarifies that a right of set-off is required to be legally enforceable, in the normal course of business, in the event of default and in the event of insolvency or bankruptcy of the

entity and all of the counterparties. The amendment also clarifies the principle behind net settlement and includes an example of a gross settlement system with characteristics that would satisfy the criterion for net settlement. The Group does not expect this amendment to have a significant impact on its consolidated financial statements.

- (iii) PAS 36 (Amendment), *Impairment of Assets - Recoverable Amount Disclosures for Non-financial Assets* (effective from January 1, 2014). The amendment clarifies that the requirements for the disclosure of information about the recoverable amount of assets or cash-generating units is limited only to the recoverable amount of impaired assets that is based on fair value less cost of disposal. It also introduces an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount based on fair value less cost of disposal is determined using a present value technique. Management will reflect in its subsequent years' consolidated financial statements the changes arising from this relief on disclosure requirements.
- (iv) PAS 39 (Amendment), *Financial Instruments: Recognition and Measurement - Novation of Derivatives and Continuation of Hedge Accounting* (effective January 1, 2014). The amendment provides some relief from the requirements on hedge accounting by allowing entities to continue the use of hedge accounting when a derivative is novated to a clearing counterparty resulting in termination or expiration of the original hedging instrument as a consequence of laws and regulations, or the introduction thereof. As the Group neither enters into transactions involving derivative instruments nor it applies hedge accounting, the amendment will not have impact on the consolidated financial statements.
- (v) PFRS 9, *Financial Instruments: Classification and Measurement*. This is the first part of a new standard on financial instruments that will replace PAS 39, *Financial Instruments: Recognition and Measurement*, in its entirety. The first phase of the standard was issued in November 2009 and October 2010 and contains new requirements and guidance for the classification, measurement and recognition of financial assets and financial liabilities. It requires financial assets to be classified into two measurement categories: amortized cost or fair value. Debt instruments that are held within a business model whose objective is to collect the contractual cash flows that represent solely payments of principal and interest on the principal outstanding are generally measured at amortized cost. All other debt instruments and equity instruments are measured at fair value. In addition, PFRS 9 allows entities to make an irrevocable election to present subsequent changes in the fair value of an equity instrument that is not held for trading in other comprehensive income.

The accounting for embedded derivatives in host contracts that are financial assets is simplified by removing the requirement to consider whether or not they are closely related, and, in most arrangement, does not require separation from the host contract.

For liabilities, the standard retains most of the PAS 39 requirements which include amortized cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in case where the fair value option is taken for financial liabilities, the part of a fair value change due to the liability's credit risk is recognized in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch.

In November 2013, the IASB has published amendments to International Financial Reporting Standard (IFRS) 9 that contain new chapter and model on hedge accounting that provides significant improvements principally by aligning hedge accounting more closely with the risk management activities undertaken by entities when hedging their financial and non-financial risk exposures. The amendment also now requires changes in the fair value of an entity's own debt instruments caused by changes in its own credit quality to be recognized in other comprehensive income rather in profit or loss. It also includes the removal of the January 1, 2015 mandatory effective date of IFRS 9.

To date, the remaining chapter of IFRS 9 and PFRS 9 dealing with impairment methodology is still being completed. Further, the IASB is currently discussing some limited modifications to address certain application issues regarding classification of financial assets and to provide other considerations in determining business model

The Group does not expect to implement and adopt PFRS 9 until its effective date. In addition, management is currently assessing the impact of PFRS 9 on the consolidated financial statements of the Group and it plans to conduct a comprehensive study of the potential impact of this standard prior to its mandatory adoption date to assess the impact of all changes.

- (vi) Annual Improvements to PFRS. Annual improvements to PFRS (2010-2012 Cycle) and PFRS (2011-2013 Cycle) made minor amendments to a number of PFRS, which are effective for annual period beginning on or after July 1, 2014. Among those improvements, the following amendments are relevant to the Group but management does not expect a material impact on the Group's consolidated financial statements:

Annual Improvements to PFRS (2010-2012 Cycle)

- (a) PAS 16 (Amendment), *Property, Plant and Equipment* and PAS 38 (Amendment), *Intangible Assets*. The amendments clarify that when an item of property, plant and equipment, and intangible assets is revalued, the gross carrying amount is adjusted in a manner that is consistent with a revaluation of the carrying amount of the asset.

- (b) PAS 24 (Amendment), *Related Party Disclosures*. The amendment clarifies that entity providing key management services to a reporting entity is deemed to be a related party of the latter. It also requires and clarifies that the amounts incurred by the reporting entity for key management personnel services that are provided by a separate management entity should be disclosed in the consolidated financial statements, and not the amounts of compensation paid or payable by the key management entity to its employees or directors.
- (c) PFRS 13 (Amendment), *Fair Value Measurement*. The amendment, through a revision only in the basis of conclusion of PFRS 13, clarifies that issuing PFRS 13 and amending certain provisions of PFRS 9 and PAS 39 related to discounting of financial instruments, did not remove the ability to measure short-term receivables and payables with no stated interest rate on an undiscounted basis, when the effect of not discounting is immaterial.

Annual Improvement to PFRS (2011-2013 Cycle)

PFRS 13 (Amendment), *Fair Value Measurement*. The amendment clarifies that the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the portfolio exception) applies to all contracts within the scope of, and accounted for in accordance with, PAS 39 or PFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in PAS 32.

2.3 Basis of Consolidation

The Group obtains and exercises control through voting rights. The Group's consolidated financial statements comprise the accounts of the Parent Company and its subsidiaries

(see Note 1) after the elimination of intercompany transactions. All intercompany balances and transactions with subsidiaries, including income, expenses and dividends, are eliminated in full. Unrealized profits and losses from intercompany transactions that are recognized in assets are also eliminated in full. Intercompany losses that indicate an impairment are recognized in the consolidated financial statements.

The financial statements of subsidiaries are prepared for the same reporting period as the Group, using consistent accounting principles.

The Parent Company accounts for its investments in subsidiaries and an associate as follows:

(a) *Investments in Subsidiaries*

Subsidiaries are entities (including structured entities) over which the Parent Company has control. The Parent Company controls an entity when it is exposed, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are

consolidated from the date the Parent Company obtains control until such time that such control ceases.

The acquisition method is applied to account for acquired subsidiaries. This requires recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Parent Company, if any. The consideration transferred also includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred and subsequent change in the fair value of contingent consideration is recognized directly in profit or loss.

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

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recognized as goodwill (see Note 15). If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognized directly as gain.

On the other hand, business combinations arising from transfers or acquisition of interests in entities that are under the common control of the shareholder that controls the Group are normally accounted for under the pooling-of-interests method and reflected in the consolidated financial statements as if the business combination had occurred at the beginning of the earliest comparative period presented, or if later, at the date that common control was established; for this purpose, comparatives are restated. The assets and liabilities acquired are recognized in the Group's consolidated financial statements at the carrying amounts recognized previously. The difference between the consideration transferred and the net assets of the subsidiary acquired is recognized as Other Reserves as part of the equity.

(b) *Investment in an Associate*

Associate is an entity over which the Group is able to exert significant influence but not control and which are neither subsidiaries nor interests in a joint venture. Investments in associate are initially recognized at cost and subsequently accounted for using the equity method.

2.4 Financial Assets

Financial assets are recognized when the Group becomes a party to the contractual terms of the financial instrument. Financial assets are classified into the following categories: financial assets at fair value through profit or loss (FVTPL), loans and receivables, held-to-maturity investments and available-for-sale financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired.

Regular purchases and sales of financial assets are recognized on their trade date. All financial assets that are not classified as at FVTPL are initially recognized at fair value plus any directly attributable transaction costs. Financial assets carried at FVTPL are initially recorded at fair value and transaction costs related to it are recognized in profit or loss.

Currently, the financial assets category relevant to the Group is 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 arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. They are included in current assets, except for maturities greater than 12 months after the reporting period which are classified as non-current assets.

The Group's financial assets categorized as loans and receivables are presented as Cash and Cash Equivalents, Trade and Other Receivables, Due from Related Parties, Restricted Deposits (presented as part of Current Assets and part of Other Non-Current Assets in the consolidated statement of financial position), Installment Contract Receivable, and Refundable Rental Deposits (presented as part of Other Non-Current Assets in the consolidated statement of financial position). Cash and cash equivalents are defined as cash on hand, savings and demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less impairment loss, if any. Impairment loss is provided when there is objective evidence that the Group will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate or current effective interest rate determined under the contract if the loan has a variable interest rate.

All income and expenses, including impairment losses, relating to financial assets that are recognized in profit or loss are presented as part of Finance Costs or Finance Income in the consolidated statement of comprehensive income.

Non-compounding interest and other cash flows resulting from holding financial assets are recognized in profit or loss when earned, regardless of how the related carrying amount of financial assets is measured.

The financial assets are derecognized when the contractual rights to receive cash flows from the financial instruments expire, or when the financial assets and all substantial risks and rewards of ownership have been transferred to another party.

2.5 Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using the moving average method. The cost of inventories include all costs directly attributable to acquisitions, such as the purchase price, import duties and other taxes that are not subsequently recoverable from taxing authorities.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

2.6 Land Held for Sale and Land Development Costs

Land held for sale and land development costs are valued at the lower of cost and net realizable value. Land held for sale and land development costs includes the cost of land and actual development costs incurred up to the end of reporting period. Interest incurred during the development of the project is capitalized (see Note 2.19).

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of developing and the estimated costs necessary to make the sale.

2.7 Prepayments and Other Current Assets

Prepayments and other current assets pertain to other resources controlled by the Group as a result of past events. They are recognized in the consolidated financial statements when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

Other recognized assets of similar nature, where future economic benefits are expected to flow to the Group beyond one year after the end of the reporting period (or in the normal operating cycle of the business, if longer), are classified as non-current assets.

2.8 Land Held For Future Development

Land held for future development is valued at the lower of cost and net realizable value. Cost includes purchase price and other costs directly attributable to the acquisition of land.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of developing and estimated costs necessary to make the sale.

2.9 Property and Equipment

Land is stated at cost less any impairment in value. Tankers are measured at revalued amount less accumulated depreciation. All other property and equipment are carried at acquisition cost less accumulated depreciation and amortization and any impairment in value.

The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred, except for periodic drydocking costs performed at least every two years on the vessel which are capitalized (see Note 2.10).

Following initial recognition, tankers are carried at revalued amounts less any subsequent accumulated depreciation and any accumulated impairment losses.

Revalued amounts represent fair values determined by external professional valuers unless market-based factors indicate immediate impairment risk. Fair value is determined on the replacement cost of an asset with an equally satisfactorily substitute asset, which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential. In estimating the fair value of the properties, it takes into account a market participant's ability to generate economic benefits by using the assets in its highest and best use.

Any revaluation surplus is recognized in other comprehensive income and credited to the Revaluation Reserves account in the consolidated statement of changes in equity. Any revaluation deficit directly offsetting a previous surplus in the same asset is charged to other comprehensive income to the extent of any revaluation surplus in equity relating to this asset and the remaining deficit, if any, is recognized in profit or loss. Annually, an amount from the Revaluation Reserves is transferred to Retained Earnings for the related depreciation relating to the revaluation increment. Upon disposal of the revalued assets, amounts included in Revaluation Reserves is transferred to Retained Earnings.

Revaluations are performed at least every two years ensuring that the carrying amount does not materially differ from that which would be determined using fair value at the end of reporting period, unless circumstances require annual revaluation.

Depreciation is computed on the straight-line basis over the estimated useful lives of the assets as follows:

| | |
|--------------------------------------|------------|
| Tankers | 30 years |
| Buildings, depot and pier facilities | 5-25 years |
| Vessel equipment | 5 years |
| Transportation and other equipment | 1-10 years |
| Hauling and heavy equipment | 1-5 years |
| Gasoline station equipment | 1-5 years |
| Office furniture and equipment | 1-3 years |

Leasehold and land improvements are amortized over the terms of the related leases or the useful lives of the improvements, whichever is shorter.

Hauling and heavy equipment held under finance lease agreements (see Note 2.15) are depreciated over their expected useful lives (determined by reference to comparable owned assets) or over the term of lease, if shorter.

Construction in progress represents properties under construction and on-going major repair works and is stated at cost. This includes cost of construction and applicable borrowing costs (see Note 2.19). The account is not depreciated until such time that the assets are completed and available for use.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 2.17).

The residual values and estimated useful lives of property and equipment are reviewed, and adjusted, if appropriate, at the end of each reporting period.

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

2.10 Drydocking Costs

Drydocking costs are considered major repairs that preserve the life of the vessel. As an industry practice, costs associated with drydocking are amortized over two years or until the next drydocking occurs, whichever comes earlier. When significant drydocking expenditures occur prior to their expiry of this period, any remaining unamortized balance of the original drydocking costs is expensed in the month of subsequent drydocking.

Amortization of drydocking costs starts only when the process has been completed and the related vessel is ready for use.

The carrying amount of drydocking costs, presented as part of the Other Non-current Asset account in the consolidated statement of financial position, is written down immediately to its recoverable amount if the carrying amount is greater than its estimated recoverable amount (see Note 2.17).

2.11 Financial Liabilities

Financial liabilities, which include interest-bearing loans and borrowings, trade and other payables (excluding income tax payable), due to related parties and security deposits (presented under Other Non-Current Liabilities in the consolidated statement of financial position), are recognized when the Group becomes a party to the contractual terms of the instrument. All interest-related charges incurred on financial liability are recognized as an expense in profit or loss under the caption Finance Costs in the consolidated statement of comprehensive income.

Interest charges that are attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of the cost of such asset (see Note 2.19). All other interest related charges are recognized as an expense in the consolidated statement of comprehensive income under the caption Finance Costs.

Interest-bearing loans and borrowings are raised for support of long-term funding of operations. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are charged to profit or loss on an accrual basis using the effective interest method and are added to the carrying amount of the instrument to the extent that these are not settled in the period in which they arise.

Trade and other payables, due to related parties and security deposits are recognized initially at their fair values and subsequently measured at amortized cost, using effective interest method for maturities beyond one year, less settlement payments.

Obligations under finance lease (included as part of Interest-bearing Loans and Borrowings) are recognized at amounts equal to the fair value of the leased property or, if lower, at the present value of minimum lease payments, at the inception of the lease (see Notes 2.15 and 29.5).

Dividend distributions to shareholders are recognized as financial liabilities upon declaration of the Parent Company.

Financial liabilities are classified as current liabilities if payment is due to be settled within one year or less after the reporting period (or in the normal operating cycle of the business, if longer), or the Group does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Otherwise, these are presented as non-current liabilities.

Financial liabilities are derecognized from the consolidated statement of financial position only when the obligations are extinguished either through discharge, cancellation or expiration. The difference between the carrying amount of the financial liability derecognized and the consideration paid or payable is recognized in profit or loss.

2.12 Provisions and Contingencies

Provisions are recognized when present obligations will probably lead to an outflow of economic resources and they can be estimated reliably even if the timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the end of the reporting period, including the risks and uncertainties associated with the present obligation. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. When time value of money is material, long-term provisions are discounted to their present values using a pretax rate that reflects market assessments and the risks specific

to the obligation. The increase in provision due to passage of time is recognized as interest expense. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the consolidated financial statements. Similarly, possible inflows of economic benefits to the Group that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the consolidated financial statements. On the other hand, any reimbursement that the Group can be virtually certain to collect from a third party with respect to the obligation is recognized as a separate asset not exceeding the amount of the related provision.

2.13 Business Combinations

Business acquisitions are accounted for using the acquisition method of accounting.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Subsequent to initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed (see Note 2.17).

Negative goodwill which is the excess of the Group's interest in the net fair value of net identifiable assets acquired over acquisition cost is charged directly to income.

For the purpose of impairment testing, goodwill is allocated to cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The cash-generating units or groups of cash-generating units are identified according to operating segment.

Gains and losses on the disposal of an interest in a subsidiary include the carrying amount of goodwill relating to it.

If the business combination is achieved in stages, the acquirer is required to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in the profit or loss or other comprehensive income, as appropriate.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Under the pooling-of-interest method, similar accounts of the entities are combined on a line-by-line basis except for the equity accounts which were offset with the new shares issued by the new entity in which the difference between the net assets received and the amount of the consideration issued (shares and cash) is accounted for as Other Reserves.

2.14 Revenue and Expense Recognition

Revenue comprises revenue from the sale of goods and rendering of services measured by reference to the fair value of consideration received or receivable by the Group for goods sold and services rendered, excluding value-added tax (VAT), rebates and trade discounts.

