



# Nurturing Progress





## **Nurturing Progress**

We believe that the future is unwritten. What happens to our nation and our way of life is entirely up to us. As stewards, much is expected from our generation because we govern the present in trust for our children. What we do today matters greatly, and will shape the kind of world that they will inherit from us.

For over 46 years, First Holdings has been a catalyst for progress in the Philippines. Our conviction has influenced the kinds of businesses that we've entered into over the years: power generation and distribution, infrastructure development, manufacturing, and real estate. Beyond stakeholders, we consider ourselves true partners in building a stronger nation and remain fully committed to our shared future with the Filipino people.

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# First Philippine Holdings Corporation and Subsidiaries

## Financial Highlights

December 31

|                                                           | 2007        | 2006        |
|-----------------------------------------------------------|-------------|-------------|
| <b>OPERATING RESULTS (In million Php)</b>                 |             |             |
| Revenues                                                  |             |             |
| Sale of electricity                                       | 49,492      | 51,176      |
| Toll operations                                           | 5,491       | 5,705       |
| Contracts and services                                    | 2,043       | 1,326       |
| Sale of merchandise                                       | 1,510       | 1,184       |
| Sale of real estate                                       | 291         | 181         |
| Equity in net earnings of associates                      | 1,690       | 4,163       |
| Gain on sale of investment in shares of stock             | 44          | 535         |
| Gain on dilution                                          | -           | 2,653       |
| Finance costs                                             | (6,729)     | (7,338)     |
| Finance income                                            | 1,934       | 3,281       |
| Net income for the year                                   | 11,680      | 15,593      |
| Net income attributable to equity holders of the parent   | 4,475       | 8,754       |
| <b>FINANCIAL POSITION (In million Php)</b>                |             |             |
| Total Assets                                              | 239,547     | 137,574     |
| Investments at equity and deposits                        | 38,197      | 18,331      |
| Long-term debt (including current portion)                | 97,957      | 42,201      |
| Total Liabilities                                         | 152,707     | 72,344      |
| Total equity attributable to equity holders of the parent | 33,605      | 36,536      |
| Minority Interest                                         | 53,235      | 28,694      |
| Total Equity                                              | 86,840      | 65,230      |
| <b>FINANCIAL RATIOS</b>                                   |             |             |
| Return on equity <sup>3</sup> (%)                         | 13.32%      | 23.96%      |
| Dividend payout ratio (%) <sup>4</sup>                    | 13.43%      | 20.93%      |
| Current Ratio (times) <sup>5</sup>                        | 1.08        | 2.31        |
| Long-term debt to equity (times) <sup>6</sup>             | 2.91        | 1.16        |
| <b>PER SHARE DATA (In Php)</b>                            |             |             |
| Earnings per share <sup>7</sup>                           |             |             |
| Basic                                                     | 7.641       | 15.243      |
| Diluted                                                   | 7.541       | 15.079      |
| Book value per share <sup>8</sup>                         | 57.02       | 62.93       |
| Price earnings ratio <sup>9</sup>                         | 9.49        | 4.13        |
| Market price                                              | 72.50       | 63.00       |
| Cash dividend per share                                   | 2.00        | 2.00        |
| Number of shares issued and subscribed                    | 589,394,893 | 580,565,599 |
| Weighted average number of shares                         |             |             |
| Basic                                                     | 585,591,888 | 574,293,127 |
| Diluted                                                   | 593,343,416 | 580,543,212 |
| Number of stockholders                                    | 13,051      | 13,473      |

<sup>1</sup> The results for the years ended December 31, 2007 and 2006 are set out on the consolidated financial statements

<sup>2</sup> The balance sheets as of December 31, 2007 and 2006 are set out on the consolidated financial statements

<sup>3</sup> Return on equity = net income for the year attributable to equity holders of the parent/total equity attributable to equity holders of the parent

<sup>4</sup> Dividend payout ratio = dividends paid by parent/prior year's net income attributable to equity holders of the parent

<sup>5</sup> Current ratio = current assets/current liabilities

<sup>6</sup> Long-term debt to equity = long-term debt (including current portion)/total equity attributable to equity holders of the parent

<sup>7</sup> The EPS computation for the years ended December 31, 2007 and 2006 are set out on the notes to the consolidated financial statements.