Revenue is recognized to the extent that the revenue can be reliably measured; it is probable that the economic benefits will flow to the Group; and the costs incurred or to be incurred can be measured reliably. In addition, the following specific recognition criteria must also be met before revenue is recognized:

- (a) *Sale of goods* – Revenue is recognized when the risks and rewards of ownership of the goods have passed to the buyer, i.e. when the customer has acknowledged delivery of goods or when the customer has taken undisputed delivery of goods.
- (b) *Charter fees* – Revenue, which consists mainly of charter income arising from the charter hire of its tankers, is recognized based on the type of charter arrangement entered into, either under a time charter (TC) or a continuing voyage charter (CVC). Under a TC, revenue is recognized based on the terms of the contract [see Note 3.1(d)]. Under a CVC, revenue is recognized upon completion of the voyage; however, appropriate accrual of revenue is made at the end of the reporting period.
- (c) *Fuel service and other revenues, port revenues and storage income* – Revenue is recognized when the performance of contractually agreed tasks has been substantially rendered. This account includes franchise income, which has minimal amount. In addition, this includes revenue arising from port and cargo handling services.
- (d) *Interest income* – Revenue is recognized as the interest accrues taking into account the effective yield on the asset.
- (e) *Rent income* – Revenue is recognized on a straight-line basis over the lease term (see Note 2.15).

Cost and expenses are recognized in the profit or loss upon utilization of goods or services or at the date they are incurred. All finance costs are reported in profit or loss on an accrual basis, except capitalized borrowing costs which are included as part of the cost of the related qualifying asset (see Note 2.19).

The cost of real estate sold, if any, before the completion of the development is determined based on the actual costs incurred to date which include the cost of land plus estimated costs to complete the project development. The estimated expenditures for the development of sold real estate, as determined by project engineers, are charged to Cost of Sales and Services account in the consolidated statement of comprehensive income with a corresponding credit to accrued expenses presented under the Trade and Other Payables account in the consolidated statement of financial position. Effects of

any revisions in the total project cost estimates are recognized in the year in which the changes become known.

2.15 Leases

The Group accounts for its leases as follows:

(a) Group as Lessee

Leases which transfer to the Group substantially all risks and benefits incidental to ownership of the leased item are classified as finance leases and are recognized as assets and liabilities in the consolidated statement of financial position at amounts equal to the fair value of the leased property at the inception of the lease or, if lower, at the present value of minimum lease payments. Lease payments are apportioned between the finance costs and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance costs are recognized in profit or loss. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Finance lease obligations, net of finance charges, are included in Interest-bearing Loans and Borrowings account in the consolidated statement of financial position.

Leases which do not transfer to the Group substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as expense in the consolidated statement of comprehensive income on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

(b) Group as Lessor

Leases wherein the Group substantially transfers to the lessee all risks and benefits incidental to ownership of the leased item are classified as finance leases and are presented as receivable at an amount equal to the Group's net investment in the lease. Finance income is recognized based on the pattern reflecting a constant periodic rate of return on the Group's net investment outstanding in respect of the finance lease.

Leases which do not transfer to the lessee substantially all the risks and benefits of ownership of the asset are classified as operating leases. Lease income from operating leases is recognized in profit or loss on a straight-line basis over the lease term.

The Group determines whether an arrangement is, or contains a lease based on the substance of the arrangement. It makes an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.16 Foreign Currency Transactions and Translations

The accounting records of the Group are maintained in Philippine pesos. Foreign currency transactions during the year are translated into the functional currency at exchange rates which approximate those prevailing on transaction dates.

Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

2.17 Impairment of Non-financial Assets

The Group's property and equipment and goodwill are subject to impairment testing. Individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

For purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at cash-generating unit level.

Impairment loss is recognized for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amounts which is the higher of its fair value less costs to sell and its value in use. In determining value in use, management estimates the expected future cash flows from each cash-generating unit and determines the suitable interest rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Group's latest approved budget, adjusted as necessary to exclude the effects of asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect management's assessment of respective risk profiles, such as market and asset-specific risk factors.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment loss, except impairment loss on goodwill (see Note 2.13), is reversed if the asset's or cash generating unit's recoverable amount exceeds its carrying amount.

2.18 Employee Benefits

The Group provides post-employment benefits to employees through a defined benefit plan, as well as a defined contribution plan.

(a) Defined Benefit Plan

A defined benefit plan is a post-employment plan that defines an amount of post-employment benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of post-employment plan remains with the Group, even if plan assets, if any, for funding the defined benefit plan have been

acquired. Plan assets, if any, may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Group's post-employment benefit pension plan covers all regular full-time employees.

The liability recognized in the consolidated statement of financial position for a defined benefit plan is the present value of the defined benefit obligation at the end of the reporting period. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using a discount rate derived from the interest rates of a zero coupon government bonds as published by Philippine Dealing and Exchange Corporation, that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related post-employment liability.

Remeasurements, comprising of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions and the return on plan assets (excluding amount included in interest) are reflected immediately in the consolidated statement of financial position with a charge or credit recognized in other comprehensive income in the period in which they arise. Net interest is calculated by applying the discount rate at the beginning of the period, taking account of any changes in the net defined benefit liability or asset during the period as a result of contributions and benefit payments. Net interest is reported as part of Finance Costs or Finance Income account in the consolidated statement of comprehensive income.

Past service costs are recognized immediately in profit or loss in the period of a plan amendment.

(b) Defined Contribution Plans

A defined contribution plan is a post-employment plan under which the Group pays fixed contributions into an independent entity. The Group has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognized if underpayment or prepayment has occurred and are included in current liabilities or current assets as they are normally of a short-term nature.

(c) Termination Benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognizes termination benefits at the earlier of when it can no longer withdraw the offer of such benefits and when it recognizes costs for a restructuring that is within the scope of PAS 37 and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than

12 months after the reporting period are discounted to their present value.

(d) Profit-sharing and Bonus Plans

The Group recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Group's shareholders after certain adjustments. The Group recognizes a provision where it is contractually obliged to pay the benefits, or where there is a past practice that has created a constructive obligation.

(e) Compensated Absences

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the end of the reporting period. They are included in Trade and Other Payables account in the consolidated statement of financial position at the undiscounted amount that the Group expects to pay as a result of the unused entitlement.

2.19 Borrowing Costs

Borrowing costs are recognized as expenses in the period in which they are incurred, except to the extent that they are capitalized. Borrowing costs that are attributable to the acquisition, construction or production of a qualifying asset (i.e., an asset that takes a substantial period of time to get ready for its intended use or sale) are capitalized as part of cost of such asset. The capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalization ceases when substantially all such activities are complete.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

2.20 Income Taxes

Tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity, if any.

Current tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the end of reporting period. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year.

All changes to current tax assets or liabilities are recognized as a component of tax expense in profit or loss.

Deferred tax is accounted for using the liability method on temporary differences at the end of reporting period between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Under the liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences

and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Unrecognized deferred tax assets, if any, are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow such deferred tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability is settled provided such tax rates have been enacted or substantively enacted at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. For purposes of measuring deferred tax liabilities and deferred tax assets for land held for sale and land development costs, the carrying amount of such properties are presumed to be recovered entirely through sale, unless the presumption is rebutted, that is when the land held for sale and development costs are held within the business model whose objective is to consume substantially all of the economic benefits embodied in the property over time, rather than through sale.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

Deferred tax assets and deferred tax liabilities are offset if the Group has a legally enforceable right to set off current tax assets against current tax liabilities and the deferred taxes relate to the same entity and the same taxation authority.

2.21 Related Party Transactions and Relationships

Related party transactions are transfer of resources, services or obligations between the Group and its related parties, regardless whether a price is charged.

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. This includes: (a) individuals owning, directly or indirectly through one or more intermediaries, control or are controlled by, or under common control with the Group;

(b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the Group that gives them significant influence over the Group and close members of the family of any such individual; and, (d) the Group's retirement plan.

In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely on the legal form.

2.22 Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Group's BOD and management committee responsible for allocating resources and assessing performance of the operating segments.

In identifying its operating segments, management generally follows the Group's products and service lines as disclosed in Note 28 which represent the main products and services provided by the Group.

Each of these operating segments is managed separately as each of these service lines requires different technologies and other resources as well as marketing approaches. All inter-segment transfers are carried out at arm's length prices.

The measurement policies the Group uses for segment reporting under PFRS 8 is the same as those used in its consolidated financial statements, except that the following, if there is any, are not included in arriving at the operating profit of the operating segments:

- post-employment benefit expenses; and,
- expenses relating to share-based payments.

In addition, corporate assets which are not directly attributable to the business activities of any operating segment are not allocated to a segment.

There have been no changes from prior periods in the measurement methods used to determine reported segment profit or loss.

2.23 Equity

Capital stock represents the nominal value of shares that have been issued.

Additional paid-in capital includes any premiums received on the initial issuance of capital stock. Any transaction costs associated with the issuance of shares are deducted from additional paid-in capital, net of any related income tax benefits.

Revaluation reserves arise from the actuarial gains or losses on the remeasurements of post-employment defined benefit plan and gains and losses arising from the revaluation of the Group's tankers, net of applicable taxes.

Other reserves pertain to the difference between the Parent Company's cost of investment and the net assets of CSC acquired accounted for under the pooling-of-interest method.

Retained earnings include all current and prior period results of operations as reported in the profit or loss section of the consolidated statement of comprehensive income.

2.24 Earnings per Share

Basic earnings per share (EPS) is computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the period.

Diluted EPS is computed by adjusting the weighted average number of ordinary shares outstanding to assume conversion of dilutive potential shares.

2.25 Events after the End of the Reporting Period

Any post-year-end event that provides additional information about the Group's position at the end of the reporting period (adjusting event) is reflected in the consolidated financial statements. Post-year-end events that are not adjusting events, if any, are disclosed when material to the consolidated financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The Group's consolidated financial statements prepared in accordance with PFRS require management to make judgments and estimates that affect amounts reported in the consolidated financial statements and related notes. Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may ultimately differ from these estimates.

3.1 Critical Management Judgments in Applying Accounting Policies

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimation, which have the most significant effect on the amounts recognized in the consolidated financial statements:

(a) Distinguishing Operating and Finance Leases

The Group has entered into various lease agreements. Critical judgment was exercised by management to distinguish each lease agreement, either as a lessor or a lessee, as either an operating or finance lease by looking at the transfer or retention of significant risk and rewards of ownership of the properties covered by the agreements. Failure to make the right judgment will result in either overstatement or understatement of assets and liabilities. Certain hauling and heavy equipment are accounted for under finance lease.

(b) Recognition of Provisions and Contingencies

Judgment is exercised by management to distinguish between provisions and contingencies. Policies on recognition and disclosure of provision and disclosure of contingencies are discussed in Note 2.12 and relevant disclosure is presented in Note 29.

(c) *Qualifying Assets on Borrowing Costs*

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Determining if an asset is a qualifying asset will depend on the circumstances and requires the use of judgment in each case. In making judgment, the management takes into account its intention when it determines whether the asset is a qualifying asset and considers the facts and circumstances and uses its judgment to determine whether an asset takes a substantial period of time to get ready for its intended use or sale. Based on the facts and circumstances affecting the Group's qualifying asset, the management concludes that the Group's retail station, depot facilities and tankers are qualifying assets as the management assesses that it takes substantial period of time for the completion of those assets.

(d) *Revenue Recognition for TC Arrangements*

In determining the appropriate method to use in recognizing the Group's revenue from TC, management considers the following criteria: (1) whether the fulfilment of the arrangement is dependent on the use of a specific vessel; and, (2) whether the arrangement conveys a right to use the vessel. Management determined that if both criteria are met, the revenue should be recognized using the straight-line method over the term of the contract (see Note 2.14).

(e) *Functional Currency*

The Group has determined that its functional currency is the Philippine peso which is the functional currency of the primary economic environment in which the Group operates.

3.2 Key Sources of Estimation Uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next reporting period:

(a) *Impairment of Trade and Other Receivables and Due from Related Parties*

Adequate amount of allowance for impairment is provided for specific and group of accounts, where objective evidence of impairment exists. The Group evaluates the amount of allowance for impairment based on available facts and circumstances affecting the collectibility of the accounts, including, but not limited to, the length of the Group's relationship with the customers, the customers' current credit status, average age of accounts, collection experience and historical loss experience.

The carrying value of trade and other receivables and the analysis of allowance for impairment on such financial assets are shown in Note 7. The carrying value of due from related parties is shown in Note 25.4. The Group has determined that no impairment loss on Due from Related Parties account is recognized in 2013, 2012

and 2011.

(b) *Determining Net Realizable Value of Inventories*

In determining the net realizable value of inventories, management takes into account the most reliable evidence available at the times the estimates are made. Future realization of the carrying amounts of inventories as presented in Note 8 is affected by price changes and action from the competitors. Both aspects are considered key sources of estimation uncertainty and may cause significant adjustments to the Group's inventories within the next financial year.

(c) *Determining Net Realizable Value of Land Held for Sale and Land Development Costs and Land Held for Future Development*

In determining the net realizable value of land held for sale and land development costs and land held for future development, management takes into account the most reliable evidence available at the times the estimates are made. Future realization of the carrying amounts of land held for sale and development costs and land held for future development are affected by price changes and demand from the target market segments. Both aspects are considered key sources of estimation uncertainty and may cause significant adjustments within the next financial year.

(d) *Estimating Useful Lives of Property and Equipment and Drydocking Costs*

The Group estimates the useful lives of property and equipment and drydocking costs based on the period over which the assets are expected to be available for use. The estimated useful lives of property and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

The carrying amounts of property and equipment and drydocking costs are analyzed in Notes 12 and 14, respectively. Based on management's assessment as of June 30, 2014 and December 31, 2013, there is no change in the estimated useful lives of the property and equipment and drydocking costs during those years. Actual results, however, may vary due to changes in estimates brought about by changes in factors mentioned above.

(e) *Fair Value Measurement of Tankers*

In determining the fair value of the Group's tankers, the Group engages the services of professional and independent appraisers. Fair value is determined on the replacement cost of an asset with an equally satisfactorily substitute asset which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential. In estimating the fair value of the properties, it takes into account a market participant's ability to generate economic benefits by using the assets in its highest and best use. Such amount is influenced by different factors including the location and specific characteristics of the property (e.g. size, features, and capacity), quantity of comparable properties

available in the market, and economic condition and behavior of the buying parties. A significant change in these elements may affect prices and value of the assets.

Based on management's review of the recorded fair value of the tankers as of June 30, 2014 and December 31, 2013,, such fair value reasonably approximates the fair value based on the latest appraisal report or of those dates as determined by an independent appraisers (see Notes 5.4 and 12.3).

(f) Determining Realizable Amount of Deferred Tax Assets

The Group reviews its deferred tax assets at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. Management assessed that the deferred tax assets recognized as of December 31, 2013 will be fully utilized in the coming years. The carrying value of deferred tax assets as of December 31, 2013 is disclosed in Note 24.

(g) Estimating Liability for Land Development

Obligations to complete development of real estate are based on actual costs and project estimates of contractors and Group's technical staff. These costs are reviewed at least annually and are updated if expectations differ from previous estimates. Liability to complete the project for sold units included in the determination of cost of sales amounting to P0.1 million as of December 31, 2013 and 2012, are presented as part of accrued expenses under Trade and Other Payables account in the consolidated statements of financial position (see Note 17).

(h) Valuation of Post-employment Defined Benefit

The determination of the Group's obligation and cost of pension and other retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 22 and include, among others, discount rates and salary increase rate. In accordance with PFRS, actual results that differ from the assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The amounts of retirement benefit obligation and expense and an analysis of the movements in the estimated present value of retirement benefit obligation are presented in Note 22.2.

(i) Estimating Development Costs

The accounting for real estate requires the use of estimates in determining costs and gross profit recognition. Cost of real estate sold includes estimated costs for future development. The development cost of the project is estimated by the Group's technical staff. At the end of reporting period, these estimates are reviewed and revised to reflect the current conditions, when necessary.

(j) *Impairment of Non-Financial Assets*

In assessing impairment, management estimates the recoverable amount of each asset or a cash-generating unit based on expected future cash flows and uses an interest rate to discount such. Estimation uncertainty relates to assumptions about future operating results and the determination of a suitable discount rate (see Note 2.17). Though management believes that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse effect on the results of operations.

Management has assessed that no impairment losses are required to be recognized on the Group's non-financial assets in June 30, 2014 and December 31, 2013.

4. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed to a variety of financial risks in relation to financial instruments. The Group's financial assets and liabilities by category are summarized in Note 5. The main types of risks are market risk, credit risk and liquidity risk.

The Group's risk management is coordinated with its Parent Company, in close cooperation with the BOD, and focuses on actively securing the Group's short to medium-term cash flows by minimizing the exposure to financial markets.

The Group does not engage in the trading of financial assets for speculative purposes nor does it write options. The most significant financial risks to which the Group is exposed to are described in the succeeding pages.

4.1 Market Risk

The Group is exposed to market risk through its use of financial instruments and specifically to currency risk and interest rate risk which result from both its operating, investing and financing activities.

(a) *Foreign Currency Risk*

Most of the Group's transactions are carried out in Philippine pesos, its functional currency. Exposures to currency exchange rates arise from the Group's sales to a certain customer and fuel importation, which are primarily denominated in U.S. dollars. The liability covering the importation is covered by letter of credits which is subsequently closed to Philippine peso trusts receipts (TRs). Further, the Group has several U.S. dollar loans from certain banks which were used to finance its capital expenditures (see Note 16). The Group also holds U.S. dollar-denominated cash and cash equivalents.