<sup>8</sup> Book value per share = total equity attributable to equity holders of the parent/no. of shares issued and subscribed

<sup>9</sup> Price-Earnings ratio = market value per share/basic earnings per share

## Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following management's discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the accompanying audited consolidated financial statements and the related notes as at December 31, 2007 and 2006 and for each of the two years in the period ended December 31, 2007 and 2006. This discussion includes forward-looking statements, which may include statements regarding future results of operations, financial condition or business prospects, which are subject to significant risks, uncertainties and other factors and are based on FPHC's current expectations, some of which are beyond FPHC's control and are difficult to predict. These statements involve risks and uncertainties and our actual results may differ materially from those anticipated in these forward-looking statements.

### OVERVIEW

The First Holdings Group's operating businesses are organized and managed separately according to the nature of the products and services, with each segment representing a strategic business unit that offers different products and serves different markets. The Group conducts the majority of its business activities in the following areas:

- Power generation and power-related activities – power generation subsidiaries under First Gen Corporation (First Gen), power distribution under First Philippine Union Fenosa Inc. (FPUFI) and our oil transporting company under First Philippine Industrial Corporation (FPIC).
- Roads and tollways operations – Subic Tipo Road and North Luzon Expressway under First Philippine Infrastructure, Inc. (FPII)
- Manufacturing – our manufacturing subsidiaries under First Philec.
- Others – investments holdings, construction subsidiaries under First Balfour Inc. (FBI), real estate development under First Philippine Industrial Park (FPIP), securities transfer services under Securities Transfer Services Inc. (STSI) and financing under First Philippine Lending Corp. (FPLC).

The table below shows the contribution of each of our business segments to our consolidated revenues, finance income, finance costs, benefit from (provision for) income tax and net income (loss). Our revenues are derived from our operations conducted in the Philippines.

| (in Millions)                               | Power Generation and Power-related Activities | Roads and Tollways Operations | Manufacturing | Others  | Eliminations | Effect of Early Adoption of IFRIC 12 | Consolidated |
|---------------------------------------------|-----------------------------------------------|-------------------------------|---------------|---------|--------------|--------------------------------------|--------------|
| <b>For the year ended December 31, 2007</b> |                                               |                               |               |         |              |                                      |              |
| Revenues                                    | ₱ 49,798                                      | ₱ 5,582                       | ₱ 2,429       | ₱ 2,748 | ₱ (40)       |                                      | ₱ 60,517     |
| Finance costs                               | (4,255)                                       | (975)                         | (9)           | (1,490) |              |                                      | (6,729)      |
| Finance Income                              | 1,535                                         | 115                           | 11            | 273     |              |                                      | 1,934        |
| Provision for (benefit from) income tax     | 1,006                                         | 138                           | 158           | 17      |              |                                      | 1,319        |
| Net income (loss)                           | 8,450                                         | 2,196                         | 335           | 575     | 124          |                                      | 11,680       |

| <b>For the year ended<br/>December 31, 2006</b> |          |         |         |          |          |      |          |
|-------------------------------------------------|----------|---------|---------|----------|----------|------|----------|
| Revenues                                        | ₱ 52,184 | ₱ 5,806 | ₱ 1,183 | ₱ 11,549 | ₱(7,604) | ₱617 | ₱ 63,735 |
| Finance costs                                   | (5,074)  | (1,419) | (3)     | (842)    |          |      | (7,338)  |
| Finance Income                                  | 2,686    | 199     | 1       | 395      |          |      | 3,281    |
| Provision for income tax                        | 1,134    | 68      | 22      | (4)      |          | 82   | 1,302    |
| Net income (loss)                               | 11,014   | 1,440   | 46      | 2,932    | 36       | 125  | 15,593   |

## **DECEMBER 31, 2007 COMPARED TO DECEMBER 31, 2006**

### **Financial Condition**

As of December 31, 2007, FPHC Group's audited consolidated assets totaled ₱239.5 billion. This is higher by 74%, or ₱102.0 billion, compared to the December 31, 2006 balance of ₱137.6 billion.