To mitigate the Group's exposure to foreign currency risk, non-Philippine peso cash flows are monitored.

Foreign currency-denominated financial assets and liabilities, translated into Philippine pesos at the closing rate follow:

| | <u>2013</u> |
|-----------------------|------------------------|
| Financial assets | P 1,174,762,469 |
| Financial liabilities | (1,465,688,449) |
| Exposure | <u>(P 290,925,980)</u> |

The following table illustrates the sensitivity of the Group's profit before tax with respect to changes in Philippine peso against U.S dollar exchange rates. The percentage changes in rates have been determined based on the average market volatility in exchange rates, using standard deviation, in the previous 12 months at a 99% confidence level.

| | <u>2013</u> |
|------------------------------------|--------------|
| Reasonably possible change in rate | 16.7% |
| Effect in profit before tax | P 48,584,639 |
| Effect in equity after tax | 34,009,247 |

Exposures to foreign exchange rates vary during the year depending on the volume of foreign currency denominated transactions. Nonetheless, the analysis above is considered to be representative of the Group's currency risk.

(b) Interest Rate Risk

The Group's policy is to minimize interest rate cash flow risk exposures on long-term financing. Long term borrowings are therefore usually made at fixed rates. As of June 30, 2014 and December 31, 2013, the Group is exposed to changes in market interest rates through its cash and cash equivalents and bank borrowings, which are subject to variable interest rates (see Notes 6 and 16). All other financial assets and liabilities have fixed rates.

Cash in banks are tested on a reasonably possible change of +/-1.1% and +/- 1.4% in 2013 and 2012, respectively. Banks loans subject to variable interest rates are tested on a reasonably possible change of +/-1.67% and +/- 1.82% for Philippine peso and +/-0.69% and +/- 0.88% for U.S. dollar in 2013 and 2012, respectively. These percentages have been determined based on the average market volatility of interest rates, using standard deviation, in the previous 12 months estimated at 99% level of confidence. The sensitivity analysis is based on the Group's financial instruments held at the end of the each reporting period, with effect estimated from the beginning of the year. All other variables are held constant.

The changes in percentages would affect profit or loss before tax by +/-P85.9 million for the year ended December 31, 2013.

(c) Other Price Risk

The Group's market price risk arises from its purchases of fuels. It manages its risk arising from changes in market prices by monitoring the daily movement of the market price of fuels and to some extent, using forward and other similar contracts to manage the fluctuation of the fuel price.

4.2 Credit Risk

Credit risk is the risk that a counterparty may fail to discharge an obligation to the Group. The Group is exposed to this risk for various financial instruments arising from granting of loans and selling goods and services to customers including related parties; and placing deposits with banks.

The Group continuously monitors defaults of customers and other counterparties, identified either individually or by group, and incorporates this information into its credit risk controls. The Group's policy is to deal only with creditworthy counterparties. In addition, for a significant proportion of sales, advance payments are received to mitigate credit risk.

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the consolidated statements of financial position (or in the detailed analysis provided in the notes to the consolidated financial statements), as summarized below.

| | | <u>June 30, 2014</u> | | <u>December 31, 2013</u> |
|---------------------------------|---|----------------------|---|--------------------------|
| Trade receivables | P | 3,960,395,742 | | 6,360,407,521 |
| Advances to suppliers | | 435,105,133 | | 926,304,898 |
| Non-trade receivables | | 131,623,403 | | 237,344,364 |
| Advances subject to liquidation | | 2,658,578 | | 14,793,393 |
| Other receivables | | <u>88,106,675</u> | | <u>49,257,584</u> |
| | P | 4,617,889,531 | P | 7,588,107,760 |
| Allowance for impairment | | <u>(243,136,155)</u> | | <u>(244,313,834)</u> |
| | P | <u>4,374,753,376</u> | P | <u>7,343,793,926</u> |

The Group's management considers that all the above financial assets that are not impaired or past due for each reporting dates are of good credit quality.

Portion of the trade receivable are secured by either cash bond or stand-by letter of credit. Other than, none of the financial assets are secured by collateral or other credit enhancements, except for cash and cash equivalents as described below.

(a) Cash and Cash Equivalents

The credit risk for cash and cash equivalents is considered negligible, since the counterparties are reputable banks with high quality external credit ratings. Included in the cash and cash equivalents are cash in banks and short-term placements which are insured by the Philippine Deposit Insurance Corporation up to a maximum coverage of P0.5 million for every depositor per banking institution.

(b) Trade and Other Receivables and Due from Related Parties

In respect of trade and other receivables, the Group is not exposed to any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. Trade receivables consist of a large number of customers in

various industries and geographical areas. Based on historical information about customer default rates, management considers the credit quality of trade receivables that are not past due or impaired to be good.

The Group has a Credit Committee which approves credit lines given to its customers. The Group's Credit and Collection Department, which regularly reports to the Credit Committee, continuously monitors customers' performance and other counterparties, identified either individually or by group, and incorporates this information into its credit risk controls. Where available at a reasonable cost, external credit ratings and/or reports on customers and other counterparties are obtained and used. The Group's policy is to deal only with creditworthy counterparties.

Some of the unimpaired trade and other receivables are past due at the end of the reporting date. The age of financial assets past due but not impaired is as follows:

| | | <u>June 30, 2014</u> | | <u>December 31, 2013</u> |
|-----------------------------------|----------|----------------------|----------|--------------------------|
| Not more than one month | P | 303,010,303 | P | 182,306,369 |
| More than one month | | | | |
| but not more than two months | | 104,260,095 | | 149,532,251 |
| More than two months but | | | | |
| not more than six months | | 50,502,174 | | 120,856,868 |
| More than six months but not more | | | | |
| than one year | | 44,833,686 | | 69,157,737 |
| More than one | | | | |
| year | | 86,048,478 | | 45,598,603 |
| | P | 588,654,737 | P | 567,451,828 |

In respect of due from related parties, the Group has assessed that these advances are collectible and the credit risk exposure is considered to be low.

4.3 Liquidity Risk

The Group manages its liquidity needs by carefully monitoring scheduled debt servicing payments for long-term financial liabilities as well as cash outflows due in a day-to-day business. Liquidity needs are monitored in various time bands, on a day-to-day and week-to-week basis, as well as on the basis of a rolling 30-day projection. Long-term liquidity needs for a 6-month and one-year period are identified monthly.

The Group maintains cash and cash equivalents to meet its liquidity requirements for up to 60-day periods. Excess cash are invested in time deposits. Funding for long-term liquidity needs is additionally secured by an adequate amount of committed credit facilities and the ability to sell long-term financial assets.

As of June 30, 2014, the Group's liabilities have contractual maturities which are summarized as follows:

| | CURRENT | | NON- CURRENT |
|--|------------------------|----------------------|-------------------------|
| | Within 6 months | 6 to 12 Months | 1 to 5 Years |
| Interest-bearing loans | | | |
| and borrowings | P 6,884,420,793 | P | P 5,580,029,952 |
| Trade and other payables (excluding income tax payable) | 2,130,578,446 | 57,521,265 | |
| Security deposits and unearned rent | | | 180,320,846 |
| | P 6,888,052,155 | P 638,605,427 | P 5,927,030,858 |

This compares to the maturity of the Group's financial liabilities as of December 31, 2013 as presented below:

| | <u>Current</u> | | <u>Non-current</u> |
|--|------------------------------|------------------------------|------------------------------|
| | <u>Within 6 months</u> | <u>6 to 12 months</u> | <u>1 to 5 years</u> |
| Interest-bearing loans and borrowings | P6,050,573,611 | P2,726,331,756 | P6,007,722,903 |
| Trade and other payables (excluding income tax payable) | 1,109,068,989 | 451,750,258 | - |
| Due to related parties | 33,991,925 | 30,169,318 | - |
| Security deposits and unearned rent | - | - | <u>325,688,899</u> |
| | <u>P7,193,634,525</u> | <u>P3,208,251,332</u> | <u>P6,333,411,802</u> |

The contractual maturities of the financial liabilities reflect the gross cash flows, which may differ from the carrying values of the liabilities at the end of the reporting periods.

5. CATEGORIES AND OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES AND FAIR VALUE MEASUREMENTS AND DISCLOSURES

5.1 Carrying Amounts and Fair Values by Category

The carrying amounts and fair values of the categories of assets and liabilities presented in the consolidated statements of financial position are presented below.

| | Notes | June 30, 2014 | | December 31, 2013 | |
|--|--------|-------------------------|-------------------------|-------------------------|-------------------------|
| | | Carrying Values | Fair Values | Carrying Values | Fair Values |
| <i>Financial Assets</i> | | | | | |
| Loans and receivables: | | | | | |
| Cash and cash equivalents | 6 | P 742,973,802 | P 742,973,802 | P 357,220,520 | P 357,220,520 |
| Trade and other receivables-net | 7 | 4,374,753,376 | 4,374,753,376 | 7,343,793,926 | 7,343,793,926 |
| Due from related parties | 25.4 | 1,948,494 | 1,948,494 | 2,747,994 | 2,747,994 |
| Restricted deposits | 10, 14 | 49,490,630 | 49,490,630 | 96,683,441 | 96,683,441 |
| Refundable rental deposits and deferred minimum lease payment: | 14 | <u>53,467,436</u> | <u>53,467,436</u> | <u>215,505,911</u> | <u>215,505,911</u> |
| | | P 5,222,633,738 | P 5,222,633,738 | P 8,015,951,792 | P 8,015,951,792 |
| <i>Financial Liabilities</i> | | | | | |
| Financial liabilities at amortized cost: | | | | | |
| Interest-bearing loans and borrowings | 16 | P 12,464,450,745 | P 12,464,450,745 | P 13,751,738,817 | P 13,751,738,817 |
| Trade and other payables | 17 | 1,833,491,100 | 1,833,491,100 | 1,560,819,247 | 1,560,819,247 |
| Due to related parties | 25.4 | 0 | 0 | 64,161,243 | 64,161,243 |
| Security deposits and unearned rent | 18 | <u>207,939,520</u> | <u>207,939,520</u> | <u>325,688,899</u> | <u>325,688,899</u> |
| | | P 14,505,881,364 | P 14,505,881,364 | P 15,702,408,206 | P 15,702,408,206 |

See Notes 2.4 and 2.11 for a description of the accounting policies for each category of financial instruments including the determination of fair values. A description of the Group's risk management objectives and policies for financial instruments is provided in Note 4.

5.2 Fair Value Hierarchy

In accordance with PFRS 13, the fair value of non-financial assets which are measured at fair value on a recurring basis and those assets and liabilities not measured at fair value but for which fair value is disclosed in accordance with other relevant PFRS, are categorized into three levels based on the significance of inputs used to measure the fair value. The fair value hierarchy has the following levels:

- (a) Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity can access at the measurement date;
- (b) Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and,
- (c) Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level within which the asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement.

For purposes of determining the market value at Level 1, a market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

5.3 Fair Instruments Measured at Amortized Cost for which Fair Value is Disclosed

The table below and in the next page summarizes the fair value hierarchy of the Group's financial assets and financial liabilities which are not measured at fair value in the 2013 consolidated statement of financial position but for which fair value is disclosed.

| | Notes | Level 1 | Level 2 | Level 3 | Total |
|--|--------|----------------------|------------|-----------------------|-----------------------|
| Financial Assets | | | | | |
| <i>Loans and receivables:</i> | | | | | |
| Cash and cash equivalents | 6 | P 357,220,520 | P - | P - | P 357,220,520 |
| Trade and other receivables - net | 7 | - | - | 7,343,793,926 | 7,343,793,926 |
| Due from related parties | 25.4 | - | - | 2,747,994 | 2,747,994 |
| Restricted deposits | 10, 14 | - | - | 96,683,441 | 96,683,441 |
| Refundable rental deposits and deferred minimum lease payments | 14 | - | - | 215,505,911 | 215,505,911 |
| | | P 357,220,520 | P - | P7,658,731,272 | P8,015,951,792 |

| | Notes | Level 1 | Level 2 | Level 3 | Total |
|---|-------|------------|------------|-------------------------|-------------------------|
| Financial Liabilities | | | | | |
| <i>Financial liabilities at amortized cost:</i> | | | | | |
| Interest-bearing loans and borrowings | 16 | P - | P - | P 13,751,738,817 | P 13,751,738,817 |
| Trade and other payables | 17 | - | - | 1,560,819,247 | 1,560,819,247 |
| Due to related parties | 25.4 | - | - | 64,161,243 | 64,161,243 |
| Security deposits and unearned rent | 18 | - | - | 325,688,899 | 325,688,899 |
| | | <u>P -</u> | <u>P -</u> | <u>P 15,702,408,206</u> | <u>P 15,702,408,206</u> |

For financial asset with fair value included in Level 1, management considers that the carrying amount of this short-term financial instrument approximates its fair value.

The fair values of the financial assets and financial liabilities included in Level 3 above which are not traded in an active market is determined by using generally acceptable pricing models and valuation techniques or by reference to the current market value of another instrument which is substantially the same after taking into account the related credit risk of counterparties, or is calculated based on the expected cash flows of the underlying net asset base of the instrument.

When the Group uses valuation technique, it maximizes the use of observable market data where it is available and rely as little as possible on entity specific estimates. Since not all significant inputs required to determine the fair value of the other instruments not included in Level 1 are observable, these are included in Level 3.

5.4 Fair Value Measurements for Non-financial Assets

a) Determining Fair Value of Tankers

The table below shows the Level within the hierarchy of non-financial asset measured at fair value on a recurring basis as of December 31, 2013.

| | Note | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------|------|------------|------------|------------------------|------------------------|
| Property and Equipment | | | | | |
| Tankers | 12 | <u>P -</u> | <u>P -</u> | <u>P 2,692,719,034</u> | <u>P 2,692,719,034</u> |

The fair value of the Group's tankers (see Note 12.3) was determined based on the appraisal report of professional and independent appraisers. Management obtains appraisal reports on its tanker from independent appraisers at least every two years. The latest appraisal report obtained covers the year ended December 31, 2012.

Fair value was determined based on the replacement cost of an asset with an equally satisfactorily substitute asset, which is normally derived from the current acquisition cost of a similar asset, new or used, or of an equivalent productive capacity or service potential. In estimating the fair value of tankers, the highest and best use of the tanker is its current use.

b) *Other Fair Value Information*

The reconciliation of the carrying amount of tankers included in Level 3 is presented in Note 12.

There has been no change to the valuation techniques used by the Group during the year for its non-financial assets. Also, there were no transfers into or out of Level 3 fair value hierarchy in 2013.

5.5 *Offsetting of Financial Assets and Financial Liabilities*

The Group is not setting off financial instruments and does not have relevant offsetting arrangements as of June 30, 2014 and December 31, 2013.

6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include the following components as of June 30 and December 31:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|-----------------------|-------|----------------------|--------------------------|
| Cash on Hand | P | 6,111,876 | P 7,731,306 |
| Cash in Banks | | 721,259,818 | 249,585,435 |
| Revolving fund | | 21,713,984 | 21,213,984 |
| Short Term Placements | | <u>5,926,105</u> | <u>78,689,795</u> |
| | P | <u>755,011,783</u> | P <u>357,220,520</u> |

Cash accounts with the banks generally earn interest based on daily bank deposit rates ranging from 0.03% to 3.00% per annum in 2014 and 2013. Short-term placements have maturity ranging from 7 to 90 days and earn effective interest ranging from 2.1% to 4.8% per annum in 2014 and 2013. Interest income earned amounted to P1.001million and P4.102 million in June 30, 2014 and June 30, 2013 respectively, and is included as part of Finance Income in the statements of comprehensive income (see Note 21.2).

The balances of the cash on hand and in banks as of June 30, 2014 and December 31, 2013 exclude restricted cash amounting to P49.5 million and P95.4 million, respectively, which are shown as Restricted Deposits account (see Note 10) and restricted time deposits under Other Non-current Assets (see Note 14) in the consolidated statements of financial position. Such amounts are not available for the general use of the Group under the loan agreement (see Note 16.3).

7. TRADE AND OTHER RECEIVABLES

This account is composed of the following:

| | | <u>June 30, 2014</u> | | <u>December 31, 2013</u> |
|---------------------------------|---|----------------------|---|--------------------------|
| Trade receivables | P | 3,960,395,742 | | 6,360,407,521 |
| Advances to suppliers | | 435,105,133 | | 926,304,898 |
| Non-trade receivables | | 131,623,403 | | 237,344,364 |
| Advances subject to liquidation | | 2,658,578 | | 14,793,393 |
| Other receivables | | 88,106,675 | | 49,257,584 |
| | P | 4,617,889,531 | P | 7,588,107,760 |
| Allowance for impairment | | (243,136,155) | | (244,313,834) |
| | P | 4,374,753,376 | P | 7,343,793,926 |

All of the Group's trade and other receivables have been reviewed for indications of impairment. Certain trade and other receivables, which are due from customers, were found to be impaired; hence, adequate amount of allowance for impairment has been recorded as of June 30, 2014 and December 31, 2013. Impairment losses amounted to P 0.6 million and P18.0 million period ended June 30, 2014 and year ended December 31, 2013, respectively, and are presented as part of Finance Costs under the Other Income (Charges) account in the consolidated statements of comprehensive income (see Note 21.1).