#### *Cash and cash equivalents decreased by 54%*

Cash consists of cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value. The decrease in cash and cash equivalents, by 54% or ₱17.4 billion, to ₱14.8 billion was primarily due to major acquisitions during the year: FPHC's increase in stake in Meralco and First Gen's 60% controlling interest in EDC.

#### *Trade and other receivables – net increased by 28%*

Trade receivables are non-interest bearing and are generally on 30 days' terms while other receivables comprise of the current portion of concession receivables pertaining to EDC, current portion of receivables from Meralco arising from FGPC and FGP's gas take-or-pay receivables, and receivables from employees, contractors and suppliers. Trade and other receivables increased by 28%, or ₱3.6 billion, to ₱16.3 billion due mainly to the recognition of EDC's trade and other receivables (net) amounting to ₱4.9 billion and current portion of EDC's concession receivable amounting to ₱2.2 billion in connection with its service contract agreement with the Philippine government for the exploration, development and exploitation of geothermal resources. This concession receivable stems from the early adoption of Philippine Interpretation IFRIC 12 (Service Concession Arrangements).

#### *Inventories – increased by 187%*

Inventories increased by 187%, or ₱3.4 billion, to ₱5.2 billion due to the additional purchase of liquid fuel, and the recognition of spare parts and supplies inventory of EDC.

#### *Other current assets increased by 115%*

This account includes, noncurrent assets held for sale, prepaid expenses, AFS and FVPL investments, share in current assets of joint venture and others. Other current assets increased by 115%, or ₱3.8 billion, to ₱7.1 billion due to the increase in AFS investments as well as the increase in current assets of FBI's joint venture with Makati Development Corporation in the construction of St. Luke's Hospital. The project was started last February 2007. The increase was, likewise, brought about by the recognition of the ₱1.7 billion parcels of land held for sale by EDC. On November 13, 2007, the BOD of EDC approved resolution whereby it has signed an

Agreement to sell such properties to PNOC. The sale is expected to be consummated within 12 months from December 31, 2007.

*Concession receivables increased by 100%*

Concession receivables of ₱34.7 billion refers to the noncurrent portion of EDC's receivables arising from its service contract agreement with the Philippine government.

*Investments at equity and deposits increased by 108%*

Investments at equity and deposits increased by 108%, or ₱19.9 billion, to ₱38.2 billion. In 2007, FPHC has started its acquisitions that raised its effective ownership in Meralco to 33.4%: FPHC purchased the 40% shares of Union Fenosa Inc. in First Philippine Union Fenosa (FPUF) last January 23, 2008 for approximately \$250 million, for which a deposit of \$220 million has been made as of year-end 2007. FPUFI has an effective 22.8% stake in Meralco. In a Deed of Sale executed last December 22, 2007, FPHC purchased an additional 6.6% stake in Meralco from Meralco Pension Fund for approximately ₱8.3 billion.

*Property, plant and equipment decreased by 9%*

Property, plant and equipment decreased by 9%, or ₱3.2 billion, to ₱33.0 billion due to foreign currency translation adjustments and depreciation and amortization during the year. The EDC acquisition, however, increased fixed assets by ₱1.1 billion.

The early adoption of Philippine Interpretation IFRIC 12 resulted in the reclassification of Roads and Tollways to intangible assets.

*Goodwill increased by 7031%*

Goodwill increased by 7031%, or ₱43.6 billion, to ₱44.2 billion due to the recognition of provisional goodwill amounting to \$1.1 billion arising from First Gen's acquisition of its 60% stake in EDC.

*Intangible assets and others increased by 41%*

This account includes: water rights from the Pantabangan reservoir for the generation of electricity, construction cost (pipeline rights) of the natural gas pipeline facility connecting the natural gas supplier's refinery to FGP's power plant including incidental transfer costs incurred in connection with the transfer of ownership of the pipeline facility to the natural gas supplier, and intangible assets recognized under the Service Concession Agreements. Intangible assets and others increased by 41%, or ₱7.7 billion, to ₱26.7 billion, due to the recognition of service concessions on EDC's Northern Negros Geothermal Powerplant Project (NNGP) amounting to ₱8.7 billion resulting from the early adoption of Philippine Interpretation IFRIC 12 (Service Concession Agreements). The intangible asset is being amortized over the term of the related Geothermal Service Contract of NNGP.

*Pension asset increased by 31%*

Pension assets increased by 31%, or ₱98 million, to ₱418 million as the actual contributions (including settlements) exceeded pension expense. The lump sum conversion of pension undertaken by FPHC in 2007 brought about an 11.3% reduction of its obligation.

*Deferred tax assets increased by 719%*

Deferred tax assets increased by 719%, or ₱6.1 billion, to ₱6.9 billion due to consolidation of EDC's deferred tax assets amounting to ₱6.8 billion consisting of the following major items: capitalized foreign exchange losses on BOT power plants, ₱4.3 billion; allowance for doubtful accounts, ₱1.2 billion; and, financial/intangible assets ₱439 million.

*Loans payable increased by 183580%*

Loans payable increased by 183580%, or ₱18.36 billion, to ₱18.4 billion. The increase pertains to foreign and local bridge loans availed of by First Gen to fund the acquisition of the 60% controlling stake in EDC. The loans are divided into \$287.5 million foreign bridge and \$141.9 million local bridge facilities. Also, on November 21, 2007, First Gen issued a promissory note to the order of the Development Bank of the Philippines for \$13.5 million payable within 180 days with interest payable monthly.

*Trade payables and other current liabilities increased by 18%*

Trade payables and other current liabilities increased by 18%, or ₱2.0 billion, to ₱12.8 billion. This account now includes accounts payable trade and others of EDC amounting to ₱3.6 billion. Also, accrued interest went up due to bridge loans availed of during the latter part of the year to fund the acquisition of EDC. The increase in trade payables and others was softened by, among others, the decrease in salaries & bonuses, construction costs, liabilities under trust receipts and liabilities to contractors and consultants.

*Income tax payable increased by 123%*

Income tax payable increased by 123%, or ₱337 million, to ₱611 million due to the recognition of EDC's current income tax payables. Moreover, FGPC's Income Tax Holiday expired in May 2007.

*Obligations to Gas Seller, including current portion, decreased by 40%*

Obligation to Gas Sellers totaled P2.7 billion, lower by 40% or ₱1.9 billion compared to the previous year. The decrease was due to payments made in accordance with the Payment Deferral Agreement (PDA) between First Gen and the Gas Sellers. The current portion amounted to ₱2.1 billion, while the non-current portion amounted to ₱0.7 billion.

*Deferred payment facility with PSALM, including current portion, decreased by 24%*

Deferred payment facility to PSALM amounted to ₱2.9 billion, of which current portion amounted to ₱353 million and the balance of ₱2.5 billion represents non-current portion. The amount stands for the obligation to Power Sector Assets and Liabilities Management Corporation (PSALM) under the Asset Purchase Agreement (APA) for the purchase of the 112 MW Pantabangan-Masiway Hydro Electric Power Plant payable in 14 semi-annual installments at 12% interest compounded annually. During the year, the amount of ₱355 million was paid reducing the obligation.

*Long-term debt, including current portion, increased by 132%*

Long-term debt, including current portion increased by 132%, or ₱55.8 billion, to ₱98.0 billion due to loan availments made by Red Vulcan amounting to \$705.1 million to finance its acquisition of EDC. Also increasing the debt balance are the existing loans of EDC amounting to \$551.6 million.

*Royalty fee payable, including current portion, increased by 100%*

This account pertains to the royalty fees due to the Department of Energy (DOE) and Local Government Units under the service contracts entered into by EDC with DOE. Royalty fee payable, including current portion, amounted to ₱1.7 billion as of December 31, 2007. The royalty fees are paid to the DOE based on an agreed payment schedule.

*Obligations to power plant contractors, including current portion, increased by 100%*

This account pertains to the balance of the obligations to the power plant contractors in connection with the construction of the geothermal power plants in some of EDC's geothermal service contract areas. The present value of obligations amounted to ₱343.0 million.