A reconciliation of the allowance for impairment at the beginning and end of June 30, 2014 and December 31, 2013 is shown below:

| | Notes | <u>June 30, 2014</u> | | <u>December 31, 2013</u> |
|---|-------|----------------------|---|--------------------------|
| Balance at beginning of year | P | 244,313,834 | P | 226,354,832 |
| Impairment Loss during the year (Bad Debts) | | 600,000 | | 17,959,002 |
| Bad Debts Recovery/Reversal | | (1,777,679) | | |
| Balance at end of year | P | 243,136,155 | P | 244,313,834 |

Trade and other receivables do not bear any interest. All receivables are subject to credit risk exposure (see Note 4.2).

Other Receivables as of December 31, 2013 and 2012 include P23.8 million partial claims from an insurance company related to an incident encountered by one of the Group's vessels. The amount represents the costs of towing and repairs incurred for the vessel, net of the applicable deductible clause. In addition, this account includes P18.2 million and P12.3 million as of December 31, 2013 and 2012, respectively, worth of reimbursable costs incurred by the Group in relation to its TC agreement with certain third party.

8. INVENTORIES

Inventories which are stated at cost are broken down as follows:

| | Notes | <u>June 30, 2014</u> | | <u>December 31, 2013</u> |
|----------------|-------|-----------------------------|---|--------------------------|
| Fuel | P | 3,940,236,773 | P | 3,589,175,766 |
| Lubricants | | 199,690,783 | | 223,353,772 |
| Other products | | <u>5,247,867</u> | | <u>3,135</u> |
| | P | <u>4,145,175,423</u> | P | <u>3,812,532,673</u> |

Under the terms of agreements covering the liabilities under trust receipts, inventories with carrying amount of P3,794.2 million and P3,589.2 million as of June 30, 2014 and December 31, 2013 respectively, have been released to the Group in trust for the bank. The Group is accountable to the bank for the trusteed inventories or their sales proceeds (see Note 16.1).

There were no inventory write-down in all of the years presented.

An analysis of the cost of inventories included in the cost of fuels and lubricants sold for the year is presented in Note 19.1.

9. LAND HELD FOR SALE AND LAND DEVELOPMENT COSTS

The land held for sale and land development costs stated at cost relate to the following as of June 30 and December 31:

| | <u>June 30, 2014</u> | <u>Dec. 31, 2013</u> |
|-----------------------------------|----------------------------|----------------------|
| Land held for sale | P 483,927,707 | P 483,927,707 |
| Land development costs | <u>19,744,767</u> | <u>19,744,767</u> |
| | P 503,672,474 | P 503,672,474 |
| Less: Cost sold during the period | <u>(9,177,106)</u> | |
| TOTAL | P 494,495,368 | P 503,672,474 |

The land held for sale was used as security for the Group's installment payable with Land Bank of the Philippines (LBP) [see Note 16.2(a)].

Land development costs pertain to expenditures for the development and improvement of the land held for sale of the Park.

10. RESTRICTED DEPOSITS

This account pertains to the time deposits that are used as securities for various banking credit facilities covered by hold-out agreements (see Notes 6, 16.1 and 16.3) amounting to P49.5million and P95.4million as of June 30, 2014 December 31, 2013, respectively. As such, these are restricted as to withdrawals. The proceeds from availment of the banking credit facilities by the Group are used for the purpose of purchasing fuel and lubricant supplies (see Note 16.1). Interest rates for this type of deposit range from 2.40% to 5.975% per annum for all the years presented.

11. PREPAYMENTS AND OTHER CURRENT ASSETS

The composition of this account as of June 30 and December 31 is shown below:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|----------------------------|-------|----------------------|--------------------------|
| Prepayments | P | 151,553,458 | P 167,721,208 |
| Creditable withholding tax | | 274,012,544 | 174,300,564 |
| Supplies | | 160,442,487 | 144,038,688 |
| Others | | <u>8,613,245</u> | <u>3,852,717</u> |
| | P | <u>594,621,734</u> | P <u>489,913,177</u> |

12. PROPERTY AND EQUIPMENT

June 30, 2014

| | | | |
|--------------------------------|---|------------------------|-------------------------------|
| Land | | | P 314,817,213 |
| Property, Plant and Equipments | P | 11,258,613,801 | |
| Less: Accumulated Depreciation | | <u>(1,930,057,912)</u> | <u>9,328,555,888</u> |
| Net Book Value-June30, 2014 | | | P <u><u>9,643,373,101</u></u> |

December 31, 2013

| | | | |
|----------------------------------|--|------------------------|-------------------------------|
| Land | | | P 314,817,213 |
| Property, Plant and Equipments | | 9,969,582,747 | |
| Less: Accumulated Depreciation | | <u>(1,655,909,491)</u> | <u>8,313,673,256</u> |
| Net Book Value-December 31, 2013 | | | P <u><u>8,628,490,469</u></u> |

12.1 Acquisition of Vessel – MT Donatella

In 2013, the Group entered into a Memorandum of Agreement (MOA) with a foreign corporation for the importation of one unit of oil tank vessel (MT Donatella) from China for US\$21.2 million [see Note 16.2(g)]. As of December 31, 2013, the vessel is still under construction. Since the vessel is not yet ready for use as of December 31, 2013, the contract price of the vessel, costs incurred for the major improvements made to the vessel and other incidental costs totaling P418.6 million are recognized as construction in progress and presented as part of Property and Equipment - net in the 2013 consolidated statement of financial position.

MT Donatella is used as collateral to secure the payment of interest-bearing loan obtained to finance the acquisition of the vessel [see Note 16.2(g)].

12.2 Double Hull Conversion of Vessels

On December 14, 2010, Philippine Maritime Industry Authority (MARINA) issued Circular 2010-01, mandating all owners and operators of oil tankers and tanker-barges with 600 deadweight tonnage and above must be double hulled within twelve months from the effectivity of the Circular. However, oil tankers carrying petroleum black products shall continue to be covered under Circular 2007-01 regardless of size.

As of December 31, 2012, MT Chelsea Resolute, MT Chelsea Denise and MT Ernesto Uno have completed their double hulling. Total costs that were capitalized as part of tanker amounted to P32.3 million, P30.3 million and P27.3 million, respectively. After the completion of the double hulling of these tankers in 2012, all of the Group's tankers are double-hulled. There was no double hulling of the Group's tankers in 2013.

12.3 Fair Value of Tankers

The Group's tankers are stated at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and impairment losses. The revaluation surplus, net of applicable deferred income taxes, is presented as part of Revaluation Reserves account in the equity section of the consolidated statements of financial position (see Note 26.5).

The information on the fair value measurement and disclosures related to the revalued tankers are presented in Note 5.4.

12.4 Borrowing Costs

Construction in progress includes accumulated costs incurred on the various depot facilities and retail stations being constructed as part of the Group's expansion program, including capitalized borrowing costs of P71.4 million and P77.8 million as of

December 31, 2013 and 2012, respectively, representing the actual borrowing costs incurred on borrowings obtained to fund the retail stations and depot facilities. The average capitalization rate used was 8.5% both in 2013 and 2012.

12.5 Collaterals

Port expansion facilities with carrying value of P192.9 million as of December 31, 2013 are used to secure the Group's installment payable with LBP [see Note 16.2(a)].

Two of the tankers of the Group with net revalued amount of P317.5 million as of December 31, 2013 are used to secure a loan with Philippine Bank of Communication (PBComm) [see Note 16.2(c)].

As of June 30, 2014 certain tankers owned by the Group were used as collaterals for the interest-bearing loans from various local commercial banks (see Note 16.4).

Moreover, certain service vehicle of the Group with carrying value of P40.9 million as of December 31, 2013 was used as collateral for mortgage payable (see Note 16.5).

13. LAND HELD FOR FUTURE DEVELOPMENT

Land held for future development represents the Group's land property totaling to 44 hectares in Phase 2 and 3 of the Park that is intended for sale once developed.

The Group's land held for future development was used as collateral for the Group's installment payable with LBP (see Note 16.2a).

14. OTHER NON-CURRENT ASSETS

The composition of this account as of June 30, 2014 and December 31, 2013 is shown below:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|---------------------------------|-------|---------------------------|--------------------------|
| Refundable rent deposits | P | 126,037,906 | P 180,951,286 |
| Drydocking costs | | 39,034,020 | 46,588,245 |
| Deferred minimum lease payments | | 35,928,655 | 34,554,625 |
| Restricted time deposits | | 5,573,281 | 1,263,795 |
| Others | | 140,990,462 | 6,857,099 |
| | P | <u>347,564,325</u> | P <u>270,215,050</u> |

Refundable rent deposits represent deposits of the Group for the lease of various parcels of land. These deposits are refundable at the end of the term of agreement and are measured at amortized cost. The total day one loss is determined by calculating the present value of the cash flows anticipated until the end of the lease terms using the related market interest-free rates and is amortized over the lease term. As the refundable rent deposits do not have an active market, the underlying interest rates were determined by reference to market interest rate of comparable financial

instrument.

Dry docking costs are being amortized over 24 months or until the occurrence of the next dry docking, whichever comes earlier.

15. GOODWILL

Goodwill amounting to P84.5 million and P84.5 million as of June 30, 2014 and December 31, 2013 respectively, represents the excess of acquisition cost over the Group's share in the fair value of identifiable net assets of the acquired subsidiaries at the date of the acquisition and arises from the expected business synergy and economies of scale of the entities combined. In 2012, the Parent Company assessed that the goodwill pertaining with PPMI is impaired, hence, impairment loss amounting to

₱1.3 million was recognized and is presented as part of Finance Costs under Other Income (Charges) account in the 2012 consolidated statement of comprehensive income. The increase in the balance of the Goodwill during 2011 pertains to the acquisition of SPTT. The movements of the account are as follows:

| | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|-------------------|----------------------------|----------------------------|
| Beginning balance | P 84,516,663 | P 84,516,663 |
| Impairment loss | | |
| Additions | - | |
| Ending balance | <u>P 84,516,663</u> | <u>P 84,516,663</u> |

16. LOANS AND BORROWINGS

The short-term and long-term interest-bearing loans and borrowings are as follows:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|---|-------|-----------------------------|-------------------------------|
| Current: | | | |
| Liabilities under letters of credits and trust receipts | P | 3,794,206,039 | P 6,777,195,674 |
| Instalment and notes payable | | 3,088,673,071 | 1,104,979,911 |
| Term and Bank loans | | | 311,764,925 |
| Obligations under finance lease | | | 7,559,190 |
| Mortgage payable (loans) | | 1,541,683 | 5,729,784 |
| | P | <u>6,884,420,793</u> | P <u>8,207,229,484</u> |
| Non-Current: | | | |
| Instalment and notes payable | P | 5,578,628,048 | P 4,678,622,549 |
| Term and Bank loans | | | 849,106,823 |
| Obligations under finance lease | | | 13,226,187 |

| | | | | |
|------------------|---|-----------------------------|---|-----------------------------|
| Mortgage payable | | <u>1,401,903</u> | | 3,553,774 |
| | P | <u><u>5,580,029,952</u></u> | P | <u><u>5,544,509,333</u></u> |

16.1 Liabilities Under Letters of Credits and Trust Receipts

The Group avails of letters of credit (LC) and TR lines with local banks to finance its purchases of inventories (see Note 8). These short-term trust receipts bear interests based on prevailing market interest rates at an average of 6% per annum 2014 and 2013

The Group is required by the banks to maintain certain collaterals for the credit line facility provided to the Group for working capital requirements. The collaterals are in the form of compensating deposits and a surety of a stockholder (see Notes 10 and 25.5).

16.2 Installment and Notes Payable

(a) Installment Loan with LBP

On April 16, 2010, the Group availed the P580.0 million loan with LBP. The loan with LBP was used to refinance the installment payable with PHINMA Group via take-out of the outstanding installment payable to PHINMA Group. The refinanced installment payable is payable for seven years with one year grace period on principal and bears an interest rate based on the prevailing LBP rate at the time of availment subject to quarterly repricing with reference to a three month PDST-F rate plus minimum spread of 2.5%. The installment payable with LBP is secured by the Group's parcel of land with carrying value of P326.7 million and P320.2 million as of December 31, 2013 and 2012, respectively, which is presented as part of land held for sale (see Note 9), and port expansion facilities with carrying value of P192.9 million and P211.6 million as of December 31, 2013 and 2012, respectively, which is presented as part of buildings, depot and pier facilities (see Note 12.5).

(b) Notes Facility Agreement with BDO Group

In 2011, the Group availed of a P750.0 million clean loan under the notes facility agreement entered into with BDO Capital & Investment Corporation, Banco De Oro Unibank, Inc., Maybank Philippines, Inc., Robinsons Bank Corporation and Banco de Oro Unibank, Inc. – Trust and Investment Group. The long-term loan amounting to P700.0 million with interest rate of 7.35% annually is payable on August 24, 2016 and the remaining P50.0 million with interest rate of 7.66% is payable on August 23, 2018.

(c) Omnibus Loan and Security Agreement (OLSA) with Philippine Bank of Communication (PBComm)

On February 10, 2012, the Group entered into a loan agreement with PBComm amounting to P107.0 million to partly finance the double hulling and drydocking of a vessel owned by the Group. In February and May 2012, PBComm released the loan amounting to P65.0 million and P42.0 million, respectively. The loan is subject to annual interest rate of 9.5% and is payable in thirty-six equal monthly installments with one quarter grace period from date of each release.

The loan is secured by a chattel mortgage on two of the tankers of the Group with net book value amounting to P317.5 million and P331.5 million as of December 31, 2013 and 2012, respectively (see Note 12.5).

The loan agreement requires the Group to maintain a debt-to-equity ratio of not more than 4:1. As of December 31, 2013 and 2012, the Group has complied with its debt covenants with the bank.

(d) OLSA with BDO Unibank, Inc. (BDO)

On April 26, 2011, the Group entered into a MOA with China Shipbuilding & Exports Corporation for the importation of one unit of oil tank (MT Thelma) in the amount of US\$19.8 million.

In connection with the MOA, the Group entered into an OLSA amounting to US\$14.5 million with BDO, the proceeds of which was used to partly finance the importation of the vessel. The loan is payable into twenty-seven consecutive equal quarterly principal installments starting in August 2012. The loan is subject to interest computed at one-year LIBOR plus applicable margin of 3.5% per annum.

In connection with the OLSA, certain advances made by certain stockholders are subordinated to the loan. Based on said agreement, the obligation of the Group to pay the stockholders' advances shall be fully subordinated, junior and subject in right of payment to the prior indefeasible payment and performance in full of the OLSA. The Group affirms that any and all obligations of the Group relative to the OLSA shall be settled first before any of its financial obligations to such shareholders' advances are paid. Accordingly, portion of the advances from shareholders are treated as non-current liabilities (see Note 25.4). In 2012, however, upon the increase in the Group's capitalization, subordination agreement was lifted by the bank in 2012.

The loan is secured by a chattel mortgage on certain tanker (MT Thelma) of the Group with a net carrying amount of P924.7 million as of December 31, 2013, and of certain tankers (MT Thelma and MT Excellence) with net revalued amount totaling P1,059.8 million as of December 31, 2012.

Related debt issuance costs amounted to P8.2 million of which P2.3 million was amortized during both 2013 and 2012, using effective interest rate of 5.02%. Amortized debt issuance costs were recognized as part of interest expense on bank loans under Finance Costs under the Other Income (Charges) account in the consolidated statements of comprehensive income (see Note 21.1). The unamortized debt issuance costs are included as part of the current and non-current portion of the related loan.

(e) Convertible Notes Facility Agreement with BDO

On July 11, 2012, the Parent Company executed a Convertible Notes Facility Agreement worth P500.0 million with warrants offering amounting to P180.0 million with BDO. The loan is subject to annual interest rate of 7.6% and is payable quarterly in arrears over its three years term. The issuance of the convertible note is part of the Group's plan to raise long-term capital, to refinance short-term debt and finance capital expenditures.

BDO is granted the option to convert all or any portion of the unpaid principal amount of the notes held by it into the conversion shares exercisable at any time upon written notice by BDO to the Parent Company specifying the time and date of the conversion. Also, BDO has the option to elect one nominee to the Parent Company's BOD which option may be exercised any time after signing date and on or before conversion date.

For and in consideration of the subscription of BDO to the convertible notes issued by the Parent Company, the latter also granted the former the right to subscribe to the warrants to be issued by the Parent Company which is convertible into common shares of the Parent Company up to the aggregate principal amount of P180.0 million. The availment of the convertible note and the issuance of the warrant were approved by the Parent Company's stockholders during a special stockholders' meeting held on September 6, 2012. The Parent Company's stockholders also authorized the execution, delivery and performance of Subscription Agreement between the Parent Company and BDO in relation to the issuance of the warrants.

The exercise price of the option to convert the note to the Parent Company's common shares and the warrant is equivalent to a determined price base plus a premium of fifteen percent. The exercise based used was the 30-day volume-weighted average price of the Parent Company's share on the PNX PM Equity HP page of Bloomberg from May 24, 2012 to July 5, 2012 which is equal to P8.3 per share. The exercise period consists of a two-year period commencing on the third anniversary date of the convertible notes issue date and expiring five years thereafter.