*Deferred tax liabilities increased by 89%*

Deferred tax liabilities increased by 89%, or ₱2.2 billion, to ₱4.8 billion due to consolidation of EDC's deferred tax liabilities amounting to ₱3.7 billion primarily pertaining to deductible expenses per PD No. 1442. The deferred tax liabilities was reduced by the extension of the ITH of FGP and expiration of the ITH of FGPC in May 2007. The expiration of FGPC's ITH resulted in the recognition of current income tax payable on the portion of income earned during the period.

*Retirement benefit liability increased by 393%*

Retirement benefit liability increased by 393%, or ₱994 million, to ₱1.2 billion. The increase pertains to the consolidation of EDC's liabilities in connection with its retirement and other post-retirement benefit plan. As of December 31, 2007, EDC's retirement and other post retirement liability amounted to ₱912.1 million.

*Other noncurrent liabilities increased by 45%*

Other noncurrent liabilities increased by 45%, or ₱1.3 billion, to ₱4.3 billion. The increase pertains to FBI's share in joint venture liabilities.

*Total equity attributable to equity holders of the Parent decreased by 8%*

Total equity attributable to equity holders of the Parent decreased by 8%, or ₱2.9 billion, to ₱33.6 billion. The decrease was brought about by the higher negative balance of the Cumulative translation adjustment (CTA), by 681%, or ₱6.5 billion, to ₱7.5 billion. Upon adoption of PAS 21, The Effects of Changes in Foreign Exchange Rates, the functional and presentation currency of the First Gen Group, FSRI, First Private Power Corp., and First Sumiden Circuits, Inc. was changed from Philippine peso to U.S. Dollar on a retroactive basis and prior year consolidated financial statements were restated. The capitalized foreign exchange differences arising from the U.S. Dollar-denominated obligations were eliminated in the translation process without negatively affecting the retained earnings. For the purposes of consolidating the accounts of First Gen to the First Holdings Group consolidated financial statements, the accounts of First Gen were translated to Philippine peso, which is the Parent Company's presentation currency. Any exchange differences from retranslation was taken directly as cumulative translation adjustments. The peso appreciation in effect brought about the negative CTA. Share in cumulative translation adjustment pertaining to FSCI, increased by 138%, or ₱11 million, to ₱19 million.

The net decrease was reduced by the increase in retained earnings by 12%, or ₱3.3 billion, to ₱31.4 billion, brought about by the net income during the period. Unrealized fair value gains on available-for-sale investments of FPHC and subsidiaries increased by 30%, or ₱6 million, to ₱26 million. Share in unrealized fair value gains on available-for-sale investments of an associate (Meralco) increased by 138%, or ₱11 million, to ₱19 million. The increase pertains to unrealized gains on AFS investments of the Group.

On November 23, 2007, the SEC approved the increase in authorized capital stock of FPHC from ₱12.1 billion, divided into 1,210,000,000 shares with par value of ₱10 a share to ₱32.1 billion, consisting of 1,210,000,000 common shares with par value of ₱10 a share and 200,000,000 preferred shares with par value of ₱100 a share. The total number of preferred shares is broken down as follows: 50,000,000 Series "A", 50,000,000 Series "B" and 100,000,000 unclassified preferred shares.

FGHC International, a wholly-owned Cayman Island-based subsidiary, First Philec and FPRC, both wholly-owned subsidiaries, executed Subscription Agreements on November 6, 2007 for 20,000,000, 15,000,000 and 15,000,000, Series "A" preferred shares, respectively. FGHC International subscribed and paid for ₱2.0 billion worth of shares while First Philec and FPRC have subscriptions for ₱1.5 billion each. The subscription of FGHC International is presented as a debit to the equity section of the 2007 consolidated balance sheet under the "Parent Company Preferred Stock Held by a Subsidiary" account.

*Minority interest increased by 86%*

Minority interest increased by 86%, or ₱24.5 billion, to ₱53.2 billion due to the increase in the portion of assets attributed to minority shareholders, primarily that of First Gen, EDC and FPII.

PFRS requires changes in the presentation of minority interests in the consolidated balance sheets and consolidated statements of income. Minority interest is now presented as a footnote in the Statement of income and as part of Equity in the consolidated financial statements.

## DECEMBER 31, 2007 COMPARED TO DECEMBER 31, 2006

### Results of Operations

#### Revenue

FPHC's consolidated revenues totaled ₱60.5 billion for the year ended December 31, 2007. This is lower by 5% (₱3.2 billion) compared to the previous year.