Considering that a fixed number of shares will be issued for options and warrants, the warrants and options may qualify as an equity instrument to be recorded as a separate component in the equity in the Group's consolidated financial statements. The Group's management, however, assesses that at the date of the initial recognition, the equity component has no value since the interest rate to be charged by the lender on the convertible note with warrants is similar to the interest rate of the note had it been issued without conversion options and warrants. As such, the fair value of the hybrid convertible note and the host instrument is the same resulting in the nil value of the equity component at the date of initial recognition.

Minimum financial ratios to maintain are as follows: (i) debt to equity ratio not to exceed 3:1; (ii) current ratio not to fall below 1:1 and (iii) debt service coverage ratio not to be less than 2.5:1.

As of December 31, 2013 and 2012, the Group has complied with its debt covenants.

(f) Notes Facility Agreement with China Banking Corporation and Pentacapital Investment Corporation

On November 8, 2012, the Parent Company entered into a notes facility agreement with China Banking Corporation and Pentacapital Investment Corporation totaling P2,500.0 million. The loan is subject to a fixed annual interest rate of 7.75% which is payable in twenty quarterly payments. The need proceeds of the loan were used by the Parent Company for the roll out of the retails stations, for debt financing, to support capital expenditures and for other general

corporate purposes. As of December 31, 2012, the total amount of the loan has already been drawn down.

By virtue of the notes facility agreement, the Parent Company affirms that it shall maintain the listing of its common shares with PSE and shall not declare or pay any dividends to stockholders (other than dividends payable solely in shares of its capital stock) or retain, retire, purchase or otherwise acquire any class of its capital stock, or make any other capital or other asset distribution to its stockholders, unless all payments due under the notes are current and updated.

Minimum financial ratios to maintain are as follows: (i) debt to equity ratio not to exceed 3:1; (ii) current ratio not to fall below 1:1 and (iii) debt service coverage ratio not to be less than 2.5:1.

As of December 31, 2013 and 2012, the Group has complied with its debt covenants.

(g) OLSA with BDO – MT Donatella

In 2013, the Group entered into a MOA with China Shipbuilding & Exports Corporation for the importation of one unit oil tank (MT Donatella) of PNX - Chelsea in the amount of US\$21.2 million (see Note 12.1). In connection with the acquisition of an oil tank vessel, the Group entered into an OLSA amounting to US\$14 million with BDO, the proceeds of which was used to partly finance the importation of the vessel. In September 2013, the local bank granted the loan and released the first tranche amounting to US\$4 million. The second tranche shall be availed of by the Group in 2014. The loan is payable for a period of five years in equal quarterly principal installments, with two quarter grace period, commencing after the second tranche. The loan bears effective interest rate of 5.25% per annum.

Interest incurred on these loans amounted to P3.3 million and is shown as part of Finance Costs under Other Income (Charges) in the 2013 consolidated statement of comprehensive income. Related debt issuance costs amounted to P6.2 million of which P0.1 million was amortized during 2013 using effective interest rate of 5.54%. Amortized debt issuance cost was also recognized as part of the Finance Costs under Other Income (Charges) in the 2013 consolidated statement of comprehensive income. Unamortized debt issuance costs are included as part of the current and non-current portion of the related loan.

The loan is secured by a chattel mortgage of MT Donatella upon its delivery and registration with the Maritime Industry Authority. The carrying amount of MT Donatella, presented as part of construction in progress, amounted to P418.6 million as of December 31, 2013 (see Note 12.1).

The OLSA requires the Group to maintain debt to equity ratio of not more than 1.5:1 and debt coverage ratio (DCR) of at least 1.20, except on drydocking year where minimum DCR shall be 1.00. The Group filed a waiver with the local bank for the debt covenant ratios. Management believes that the DCR will be met once PNX – Chelsea starts operations; hence, the application for the waiver will be approved by the local bank. Accordingly, the Group still classified the liability as non-current.

(h) Notes Payable

The Group availed of various borrowings from local banks with interest rates ranging from 7.0% to 10.2% per annum and will mature within five to seven years. The loans, which are secured by the Groups's certain buildings, depot and pier facilities and hauling and heavy equipment, is payable quarterly (see Note 12.5).

16.3 Term Loans

(a) Term Loan Agreement (TLA) with Development Bank of the Philippines (DBP)

On September 12, 2007, the Group entered into a MOA with China Shipbuilding & Exports Corporation for the construction of one unit of oil tank (vessel) in the amount of US\$15.0 million.

In connection with the MOA, the Group entered into a TLA amounting to US\$13.0 million with DBP, the proceeds of which shall be exclusively used to finance the construction of the vessel. In February 2008 and May 2009, DBP granted the loan amounting to US\$3.9 million (P159.0 million) and US\$9.1 million (P432.5 million), respectively. The loan is payable over five years in equal quarterly principal installments, with one quarter grace period on principal, commencing November 2009 and was subject to 10.5% interest rate per annum.

In 2010, DBP approved the reduction of interest rate from 10.5% to 9% subject to annual review effective September 14, 2010. The agreement also stipulated for interest-bearing hold-out deposits amounting to at least P10.0 million. The Hold-out Deposits were agreed to be released by the DBP in 2012. Hold-out deposit earns interest at the rate of 2.5% per annum. In the 2012, DBP further reduced the interest rate to 7.5% effective March 23, 2012.

The loan is secured by a chattel mortgage on certain vessel of the Group with net book value amounting to P777.8 million and P808.1 million as of December 31, 2013 and 2012, respectively. The loan is also secured by certain collateral on receivables of CSC and guaranteed by certain stockholders of the Group (see Note 25.5).

(b) Loan Agreement with Robinsons Bank Corporation (RBC)

On November 23, 2011, the Group entered into a loan agreement with RBC amounting to P65.0 million to partly finance the double hulling and drydocking of certain vessel of the Group (see Notes 12). The loan is subject to annual interest rate of 8.0% and is payable in twenty-four equal monthly installments.

The loan is secured by a chattel mortgage on one of the vessels of the Group with net book value amounting to P124.2 million and P130.7 million as of December 31, 2013 and 2012, respectively, and receivables of CSC from certain customer (see Note 7). The loan is also guaranteed by certain stockholders of CSC.

The loan agreement requires CSC to maintain debt-to-equity ratio of not more than 3:1 and debt coverage ratio of at least 1.20. CSC filed a waiver with RBC for the debt covenant ratios. No response was received from RBC. However, management believes that its application for the waiver will be approved by RBC. Accordingly, the Group still classified certain portion of liability as non-current (see Note 29.7).

(c) TLA with Maybank Philippines, Inc.

On July 18, 2012, the Parent Company signed with Maybank Philippines, Inc. a five year clean term loan amounting to P300.0 million to be used exclusively for capital expenditure and permanent working capital. The loan is subject to annual interest rate of 6.0% and is payable in twenty equal quarterly installments.

In connection with the TLA, all existing and future advances to the Parent Company by its stockholders or related parties are subordinated to the loan. The Parent Company agrees that any and all of its obligations relative to the TLA shall be settled first before any of its financial obligations to such shareholders' and related parties' advances are paid.

The TLA also requires the Parent Company to maintain debt-to-equity ratio of not more than 3:1, current ration of at least 1:1 and debt coverage ratio of at least 1.5.

As of December 31, 2013 and 2012, the Group has complied with its debt covenants with the bank.

(d) TLA with Maybank International Ltd.

On November 20, 2012, the Parent Company entered into a TLA amounting to US\$ 24.0 million with Maybank International Ltd. to fund various capital expenditures. The total amount of the loan is broken down into US\$14.0 million (tranche 1) which is due in five years and US\$10.0 million (tranche 2) with a term of three years.

The loan is subject to interest computed at one-year LIBOR plus applicable margin of 4.25% per annum, or cost of funds plus a margin of 2.0% per annum, whichever is higher. Interest payments are to be serviced quarterly in arrears. Maybank International Ltd. reserves the right to vary, at its absolute discretion from time to time, such rate of interest, which variation may take place by varying the LIBOR or the margin or spread above the LIBOR, or both.

The TLA also requires the Parent Company to maintain debt-to-equity ratio of not more than 3:1, current ration of at least 1:1 and debt coverage ratio of at least 1.5.

Moreover, Maybank International Ltd. has the right of first refusal and right to match any fund raising exercise that may be required to refinance the U.S. dollar-denominated term facility either via follow-on offering of the Parent Company's shares or a syndicated term loan.

It is also stipulated in the TLA that the Parent Company shall enter into and maintain during the term of Tranche 1 of the loan a cross-currency swap agreements (each, a "CCS") to hedge 100% of the Parent Company's foreign exchange and interest rate exposures in relation to tranche 1 of the loan. The Parent Company shall likewise enter into and maintain CCSs during the term of tranche 2 of the loan for the same undertaking. Each CCS shall be based on the 2012 International Swaps and Derivatives Association (ISDA) Master Agreement.

The balance of the principal of the loan amounted to P794.8 million and P987.2 million, translated into Philippine Peso using the closing rate as of December 31, 2013 and 2012, respectively.

As of December 31, 2013 and 2012, the Group has complied with its debt covenants with the bank.

(e) TLA with Asia United Bank (AUB)

In 2013, the Group obtained interest-bearing loans from AUB to partially finance the acquisition of tug boats amounting to P100 million. The loan bears fixed interest rate at 7.00% for the first three years from the initial drawdown date, and shall be repriced at the end of the third year from the initial drawdown date (the "Repricing Date"). The repriced rate shall be based on the relevant 2Y PDST-F as of the Repricing Date, plus a spread of 2.00% subject to a floor of 7.00%. The loan is payable in 18 quarterly installments over a period of five years. The first payment will commence on the third interest payment date from the initial drawdown date. The last quarterly installment of the loan is due on November 6, 2018.

As of December 31, 2013, the interest-bearing loans amounted to P100 million, of which P11.1 million was presented under current liabilities section in the consolidated statement of financial position.

Interest expense related to the loans amounted to P1.1 million and is shown as part of Finance Cost under Other Income (Charges) in the 2013 consolidated statement of comprehensive income.

Certain trade receivables amounting to P8.3 million were assigned to secure the payment of these interest-bearing loans (see Note 7).

16.4 Bank Loans

The bank loans represent secured loans from local commercial banks for working capital purposes. The loans bear annual interest rates ranging from 7.5% to 14.0% in 2013 and 2012, subject to monthly repricing. These loans are secured by certain vessels (MT Chelsea Intrepid, Patricia and Ernesto Uno) owned by the Group with net book value, amounting to P201.9 million and P349.8 million as of December 31, 2013 and 2012, respectively (see Note 12.5), and by certain stockholders (see Note 16.7).

16.5 Mortgage Payable

The mortgage payable represents secured loans which bear interest rates ranging from 7.6% to 11.4% per annum, and with terms ranging from 18 months to 36 months. The mortgages are secured by certain service vehicles of the Group, presented as part of Property and Equipment account in the consolidated statements of financial position (see Note 12).

16.6 Obligations under Finance Lease

The finance lease liability has an effective interest rate of 5.07% which is equal to the rate implicit in the lease contract (see Note 29.5). Lease payments are made on a monthly basis.

16.7 Credit Line

The Parent Company has an available credit line of P10.0 billion and P8.3 billion under LC and TR, respectively. These lines obtained from various banks are being utilized by the Parent Company for procurement of inventories both local and foreign. The credit line is secured by the following:

- (a) Assignment of future receivables;
- (b) Suretyship of PPHI and pledge of its share in the Parent Company amounting to P46.9 million (at P1 par value);
- (c) Joint several signature of certain stockholders; and,
- (d) Negative pledge over the remaining shares of PPHI in Parent Company in favor of the bank amounting to P1.1 billion.

Interest expense for 2013, 2012 and 2011 presented as part of Finance Costs account in the statements of comprehensive income amounted to P617.5 million, P467.4 million and P305.4 million (see Note 21.1), respectively, net of the capitalized borrowing cost of P71.4 million, P77.8 million and P91.2 million as of December 31, 2013, 2012 and 2011, respectively (see Note 12.4).

17. TRADE AND OTHER PAYABLES

This account consists of:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|--------------------------------------|-------|-----------------------------|-------------------------------|
| Trade payables | P | 954,213,297 | P 746,957,493 |
| Advances from customers and locators | | 346,482,915 | 290,926,769 |
| Accrued expenses | | 402,576,115 | 362,111,496 |
| Retention payable | | 67,938,463 | 106,903,516 |
| Income tax payable | | 9,608,080 | 9,608,080 |
| Non-trade payables | | 7,822,472 | 22,462,466 |
| Others | | 44,849,757 | 31,457,507 |
| | P | <u>1,833,491,100</u> | <u>P 1,570,427,327</u> |

Accrued expenses mostly pertain to payables to various contractors for the construction of retail stations that remain unpaid at the end of the year. In addition, this comprises amounts to be paid in relation to charter hire cost, repairs and maintenance, interest expense arising from loans and professional fees.

The advances from customers include option money from two different locators amounting to P0.1 million as of December 31, 2013. The said locators have the right and option to purchase subject properties under the terms and condition agreed by the said locator and the Group. However, in the event that the said locator does not exercise its right to purchase the subject properties, the option

money shall be refunded to the said locator plus interest at the rate equivalent to the prevailing treasury bill rate plus 2% per annum.

In addition, the advances from customers pertain to the advance payment of the various customers for their fuel purchases. Advances from customers are measured at the amount of cash received from the customers and are offset against trade receivables once the related sales transactions are consummated.

Retention payable is the amount withheld by the Group from its contractors for the construction of buildings, depot and pier facilities. The amount of retention, which is equivalent to ten percent of the total contract price, is payable upon the completion and turnover by the contractor of a construction project and the acceptance thereof by the

18. OTHER NON-CURRENT LIABILITIES

This account consists of:

| | Notes | <u>June 30, 2014</u> | <u>December 31, 2013</u> |
|-------------------------------|-------|----------------------|--------------------------|
| Security deposits | P | 165,632,331 | P 275,962,723 |
| Retirement benefit Obligation | | 11,514,273 | 51,100,685 |
| Unearned rent | | 42,307,189 | 49,726,176 |
| Others | | <u>8,425,648</u> | <u>-</u> |
| | P | <u>227,879,440</u> | P <u>376,789,584</u> |

Security deposits represent deposits received from dealers for the lease of retail stations and equipment that are installed in retail stations and are refundable at the end of the lease terms. The deposits are carried at amortized cost using the effective interest rates at the inception of the lease contracts. The day one gain is determined by calculating the present value of the cash flows anticipated until the end of the lease term using certain risk-free rates and is amortized over the lease terms. As the deposits do not have an active market, the underlying interest rates were determined by reference to market interest rate of comparable financial instrument.

19. COST OF SALES AND SERVICES

This account is composed of the following as of June 30:

| | Notes | <u>June 30, 2014</u> | <u>June 30, 2013</u> |
|-----------------------------------|-------|-----------------------|-------------------------|
| Cost of fuels and lubricants sold | 19 P | 16,613,172,431 | P 20,028,859,319 |
| Cost of Real Estate Sold | 19 | 7,215,476 | - |
| Cost of Services | 19 | <u>267,478,531</u> | <u>199,098,737</u> |
| | P | <u>16,887,866,438</u> | P <u>20,227,958,056</u> |

19.1 Cost of Fuels and Lubricants Sold

The cost of fuels and lubricants sold are broken down as follows:

| | Notes | <u>June 30, 2014</u> | <u>June 30, 2013</u> |
|----------------------------------|-------|------------------------------|------------------------------|
| Inventories at beginning of year | | 3,812,532,673 | 3,688,759,676 |
| Net purchases during the year | | <u>16,945,815,181</u> | <u>20,482,178,346</u> |
| Goods available for sale | | 20,758,347,854 | 24,170,938,022 |
| Inventories at end of year | | <u>(4,145,175,423)</u> | <u>(4,142,078,703)</u> |
| | | <u><u>16,613,172,431</u></u> | <u><u>20,028,859,319</u></u> |

20. OPERATING EXPENSE BY NATURE

The details of operating expenses by nature are shown below:

| | Notes | June 30, 2014 | June 30, 2013 |
|----------------------------------|-------|-----------------------|----------------|
| COST OF SALES: | | | |
| Fuels | 19 | 16,520,258,357 | 19,910,985,029 |
| Lubricants | 19 | 92,914,074 | 117,874,290 |
| Costs of Real Estate Sold | 19 | 7,215,476 | |
| Costs of Services | 19 | 267,478,531 | 199,098,737 |
| OPERATING EXPENSES: | | | |
| Salaries and employees' benefits | | 102,838,188 | 96,572,632 |
| Depreciation and amortization | | 195,330,985 | 169,331,711 |
| Trucking charges | | 29,561,817 | 95,474,078 |
| Fuel, oil and lubricants | | 32,341,521 | 18,611,566 |
| Advertisements and promotion | | 71,569,393 | 84,619,737 |
| Rent | | 169,891,491 | 155,888,374 |
| Office supplies | | 2,747,945 | 2,992,572 |
| Repairs and maintenance | | 34,273,746 | 24,439,512 |
| Travel and transportation | | 20,226,974 | 19,952,656 |
| Professional fees | | 22,353,749 | 29,164,763 |
| Taxes and licenses | | 32,926,283 | 37,480,635 |
| Representation | | 5,100,383 | 6,536,377 |
| Insurance | | 18,050,843 | 13,085,053 |
| Bank charges | | 2,710,450 | 1,353,884 |
| Documentary Stamps | | 51,961,466 | 47,923,818 |
| Security fees | | 23,844,689 | 16,438,692 |
| Dues and Subscription | | 4,042,484 | 6,888,859 |
| Service Fee | | 28,795,276 | 25,065,678 |
| Utilities | | 22,031,457 | 19,923,747 |
| Provisions for Bad Debts | | 600,000 | 1,800,000 |

| | | |
|---------------|------------------------------|-----------------------|
| Rebates | 20,403,982 | 19,988,842 |
| Miscellaneous | 3,904,348 | 7,514,496 |
| Other Expense | 5,722,269 | 6,500,246 |
| | <u>17,789,096,177</u> | <u>21,135,505,984</u> |

The expenses are classified in the consolidated statements of comprehensive income as follows:

| | Notes | June 30, 2014 | June 30, 2013 |
|-------------------------------------|-------|------------------------------|-----------------------|
| Cost of Sales & Services | 19 | 16,887,866,438 | 20,227,958,056 |
| Selling and administrative expenses | 20 | 901,229,739 | 907,547,928 |
| | | <u>17,789,096,177</u> | <u>21,135,505,984</u> |

21. SALARIES AND EMPLOYEE BENEFITS

21.1 Salaries and Employee Benefits Expense

Expenses recognized for salaries and employee benefits (see Note 19) are presented below:

| | June 30, 2014 | June 30, 2013 |
|-------------------------------------|---------------------------|-------------------|
| Salaries and wages | 81,033,821 | 76,601,245 |
| Employee welfare and other Benefits | 11,813,813 | 10,858,136 |
| 13th month pay | 6,470,584 | 5,683,549 |
| Other Benefit and Bonuses | 3,519,969 | 3,429,703 |
| | <u>102,838,188</u> | <u>96,572,632</u> |

21.2 Post-employment Defined Benefit Plan

(a) Characteristics of the Defined Benefit Plan

The Group has an unfunded and noncontributory post-employment defined benefit plan. The post-employment plan covers all regular full-time employees.

The normal retirement age is 60 with a minimum of 5 years of credited service. Normal retirement benefit is an amount equivalent to 150% of the final monthly covered compensation (average monthly basic salary during the last 12 months of credited service) for every year of credited service.

(b) Explanation of Amounts Presented in the Consolidated Financial Statements

Actuarial valuations are made annually to update the retirement benefit costs and the amount of contributions. All amounts presented below are based on the actuarial valuation report obtained

from an independent actuary in 2013 including the comparative year which has been restated in line with the adoption of PAS 19 (Revised), see Note 2.2(a)(ii).

The amount of post-employment defined benefit obligation, which is presented as part of Other Non-current Liabilities account (see Note 18) in the consolidated statements of financial position pertains to present value of the obligation amounting to P51.1 million and P36.4 million as of December 31, 2013 and 2012, respectively.

The movements in the present value of the post-employment defined benefit obligation recognized in the books are as follows:

| | <u>2013</u> |
|--|---------------------|
| Balance at beginning of year | P 36,440,105 |
| Current service cost | 9,217,663 |
| Interest expense | 2,413,691 |
| Remeasurements: | |
| Actuarial losses (gains) arising from: | |
| - changes in financial assumptions | 7,880,254 |
| - changes in demographic assumptions | (41,748,870) |
| - experience adjustments | 37,016,452 |
| Benefits paid | (<u>118,610</u>) |
| | |
| Balance at end of year | <u>P 51,100,685</u> |

The components of amounts recognized in profit or loss and in other comprehensive income in respect of the defined benefit post-employment plan are as follows:

| | <u>2013</u> |
|--|---------------------|
| <i>Reported in profit or loss:</i> | |
| Current service cost | P 9,217,663 |
| Interest expense | <u>2,413,691</u> |
| | <u>P 11,631,354</u> |
| | |
| <i>Reported in other comprehensive income:</i> | |
| Actuarial losses arising from changes in: | |
| - financial assumptions | P 7,880,254 |
| - demographic assumptions | (41,748,870) |
| - experience adjustments | <u>37,016,452</u> |
| | <u>P 3,147,836</u> |

Current service cost is presented as part of salaries and employee benefits under Selling and Administrative Expenses in the consolidated statements of comprehensive income (see Note 22.1).

The interest expense is included as part of Finance Costs under the Other Income (Charges) account (see Note 21.1).

In determining the amounts of the defined benefit post-employment obligation, the following significant actuarial assumptions were used:

| | <u>2013</u> |
|-----------------------------------|----------------|
| Discount rates | 4.60% to 5.32% |
| Expected rate of salary increases | 5.00% to 8.00% |

Assumptions regarding future mortality experience are based on published statistics and mortality tables. These assumptions were developed by management with the assistance of an independent actuary. Discount factors are determined close to the end of each reporting period by reference to the interest rates of a zero coupon bond government bonds with terms to maturity approximating to the terms of the retirement obligation. Other assumptions are based on current actuarial benchmarks and management's historical experience.

(c) Risks Associated with the Retirement Plan

The plan exposes the Group to actuarial risks such as interest rate risk, longevity risk and salary risk.

Interest Risk

The present value of the defined benefit obligation is calculated using a discount rate determined by reference to market yields of government bonds. Generally, a decrease in the interest rate of a reference government bonds will increase the plan obligation.

Longevity and Salary Risks

The present value of the defined benefit obligation is calculated by reference to the best estimate of the mortality of the plan participants both during and after their employment, and to their future salaries. Consequently, increases in the life expectancy and salary of the plan participants will result in an increase in the plan obligation.

Inflation Risk

A significant proportion of the defined benefit obligation is linked to inflation. The increase in inflation will increase the Group's liability.

(d) *Other Information*

The information on the sensitivity analysis for certain significant actuarial assumptions and the timing and uncertainty of future cash flows related to the retirement plan are described below.

Sensitivity Analysis

| | <u>Impact of Retirement Benefit Obligation</u> | | |
|----------------------|--|-------------------------------|-------------------------------|
| | <u>Change in Assumption</u> | <u>Increase in Assumption</u> | <u>Decrease in Assumption</u> |
| Discount rate | +/- 1.0% | (P 4,520,745) | P 5,438,812 |
| Salary increase rate | +/- 1.0% | 4,865,011 | (4,166,542) |

The above sensitivity analysis is based on a change in an assumption while holding all other assumptions constant. This analysis may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated. Furthermore, in presenting the above sensitivity analysis, the present value of the defined benefit obligation has been calculated using the projected unit credit method at the end of the reporting period, which is the same as that applied in calculating the defined benefit obligation liability recognized in the consolidated statements of financial position.

The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous years.

Funding Arrangements and Expected Contributions

The plan is currently unfunded. While there are no minimum funding requirement in the country, the unfunded status of the plan may pose a cash flow risk in about 21 years' time when a significant number of employees is expected to retire.

The Group does not expect to make contribution to the plan during the next financial year.

The maturity profile of undiscounted expected benefit payments from the plan within ten years as of December 31, 2013, follows:

| | |
|-----------------------------------|----------------------------|
| Within one year | P 11,722,940 |
| More than one year to five years | 39,511,615 |
| More than five years to ten years | <u>34,341,627</u> |
| | <u>P 85,576,182</u> |

The weighted average duration of the defined benefit obligation at the end of the reporting period is 21 years.

22. REGISTRATION WITH THE BOARD OF INVESTMENTS

22.1 BOI Registration as New Industry Participant – Batangas Depot

The Parent Company was registered with the Board of Investments (BOI) on February 26, 2010 as a new industry participant with new investment in storage, marketing and distribution of petroleum products under RA 8479 (Downstream Oil Industry Deregulation Act) for its storage tanks in Calaca, Batangas. Under its registration, the Parent Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987.

Under its registration, the Parent Company is also entitled to certain tax and non-tax incentives as follows:

- (a) Income tax holiday (ITH) for five years from February 26, 2010, without extension or bonus year from the date of registration;
- (b) Additional deduction from taxable income of 50% of the wages corresponding to the increment in the number of direct labor for skilled and unskilled workers in the year of availment as against the previous year if the project meets the prescribed ratio of capital equipment to number of workers set by the board of not more than US\$10,000 to one worker and provided that this incentive shall not be availed of simultaneously with the ITH;
- (c) The Parent Company may qualify to import capital requirement, spare parts and accessories at zero percent (0%) from the date of registration up to June 16, 2011 pursuant to the Executive Order No. 528 and its implementing rules and regulations.

Special transport equipment such as but not limited to tanks, trucks/lorries may be imported with incentives subject to land transportation operation requirements;

- (d) Tax credit on domestic capital equipment shall be granted on locally fabricated capital equipment;
- (e) Importation of consigned equipment for a period of five years from the date of registration, subject to posting of a re-export bond; and,
- (f) Other non-fiscal incentives, which may be applicable.

22.2 BOI Registration as New Industry Participant – Zamboanga Depot

The Parent Company was also registered with the BOI on November 25, 2010 as a new industry participant with new investment in storage, marketing and distribution of petroleum products under RA 8479 (Downstream Oil Industry Deregulation Act) for its storage tanks in Talisayan, Zamboanga City. Under its registration, the Parent Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987.

Under its registration, the Parent Company's transaction relating to Zamboanga Depot is also entitled to certain tax and non-tax incentives as also mentioned in Note 23.1. The ITH will expire five years from November 25, 2010.

22.3 BOI Registration for the New Investment in Downstream Oil Industry Activities – Davao Expansion

On May 14, 2010, the Parent Company was registered with the BOI for the new investment in downstream oil industry activities under RA 8479 (Downstream Oil Industry Deregulation Act) for the additional two storage tanks for petroleum products with storage capacity of 7.4 million liters in Davao depot. Under its registration, the Parent Company shall be entitled to avail of the incentives as cited in the previous page. However, ITH for five years from May 14, 2010 is subjected to the base figure of

148.2 million liters representing the Parent Company's highest attained sales volume of its existing depot facilities (in Davao Depot) prior to the filing of application for registration of new investment.

22.4 BOI Registration for New Investment – Bacolod Storage Terminal

On May 10, 2012, the Parent Company was registered with the BOI as a new industry participant with new investment in storage, marketing and distribution and bulk marketing of petroleum products under RA 8479 for its storage terminal in Bacolod City. Under its registration, the Parent Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987.

Under its registration, the Parent Company's transaction relating Bacolod storage terminal is also entitled to certain tax and non-tax incentives as also mentioned in the previous page. The ITH will expire five years from May 10, 2012.

22.5 BOI Registration for New Investment – Cagayan De Oro City Storage Terminal

On May 10, 2012, the Parent Company was registered with the BOI as a new industry participant with new investment in storage, marketing and distribution and bulk marketing of petroleum products under RA 8479 for its storage terminal in Bacolod City. Under its registration, the Parent Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987.

Under its registration, the Parent Company's transaction relating Cagayan de Oro City storage terminal is also entitled to certain tax and non-tax incentives as also mentioned in the previous page. The ITH will expire five years from May 10, 2012.

22.6 BOI Registration for MT Thelma and MT Cherylyn

On November 23, 2011 and December 10, 2008, CSC had registered its activity for MT Thelma and MT Cherylyn, respectively, with the BOI under Executive Order No. 226, otherwise known as the Omnibus Investments Code of 1987 as a new operator of domestic/interisland shipping on a pioneer status. As a registered entity, CSC is entitled to tax and non-tax incentives which include a

six-year ITH. For MT Cherylyn, the related tax incentives started in April 2009. Meanwhile, the tax incentive for MT Thelma started in November 2011. ITH incentives shall be limited only to the revenues generated by the registered project.

23. TAXES

The components of tax expense as reported in the consolidated profit or loss follow:

| | <u>2013</u> |
|---|-----------------------------|
| <i>Reported in profit or loss:</i> | |
| Current tax expense: | |
| Regular corporate income tax (RCIT) at 30% | P 35,715,470 |
| Final tax at 20% and 7.5% | 1,635,260 |
| Minimum corporate income tax (MCIT) at 2% | <u>1,822,943</u> |
| | <u>39,173,673</u> |
| Deferred tax expense (income) relating to origination and reversal of temporary differences | <u>(37,794,520)</u> |
| | <u>P 1,379,153</u> |
| <i>Reported in other comprehensive income:</i> | |
| Deferred tax expense (income) relating to origination and reversal of temporary differences | <u>P 1,109,855</u> |

A reconciliation of tax on pretax profit computed at the applicable statutory rates to tax expense (income) reported in the consolidated profit or loss is as follows:

| | <u>2013</u> |
|---|-----------------------|
| Tax on pretax profit at 30% | P 199,931,027 |
| Adjustment for income subjected to lower income tax rates | (909,213) |
| Tax effects of: | |
| Adjustment for income and expenses under income tax holiday | (201,324,277) |
| Unrecognized deferred tax asset | 47,988 |
| Non-deductible expenses | 3,633,628 |
| Non-taxable income | - |
| Unrecognized deferred | |

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| | |
|--|---------------------------|
| tax asset | - |
| Reversal of net operating loss carry over (NOLCO) | <u>-</u> |
| Tax expense reported in profit or loss | <u>P 1,379,153</u> |

Deferred tax asset on NOLCO of PGMI amounting to P168,045 as of December 31, 2013 was not recognized since management assessed that this is not recoverable as PGMI does not expect any taxable income in the coming years.

24. RELATED PARTY TRANSACTIONS

The Group's related parties include the ultimate parent company, the parent company, stockholders, the Group's key management personnel, entities under common ownership by the ultimate parent company and others as described in the succeeding pages.

The summary of the Group's significant transactions with its related parties as of December 31, 2013 and 2011, and for the years ended December 31, 2013, 2012 and 2011:

| <u>Related Party Category</u> | <u>Notes</u> | <u>Amount of Transactions 2013</u> | <u>Outstanding Balance 2013</u> |
|---|----------------|--|-------------------------------------|
| Other related parties under common ownership | | | |
| Sales of goods | 7, 25.1 | P 39,139,112 | P 37,334,222 |
| Purchases of services | 17, 25.2 | - | |
| Rentals | 25.3 | 43,119,800 | |
| Due from related parties | 25.4 | (5,552,006) | 2,747,994 |
| Due to related parties | 25.4 | (21,390,502) | 62,161,243 |
| Donations | 25.8 | 1,500,500 | |
| Associate | | | |
| Technical ship Services | 17, 19.2, 25.5 | 20,611,959 | 3,205,287 |
| Other related party | | | |
| Due to related parties | 25.4 | | 2,000,000 |
| Key management personnel | | | |
| Salaries and employee benefits | 25.7 | 50,027,748 | |

24.1 Sales of Goods

The Group sells products to certain related parties. Goods are sold on the basis of the price lists in force with non-related parties. Revenues arising from these transactions are presented as part of Sale of Goods in the consolidated statements of comprehensive income. The outstanding receivables from sales of goods to other related parties are presented as part of Trade Receivables under the Trade and Other Receivables account in the consolidated statements of financial position (see Note 7).

The outstanding receivables from related parties are unsecured and do not bear any interest. No impairment loss was recognized in 2013, 2012 and 2011 based on Management's assessment.

24.2 Purchases of Services

The Group purchased services from related parties on the basis of price lists in force with non-related parties. The amounts of transactions are presented as part of the Cost of Sales and Services account in the consolidated statements of comprehensive income (see Note 19.1) while the related outstanding payables for services obtained in 2013 and 2012 are presented as part of Trade Payables under the Trade and Other Payables account (see Note 17).

24.3 Rentals

The Group has the following lease agreements with the following related parties:

- (a) Udenna Corporation – of which total rent expense incurred in the years 2013 amounted to P6.5 million. There is no outstanding payable as of all the years presented.
- (b) Udenna Development (UDEVCO) Corporation – of which total rent expense in 2013 amounted to P28.5 million. Rental deposit for the lease amounted to P7.1 million as of December 31, 2013, and is presented as Refundable Rental Deposits under Other Non-current Assets in the consolidated statements of financial position (see Note 14).
- (c) Valueleases, Inc. – of which total rent expense in 2013 amounted to P8.1 million. Refundable Rental Deposits amounted to P0.1 million as of December 31, 2013, and is presented as part of Other Non-current Assets in the consolidated financial statements (see Note 14).

The rent expenses aforementioned are presented as part of Selling and Administrative Expenses in the consolidated statement of comprehensive income (see Notes 20 and 29.3).

24.4 Due from and Due to Related Parties

The Group grants and obtains unsecured advances to and from PPHI and other unconsolidated related companies for working capital requirements and other purposes.

As of December 31, 2013 the outstanding receivable and payable balances from these advances are shown as Due From Related Parties and Due to Related Parties, respectively, in the consolidated statements of financial position. Due from Related Parties and Due to Related Parties - current are either receivable in cash or paid through offsetting, unsecured noninterest-bearing liabilities and are expected to be paid within one year. Non-current Due to Related Parties, on the other hand, are unsecured non-interest bearing liabilities. These are stated at their carrying value since the date of repayment is not currently determinable.

Due from related parties represent outstanding advances to Udenna Environmental Services, Inc. amounting to P2.7 million million as of December 31, 2013, respectively.

The movement of due from related parties as of December 31, 2013 is as follows:

| | <u>2013</u> |
|------------------------------|----------------------|
| Balance at beginning of year | P 8,300,000 |
| Additions | 17,362,078 |
| Collections | <u>(22,914,084)</u> |
| Balance at end of year | <u>P 2,747,994</u> |

No impairment loss is recognized in 2013, 2012 and 2011 related to advances to related parties.

The breakdown of the Due to Related Parties as of December 31, 2013 is as follows:

| | <u>2013</u> |
|--|------------------|
| <i>Related parties under common ownership:</i> | |
| UMRC | P 62,161,243 |
| <i>Other related party:</i> | |
| Global International (Subic) Phils, Corp. | <u>2,000,000</u> |

The movement of Due to Related Parties in 2013 and 2012 follows:

| | <u>2013</u> |
|------------------------------|----------------------|
| Balance at beginning of year | P 85,551,745 |
| Additions | - |
| Payments | <u>(21,390,502)</u> |
| Balance at end of year | <u>P 64,161,243</u> |

24.5 Technical Ship Services Agreement

On April 1, 2013, the Group entered into a Technical Ship Services Agreement (the Agreement) with NPMSC, a newly incorporated associate of CSC. Under the Agreement, NPMSC shall carry out technical services in respect of CSC's tanker vessel as agents for and on behalf of the CSC. NPMSC's responsibilities include crew management, technical management, accounting services, and the arrangement for the supply of provisions.

Total technical ship services fee incurred in 2013 is presented as Service Fees under the Cost of Sales and Services account in the 2013 consolidated statement of comprehensive income (see Note 19.2), while the related outstanding liability is presented as part of Trade and Other Payables in the 2013 consolidated statement of financial position (see Note 17).

24.6 Loan Collateral

- (a) Surety and a negative pledge over the remaining shares of a stockholder secured the liabilities under letters of credits and trust receipts (see Note 16.1).
- (b) The TLA with DBP, OLSA with BDO and PBComm, loan agreement with RBC and certain banks loans of the Group were guaranteed by certain stockholders through a surety agreement with the respective banks. The vessels owned by the Group were also used as security on particular loans.

24.7 Others

The Group has made donations amounting to P0.5 million, P1.5 million and P0.5 million in 2013, 2012 and 2011, respectively, to Udenna Foundation, Inc., a non-stock, non-profit organization established by the ultimate parent company. This is presented as part of Other Expense under the Other Operating Expenses in the consolidated statements of comprehensive income. In addition, the Group has made donations amounting to P1.0 million, P3.8 million and P4.6 million 2013, 2012 and 2011, respectively, to PhoenixPhilippines Foundation, Inc., a non-stock non-profit organization established by the Parent Company.

25. EQUITY

25.1 Capital Stock

Capital stock consists of:

| | Shares | | Amount | |
|--|----------------------|----------------------|------------------------|------------------------|
| | June 30, 2014 | December 31, 2013 | June 30, 2014 | December 31, 2013 |
| Preferred – cumulative, nonvoting, non-participating, non-convertible into common shares – P1 par value | | | | |
| Authorized: | <u>50,000,000</u> | <u>50,000,000</u> | <u>50,000,000</u> | <u>50,000,000</u> |
| Issued and outstanding | <u>5,000,000</u> | <u>5,000,000</u> | <u>5,000,000</u> | <u>5,000,000</u> |
| Common shares — P1 par value | | | | |
| Balance at beginning of year | 2,500,000,000 | 2,500,000,000 | 2,500,000,000 | 2,500,000,000 |
| Increase in authorized stock | - | - | - | - |
| Balance at end of period | <u>2,500,000,000</u> | <u>2,500,000,000</u> | <u>2,500,000,000</u> | <u>2,500,000,000</u> |
| Issued: | | | | |
| Balance at beginning of period | 1,428,777,232 | 906,059,416 | 906,059,416 | 906,059,416 |
| Issuance during the period | - | - | - | - |
| Stock dividends | - | 329,717,816 | 329,717,816 | 329,717,816 |
| Reclassification | - | - | - | - |
| Balance at end of period | <u>1,428,777,232</u> | <u>1,428,777,232</u> | <u>1,428,777,232</u> | <u>1,428,777,232</u> |
| | | | P <u>1,433,777,232</u> | P <u>1,433,777,232</u> |

On April 23, 2012, the SEC approved the Parent Company's increase in authorized capital stock from P800.0 million divided into 750.0 million common shares with a par value of P1 and 50.0 million preferred shares with par value of P1 per share into P2,550.0 million divided into 2,500.0 million common shares with par value of P1 per share and 50.0 million preferred shares with par value of P1 per share.

The preferred shares shall have the following features:

- (a) Non-convertible into common shares;
- (b) Non-participating in any other corporation activities or other further dividends, non-voting except in cases specified by law;
- (c) No pre-emptive rights over the holders of common shares as to distribution of net assets in the event of dissolution or liquidation and in the payment of dividends at a specified rate. The Board of Directors shall determine its issued value at the time of issuance and shall determine its dividend rates and the dividends shall be paid cumulatively; and,
- (d) The preferred shares shall be redeemable at the Parent Company's option under such terms as the Board of Directors may provide at the time of issuance. It shall also be re-issuable when fully redeemed.

Moreover, preferred shares have the following features among others as provided in the subscription agreement;

- (a) Dividends on the Preferred Shares shall have a fixed rate of 11.50% per annum calculated in respect of each share with reference to the Issue Price thereof in respect to each dividend period.
- (b) Dividends shall be payable every September 21, December 21, March 21 and June 21 of each year (each a "Dividend Payment Date"). The dividends on the Preferred Shares shall be calculated on a 30/360 day basis and shall be paid quarterly in arrears on the last day of each 3-month dividend period (each a Dividend Payment Date), as and if declared by the Board of Directors. If the Dividend Payment Date is not a banking day, dividends shall be paid on the next succeeding banking day, without adjustment as to the amounts of dividends to be paid.
- (c) The Preferred Shares shall have priority in the payment of dividends at the stipulated rate at the time of issuance and in the distribution of corporate assets in the event of liquidation and dissolution of the Parent Company. As such, the Board of Directors to the extent permitted by law shall declare dividends each quarter sufficient to pay the equivalent dividend. Dividends on the shares shall be cumulative. If for any reason the Parent Company's Board of Directors does not declare a dividend on the Preferred Shares for a particular dividend period, the Parent Company shall not pay a dividend for said dividend period. However, on

any future Dividend Payment Date on which dividends are declared holders of the shares shall receive the dividends accrued and unpaid to the holders of the Preferred Shares prior to such Dividend Payment Date. Holders of Preferred Shares shall not be entitled to participate in any other further dividends beyond the dividends specifically payable on the Preferred Shares.

Moreover, the subscription agreement requires that the Parent Company undertakes to maintain a long-term debt to equity ratio of 1:1 throughout the life of the preferred shares.

As of June 30, 2014 the Parent Company has 64 a stockholders owning 100 or more shares each of the Parent Company's capital stock.

On January 29, 2014, the Board of Directors approved the declaration of cash dividend of P 0.10 per share. Further it was disclosed last March 03, 2014, the date of record is March 17, 2014 and the payment date is April 11, 2014.

25.2 Listing with PSE

On July 11, 2007, the Parent Company offered a portion of its stocks for listing with the PSE. Number of common shares registered was 145.0 million with an issue price of ₱9.80. As of June 30, 2014 and December 31, 2013, the number of holders of such securities is 64 and 53 respectively. The market price of the Parent Company's shares as of June 30, 2014 and December 31, 2013 is ₱6.30 and ₱4.50 respectively.

The history of public offerings and private placements of the shares of the Parent Company are as follows:

| <u>Transaction</u> | <u>Subscriber</u> | <u>Issue Date</u> | <u>Number of Shares</u> |
|--|------------------------|-------------------|-----------------------------|
| Initial public offering | Various | July 11, 2007 | 29,000,000 |
| 30% stock dividends | Various | August 6, 2008 | 43,000,198 |
| 40% stock dividends | Various | August 3, 2009 | 73,660,476 |
| Placement | Social Security System | November 13, 2009 | 7,500,000 |
| 40% stock dividends | Various | October 20, 2010 | 107,664,266 |
| 30% stock dividends | Various | May 6, 2011 | 113,047,475 |
| 50% stock dividends | Various | April 26, 2012 | 244,936,203 |
| Shares issuance for CSC acquisition | UMRC | September 6, 2012 | 171,250,798 |
| Placement | Various | March 11, 2013 | 130,000,000 |
| 30% stock dividends | Various | June 10, 2013 | 329,717,816 |
| Payment of subscription | PPHI | October 8, 2013 | <u>63,000,000</u> |
| | | | <u>1,312,777,232</u> |

25.3 Additional Paid-in Capital

In 2013, the Parent Company issued 130.0 million of its common shares at P9.40 per share and 63.0 million common shares at P5.10 per share. The excess of the par value for such subscriptions amounting to P1,350.3 million was recorded as part of Additional Paid-in Capital account. In addition, direct cost of the share issuances amounting to P34.1 million was deducted from the

Additional Paid-in Capital account.

In 2012, the Parent Company issued 171,250.8 million shares in favor of UMRC in relation to the share-for-share swap acquisition of CSC. The excess of par value of such issuance amounted to P1,248.9 million was recorded as part of Additional Paid-in Capital account (see Note 30).

In 2010, the Parent Company issued 5.0 million of its preferred shares at P100 per share. The excess of par value for such subscription amounting to P495.0 million was recorded as part of Additional Paid-in Capital account in the consolidated statements of financial position. In addition, the excess of the selling price over the acquisition cost of the treasury shares sold in 2010 also constitutes the Additional Paid-in Capital account.

In 2009, the Social Security System (SSS) has bought an initial 2.83% stake in the Parent Company representing 7.5 million subscribed common shares for P42.0 million or at P5.60 per share. The excess of par value for such subscription amounting to P34.5 million was recorded under Additional Paid-in Capital account in the consolidated statements of financial position.

In 2007, the Parent Company listed its shares of stock with PSE. Premiums received in excess of the par value during the public offering amounting to P227.1 million were recorded under Additional Paid-in Capital account in the consolidated statements of financial position.

25.4 Other Reserves

In 2012, the Parent Company issued 171,250.8 million common shares plus cash of P157.8 million in exchange of the net assets of CSC. The acquisition of CSC is accounted for under business combination using pooling-of-interest method wherein the difference between the consideration given up over the carrying value of the net assets of CSC is recognized as Other Reserves (see Note 30).

25.5 Revaluation Reserves

The components and reconciliation of items of other comprehensive income presented in the statements of changes in equity at their aggregate amount under Revaluation Reserves account, are shown below.

| | <u>Property and Equipment</u> | <u>Defined Benefit Obligation</u> | <u>Total</u> |
|---|-----------------------------------|---|------------------|
| Balance as of January 1, 2013 | P 294,152,102 | (P 11,729,072) | P 282,423,030 |
| Remeasurements of defined post-employment obligation | - | (3,147,836) | (3,147,836) |
| Revaluation of tankers | 6,847,358 | - | 6,847,358 |
| Depreciation transfer to retained earnings – revalued tankers | (17,701,323) | - | (17,701,323) |
| Other comprehensive loss before tax | (10,853,965) | (3,147,836) | (14,001,801) |
| Tax income | <u>3,256,190</u> | <u>944,352</u> | <u>4,200,542</u> |

| | | | |
|------------------------------------|-----------------------------|------------------------------|-----------------------------|
| Other comprehensive loss after tax | (<u>7,597,775</u>) | (<u>2,203,484</u>) | (<u>9,801,259</u>) |
| Balance as of December 31, 2013 | <u>P 286,554,327</u> | <u>(P 13,932,556)</u> | <u>P 276,621,771</u> |

25.7 Retained Earnings

On January 29, 2014, the Board of Directors approved the declaration of common share cash dividend of P 0.10 per share. Further it was disclosed last March 03, 2014, the date of record is March 17, 2014 and the payment date is April 11, 2014. Total amount of cash dividend is P142,877,232.20.

On March 8, 2013, the stockholders ratified the BOD approval of 30% stock dividends (or a total of 329.7 million shares), valued at par and distributed on June 10, 2013 to stockholders of record as of May 15, 2013. Cash dividends of 10 centavos per common shares totaling to P103.6 million were also declared and paid in 2013. In addition, total cash dividends declared and distributed to preferred stockholders amounted to P57.5 million in 2013.

On March 8, 2012, the stockholders ratified the BOD's approval of 50% stock dividends (or a total of 244.9 million shares), valued at par and distributed on April 26, 2012 to stockholders of record as of March 28, 2012. In addition, cash dividends of 10 centavos per common shares totaling to P49.0 million were also declared and paid in 2012. In addition, total cash dividends declared and distributed to preferred stockholders amounted to P57.5 million in 2012.

On March 11, 2011, the stockholders ratified the BOD's approval of 30% stock dividends (or a total of 113.0 million shares), valued at par and distributed on May 6, 2011 to stockholders of record as of April 8, 2011. In addition, cash dividends of 10 centavos per common share totaling to P37.7 million were also declared and paid in 2011.

On March 21, 2011, June 21, 2011, September 21, 2011 and December 1, 2011, the BOD declared and approved the payment of cash dividend to preferred shareholders totaling to P70.7 million.

25.8 Capital Management Objectives, Policies and Procedures

The Group's capital management objectives are:

- To ensure the Group's ability to continue as a going concern; and,
- To provide an adequate return to shareholders by pricing products and services commensurately with the level of risk.

The Group monitors capital on the basis of the carrying amount of equity as presented on the face of the consolidated statements of financial position. Capital for the reporting periods under review is summarized as follows:

| | <u>June 30, 2014</u> | 2012 (As Restated – see Note 2.2) |
|-------------------|-------------------------|---|
| Total liabilities | P 14,680,244,368 | P 15,839,647,662 |

| | | |
|----------------------|----------------------|----------------------|
| Total equity | <u>6,728,760,945</u> | <u>6,497,905,304</u> |
| Debt-to-equity ratio | <u>2.18: 1.0</u> | <u>2.44: 1.0</u> |

The decrease of the total liabilities in 2014 is the result of the reduction borrowings for the procurement of petroleum balanced by the utilization of suppliers' credit. The increase in equity is due to the accumulated earnings net of the cash dividend declared.

The Group's goal in capital management is to maintain a debt-to-equity structure ratio of 2.7 to 1.

The Group sets the amount of capital in proportion to its overall financing structure, i.e., equity and financial liabilities. The Group manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, issue new shares or sell assets to reduce debt.

26. EARNINGS PER SHARE

EPS were computed as follows:

| | <u>June 30, 2014</u> | <u>June 30, 2013</u> |
|--|----------------------|----------------------|
| a) Net profit pertaining to common shares | P 381,208,211 | P 343,517,180 |
| b) Net profit attributable to common shares and potential common shares | 381,208,211 | 343,517,180 |
| c) Weighted average number of outstanding common shares | 1,428,777,232 | 1,428,777,232 |
| d) Weighted average number of outstanding common and potential common shares | 1,428,777,232 | 1,428,777,232 |
| Basic EPS (a/c) | P <u>0.27</u> | P <u>0.24</u> |
| Diluted EPS (b/d) | P <u>0.27</u> | P <u>0.24</u> |

The options and warrants attached on the convertible notes do not have dilutive effect since the average market price of the common shares of the Parent Company during the year does not exceed the exercise price of the options or warrants (see Note 16.2e).

The 2012 and 2011 basic and diluted EPS were restated for the changes brought about by the Group's adoption of PAS 19 (Revised) and the stock dividends declared which is considered as a bonus issue under PAS 33, *Earnings per Share*. PAS 33 requires to treat stock dividends issued as if it occurred at the beginning of 2011, the earliest period presented for EPS computation.

27. COMMITMENTS AND CONTINGENCIES

27.1 Capital Commitments

As of June 30, 2014, the Group has commitments of more than P1,500.0 million for expansion on petroleum retail network, shipping, depot, terminalling, real estate and logistics facilities, information technology infrastructure and other major expansions related to its business development. The Group has a network of 405 operating retail service stations as of June 30, 2014. An additional of 65 retail service stations are under various stages of completion as of June 30, 2014.

In 2013, the Group plans to expand further its petroleum retail service stations and carry out its investments in its subsidiaries to put up depot and terminalling facilities in strategic locations and completing its chain of logistical support to strengthen its foothold in the industry.

27.2 Letters of Credits

As of June 30, 2014 and December 31, 2013 the Parent Company has unused LCs amounting to P3,552.0 million and P1,021.0 million, respectively.

27.3 Operating Lease Commitments – Group as Lessee

The Group is a lessee under several operating leases. The leases have terms ranging from 2 to 22 years, with renewal options, and include annual escalation rates of 2% to 10%. The future minimum rentals payable under these cancelable operating leases are presented as follows:

| | <u>2013</u> |
|--|------------------------|
| Within one year | P 259,337,311 |
| After one year but not more than five years | 1,042,366,014 |
| More than five years | <u>2,009,559,064</u> |
| | <u>P 3,311,262,389</u> |

27.4 Operating Lease Commitments – Group as Lessor

The Group is a lessor under several operating leases with third parties. The leases have terms ranging from 2 to 25 years, with renewal options, and include annual escalation rates of 2% to 10%. The future minimum rentals receivables under these cancelable operating leases are presented below:

| | <u>2013</u> |
|--|----------------------|
| Within one year | P 45,535,652 |
| After one year but not more than five years | 100,847,748 |
| More than five years | <u>5,499,057</u> |
| | <u>P 151,882,457</u> |

Rent income in 2013, 2012 and 2011 amounting to P47.5 million, P54.3 million and P22.3 million, respectively, is presented as part of Rent and Storage Income account in the consolidated statements of comprehensive income.

27.5 Finance Lease Commitments – Group as Lessee

The Group is a lessor under several finance lease covering certain hauling trucks with a lease term of 2 to 5 years. The leases provide options to purchase the transportation equipment at the end of the lease terms. Future minimum lease payments (MLP) under the finance leases together with the present value (PV) of the net minimum lease payments (NMLP) is as follows:

| MLP | 2013 | | of NMLP |
|---|----------------------------|----------------------------|----------------|
| | Future NMLP | PV of MLP | |
| Within one year | P 9,007,429 | 7,559,190 | |
| After one year but not more than five years | <u>14,253,842</u> | <u>13,226,187</u> | |
| | 23,261,271 | 20,785,377 | |
| Amounts representing finance charges | (2,475,894) | - | |
| Present value of MLP | <u>P 20,785,377</u> | <u>P 20,785,377</u> | |

The liabilities relating to the finance leases are shown as part of Interest-bearing Loans and Borrowings (see Note 16).

27.6 TC Agreement

The Group has existing commitments to charterers under TC agreements for the use of its tankers in transporting oil products for a fixed period. Also associated with these TC agreements is the obligation to keep the Group's tankers in good working condition and compliant with all the shipping regulations as required by the MARINA.

27.7 Loan Agreement with RBC

The loan agreement with RBC requires CSC to maintain debt-to-equity ratio of not more than 3:1 and debt coverage ratio of at least 1.20. CSC filed a waiver with RBC for the debt covenant ratios. No response was received from RBC. However, management believes that its application for the waiver will be approved by RBC. Accordingly, the Group still classified certain portion of liability as non-current [see Note 16.3 (b)].

27.8 Others

In May 2011, the Bureau of Customs (BOC) filed before the Department of Justice (DOJ) a complaint against the Group's President and Chief Executive Officer and other respondents for alleged violation of Sections 3602, 2501(l)(1) & (5), 1801, 1802 and 3604 of the Tariff and Customs Code of the Philippines. In November 2012, the DOJ dismissed the case for lack of probable cause against all respondents. In April 2013, the DOJ, upon motion for reconsideration filed by the BOC, reversed its earlier resolution and recommended the filing of Criminal Informations against the respondents. Criminal Informations for alleged violations of Section

3602, in relation to Sections 3601, 2530 1 (l) & 5, 1801 and 3604 of the Tariff and Customs Code of the Philippines were filed before the Regional Trial Courts of Batangas and Davao City in August 2013. Separately, in September and October 2013, RTC Batangas and Davao City, respectively, have dismissed all charges against the Group's President and Chief Executive Officer.

In the normal course of business, the Group makes various commitments and incurs certain contingent liabilities that are not given recognition in the consolidated financial statements. As of December 31, 2013, the management believes that losses, if any, that may arise from these commitments and contingencies will not have material effects on the consolidated financial statements.

Item II - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Comparable discussion on Material Changes in Results of Operations for the three Months' Period Ended June 30, 2014 vs. June 30, 2013.

Revenues

The Group generated total revenues of ₱ 18,515 billion in 2014 which is 15% lower than its 2013 level of ₱ 21.832 billion, primarily due to the 21% decrease in sales volume of refined petroleum products. However, this was minimized due to the higher revenues from fuels service, shipping, storage and other revenue by 48.5%.

Sales revenues from trading and distribution of petroleum products decreased by 16% from ₱21.709 billion in 2013 to ₱ 18,308 billion in 2014 resulting principally from a decline in volume for the wholesale. The effect was however minimized as volume in retail (station sales) increased by 7% due wider distribution network and growth in same store sales. The decrease on wholesale account is a conscious effort of the Company to manage resources and profitability . The Parent Company had four hundred five (405) Phoenix Fuels Life retail service stations as of June 30, 2014 compared to three hundred forty three (343) retail stations as of the same period last year. The Parent Company has a number of retail stations undergoing construction and projected to be opened within the year.

The Group generated ₱ 183 million from its fuels service, storage, port and other income in 2014 versus ₱ 123 million in 2013, a 48.5% increase compared to the same period last year. This due to increase in turn-over of on storage service compared to last year, additional service of charter hire to third party, and revenue from tug-boat operations.

Cost and expenses

The Group recorded cost of sales and services of ₱ 16.887 billion, a decline of 16% from its 2013 level of P 20.228 billion primary due to a 21% decrease in the sales volume of petroleum products. The lower decline in percentage of costs of sales by 16% compared to the decline of 21% in volume is a result of sales mix. This year, the ratio of retail compared to commercial/industrial (C&I) accounts improved due to strategy of Company to push more volume in Retail. Retail stations normally sells more premium products like gasoline as opposed by the C&I which is more diesel.

Selling and administrative expenses decreased by 0.70% as a result of lower variable costs like delivery costs due to lower volume, this however was balanced by the higher rentals, depreciation, salaries & wages as a result of the continuous expansion of the Group's business operations. With its growing retail presence nationwide and the scaling-up of operations, the Company incurred increases in manpower, and logistics costs thus resulted to the aforementioned increase.

Net Income

The Group's net income for the first half of 2014 is ₱ 402 million versus 2013 first half net income of ₱ 372 million, an increase of 8%. In spite of the lower volume by 21%, the Company able to manage the profit both a result of various strategy not limited to sales segment but as well as on its trading, supply management and other various margin enhancing strategies.

The Parent Company is registered with the Board of Investments on November 16, 2005 as a new industry participant with new investments in storage, marketing and distribution of petroleum products under RA 8479 (Downstream Oil Industry Regulation Act) and, as such, continues to enjoy an income tax holiday for five (5) years from November 16, 2005.

The Parent Company obtain additional registration approval from the Board of Investments (BOI) under R.A. 8479 or Oil Industry Deregulation Law for its Calaca, Batangas Terminal.. This entitles the Parent Company to an Income Tax Holiday (ITH) on the revenue activities from this additional storage capacity for five (5) years starting February 2010. Another BOI registration was granted for the Davao Terminal Expansion facility effective February 2010 thus entitling the Parent Company another set of incentives including the five (5) year ITH in its Davao Terminal Marketing and Storage activities. These additional ITH incentives will allow the Company to enjoy an effective income tax rate well below 30% as it continuously expands its storage and obtains further incentives from the BOI.

The Parent Company was also registered with the BOI on November 25, 2010 as new industry participant with new investment in storage, marketing and distribution of petroleum products under RA 8479 (Downstream Oil Industry Deregulation Act) for its storage tanks in Talisayan, Zamboanga City. Under its registration, the Company is required to observe certain general and specific terms and conditions stated in the provisions of the Omnibus Investments Code of 1987.

The Parent Company gets new approvals with the BOI for its two (2) new facilities. Both the Cagayan de Oro City and the Bacolod City were registered and issued certification by the BOI last May 12, 2012. The registration entitles the Parent Company ITH for five years from registration plus other fiscal and non-fiscal incentives accorded to BOI registered entity.

Financial Condition

(As of June 30, 2014 versus December 31, 2013)

Total resources of the Group as of June 30, 2014 stood at ₱ 21.409 billion, lower by 4% compared to the ₱ 22.338 billion as of December 31, 2013. This is mainly as a result of lower accounts receivable due to collection of huge account sales last fourth quarter of 2013.

Cash and cash equivalents increased by 111% from ₱ 357 million in December 31, 2013 to ₱ 755 million due to timing of collections of receivables as against payment various liabilities and the objective of the Company certain level of Cash and cash equivalent needed on the day to day operations.

The Group's liquidity position, though lower against last year, this continued to be strong with Current Assets amounting to ₱ 11.001 billion as of June 30, 2014, compared ₱ 13.054 billion as of December 31, 2013. This a result of reduction of liabilities and the increase in Property, Plant and Equipment.

Trade and other receivables decreased by 40%, from ₱ 7.344 billion as of December 31, 2013 to ₱ 4.375 billion as of June 30, 2014, which were mainly due to improving receivable turn-over and increased efforts of the Company to collect past due accounts. The December 31, 2013 accounts receivable balance is not on a normal level due to the huge sales by the Company to government entity towards year-end which collection is due and collected first quarter of 2014. The Group continues to enhance its credit policies to minimize overdue accounts.

Inventories increased by 9%, from P 3.813 billion as of December 31, 2013 to P 4.145 billion as of June 30, 2014. The Company maintains an average of one month worth of inventory to ensure stable supply in retail stations and commercial/industrial clients. However, this may go higher than the desired level due to vessel arrival timing. In the case of this quarter end, imports arrived more towards end of quarter. Subsequently, this was reduced to the normal level.

Due to/from related parties in June 30, 2014 and December 31, 2013 is ₱ 1.948 million and ₱ 2.748 million respectively. The decrease of ₱ 0.799 million or 29% is due to collection of those previously billed various charges to related parties.

Input taxes-net decrease by 31% in June 30, 2014 is the result of offsetting of higher output taxes this year due to increased level of inventory as well as input taxes of capital expenditures and increase in inventory level which input taxes has been paid.

Other current assets are at ₱ 594.6 million and ₱ 489.9 million as of June 30, 2014 and December 31, 2013 respectively. The increase represents prepaid rentals on leased retail service stations properties and depot sites, prepaid insurance, creditable withholding taxes and other current assets.

As of June 30, 2014, the Group's property and equipment, net of accumulated depreciation, increased to ₱ 9.643 billion compared to ₱ 8.628 billion as of December 31, 2013 due to investments in additional shipping vessel, depot capacity in existing areas and new sites. As of the first quarter, the Parent Company is takes the delivery of brand new marine tanker for fuel importation, plus costs ongoing storage facility expansions. Additional retail stations were also constructed and or under construction in Luzon, Mindanao and Visayas as part of the Company objective to further expand retail network.

Loans and Borrowings decreased by 9% from ₱ 13.752 billion as of December 31, 2013 to ₱12.464 billion as of June 30, 2014. The decrease was a result of payments on amortization of long term debts. In addition, portion of inventories were financed by suppliers' credit terms.

Trade and other payables increased by 17%, from ₱ 1.570 billion as of December 31, 2013 to ₱ 1.833 billion as of June 30, 2014. This is the result of the higher inventory and the partially the decrease of trust receipt payable under loans and borrowings.

Total Stockholders' Equity increased to ₦ 6.729 billion as of June 30, 2014 from ₦ 6.498 billion as of December 31, 2013 as a result of the period net income for the quarter less the cash dividend declared during the quarter for both common shares and preferred shares.

Key Performance Indicators and Relevant Ratios

The Company's key performance indicators and relevant ratios and how they are computed are listed below:

| | June 30, 2014 (2-quarters) | December 31, 2013 Full Year |
|--|-------------------------------|--------------------------------|
| Current Ratio ¹ | 1.26 : 1 | 1.33 : 1 |
| Debt to Equity-Total ² | 2.18 : 1 | 2.44 : 1 |
| Return on Equity-Common ³ | 6.08% | 11% |
| Net Book Value Per Share ⁴ | 4.71 | 4.54 |
| Debt to Equity-Interest Bearing ⁵ | 1.85 : 1 | 2.12 : 1 |
| Earnings Per Share-Adjusted ⁶ | 0.27 | 0.45 |

Notes:

1 - Total current assets divided by current liabilities

2 - Total liabilities divided by tangible net worth

3 - Period or Year Net income divided by average total stockholders' equity

4 - Total stockholder's equity (net of Preferred) divided by the total number of shares issued and outstanding

5 - Interest Bearing Debts divided by Total stockholder's equity (net of Preferred)

6 - Period or Year Net income after tax divided by weighted average number of outstanding common shares

These key indicators were chosen to provide management with a measure of the Company's financial strength (Current Ratio and Debt to Equity) and the Company's ability to maximize the value of its stockholders' investment in the Company (Return on Equity, Net Book Value Per Share and Earnings Per Share). Likewise, these ratios are used to compare the Company's performance with similar companies.

The Company debt to equity (DE) ratio for 2013 is higher at 2.44: 1 due to needed high level of inventory to maintain to support the sales requirement in the first month of 2014. June 30, 2014 shows significant improvement on DE at 2.18 : 1 on total debt and 1.85 : 1 for interest bearing debt. This is a result of accumulated income for the period and management of debt level.

The foregoing key indicators were chosen to provide management with a measure of the Group's financial strength (Current Ratio and Debt to Equity) and the Group's ability to maximize the value of its stockholders' investment in the Group's (Return on Equity, Net Book Value Per Share and Earnings Per Share). Likewise these ratios are used to compare the Group's performance with its competitors and similar-sized companies.

Material Changes to the Group's Balance Sheet as of June 30, 2014 compared to December 31, 2013 (Increase/decrease of 5% or more)

111% increase in Cash and Cash Equivalents

This is a result of higher revenue during the period. Certain levels of Cash are also maintained to support maturing obligations.

40% decrease in Trade and other receivables

Primarily due to improving days-sales-receivable as a result of collection.

29% decrease in Due from related parties

Various collection and billings during the period-net.

31% increase on Value Added Tax-net

Increase in Input VAT as a result of higher inventory plus accumulated Input Taxes on capital expenditures.

12% increase in property, plant and equipment

Due to vessel acquisition, retail network expansion and other capital expenditures.

21% increase in other non-current assets

As a result of increased prepayments e.g. rental, insurance, etc. plus the creditable withholding taxes.

9% decrease in Loans and Borrowings (Current and Long-term)

A result of amortization of bank debts and reduction of short-term debt.

17% increase in Trade and other payables

Trade Payable to foreign suppliers for purchases of inventory to support increasing volume.

102% increase in deferred tax liability

As a result of deferred tax liability for tanker vessel appraisals increments.

40% reduction on non-current liability

Due to some retirement of cash security deposits in favor of other form of security.

Material changes to the Group's Income Statement as of June 30, 2014 compared to June 30, 2013 (Increase/decrease of 5% or more)

16% decrease in Sale of petroleum products

Principally due to 21% lower sales volume compared to 2013. However, it was minimized by the higher service revenue.

48% increase in Fuel service, Shipping, storage income and other revenue

Higher turn-over on service volume specifically on storage volume of new terminal, additional

revenue on charter hire and tugboat revenue.

16% decrease in cost of sales

Primarily due to decrease sales of petroleum products minimized by the effect of better sales mix compared to last year.

9.4% increase in Finance Costs (net)

Due to interest on the instalment payables, bank term loans and TRs availed to finance a higher level of inventory.

104% increase in other income/Costs

Due to periodic inventory losses recorded during the period plus other various other costs.

5.85% increase in income tax

Due to the increase of income not related to its BOI registered activity

There are no other material changes in the Group's financial position (5% or more) and condition that will warrant a more detailed discussion. Furthermore, there are no material events and uncertainties known to management that would impact or change the reported financial information and condition of the Group.

PART II – OTHER INFORMATION

1. The Parent Company held its annual stockholders' meeting last March 08, 2014 at the Marco Polo Hotel, Davao City, Philippines.
2. The Board of Directors approved last January 29, 2014 the declaration of cash dividend of P 0.10 per share. Further it was disclosed last March 03, 2014, the date of record is March 17, 2014 and the payment date is April 11, 2014.
3. As of June 30, 2014, there are no known trends or demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result, in increasing or decreasing the Group's liquidity in any material way. The Group does not anticipate having any cash flow or liquidity issues. The Group is not in default or breach of any note, loan, lease or other indebtedness or financing arrangement requiring it to make payments.
4. There are no material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the Parent Company with unconsolidated entities or other persons created during the reporting period.
5. There are no material commitments for capital expenditures, events or uncertainties that have had or that are reasonably expected to have a material impact on the continuing operations of the Parent Company.
6. There were no seasonal aspects that had a material effect on the financial condition or results of operations of the Parent Company.

SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Registrant

P-H-O-E-N-I-X PETROLEUM PHILIPPINES, INC.

By:



DENNIS A. UY

President and Chief Executive Officer



JOSEPH JOHN L. ONG

Chief Finance Officer