The following table sets out the contribution of each of the components of revenues as a percentage of the Company's total revenue for December 31, 2007 and 2006:

|                                 | For the year ended December 31        |             |                 |             | Increase (decrease) |            |
|---------------------------------|---------------------------------------|-------------|-----------------|-------------|---------------------|------------|
|                                 | 2007                                  |             | 2006            |             | Amount              | %          |
|                                 | (amounts in MM ₱, except percentages) |             |                 |             |                     |            |
| Sale of electricity             | ₱ 49,492                              | 82%         | ₱ 51,176        | 80%         | (₱ 1,684)           | -3%        |
| Toll operations                 | 5,491                                 | 9%          | 5,705           | 9%          | (214)               | -4%        |
| Contracts and services          | 2,043                                 | 3%          | 1,326           | 2%          | 717                 | 54%        |
| Equity in earnings of associate | 1,690                                 | 3%          | 4,163           | 7%          | (2,473)             | -59%       |
| Sale of merchandise             | 1,510                                 | 3%          | 1,184           | 2%          | 326                 | 28%        |
| Sale of real estate             | 291                                   | 0%          | 181             | 0%          | 110                 | 61%        |
| <b>Total</b>                    | <b>₱ 60,517</b>                       | <b>100%</b> | <b>₱ 63,735</b> | <b>100%</b> | <b>(₱ 3,218)</b>    | <b>-5%</b> |

The company's revenues comprise of:

#### *Sale of electricity*

Sale of electricity accounts for 82% of total revenue in 2007 and 80% in 2006. Revenue from sale of electricity went down by 3% (₱1.7 billion) to ₱49.5 billion from ₱51.2 billion in 2006, due to the strengthening of peso. In dollar terms (which is the functional currency of the power generation group), revenues rose by 5% (\$51.9 million) due to the following: full-year operation of Pantabangan-Masiway hydro-power facility. This facility was turned over to First Gen on November 18, 2006, thereby, contributing around 45 days' worth of revenues in 2006; revenues from sale of electricity of the newly-acquired EDC amounting to \$21.8 million; capacity charges for both Santa Rita and San Lorenzo also increased due to the implementation of one of the power augmentation initiatives, which improved the Net Dependable Capacity of both plants. The average NDC for Santa Rita and San Lorenzo reached 1,019 MW and 505 MW, respectively.

### *Toll operations*

Revenue from toll operations is derived from the use of the motoring public of the North Luzon Expressway (NLE) and Subic-Tipo Road. Revenue from toll operations is the second revenue driver, contributing 9% of total revenues in 2006 and in 2005. Revenues from toll operations went down by 4% (₱214 million) to ₱5.5 billion from ₱5.7 billion last year, inspite of the implemented toll rate reduction of about 11%. The pull-down effect of the toll rate reduction was mitigated by the 5% increase in average daily traffic to 146,819 vehicle entries.

### *Contracts and services*

Revenue from contracts and services is primarily derived from construction contracts, engineering projects and pipeline shipment of fuel and other petroleum products. Revenue from contracts and services accounts for 3% of total revenues in 2007 from 2% in 2006.

Revenues from contracts and services increased by 54% (₱717 million) to ₱2.0 billion, due mainly to construction projects of FBI and service contracts of First Philec.

### *Equity in net earnings of associates*

This represents the Company's share in the consolidated net income of, among others, Meralco, First Private Power Corporation, Rockwell Land Corporation and First Sumiden Circuits, Inc.

Equity in net earnings of associates declined by 59% (₱2.5 billion) to ₱1.7 billion. The decline was due to the lower income posted by Meralco: Meralco's net income amounted to ₱4.0 billion from ₱13.9 billion in 2006 due to absence of one time gains. Earnings in 2006 reflected the write-back of all provisions for probable losses booked between 2004 and 2006. The write-back followed the SC Decision upholding a regulatory order that allowed Meralco to raise charges through the unbundling of its tariffs.

### *Sale of Merchandise*

Revenue from sale of merchandise is derived from the sale of power and distribution transformers. Sale of merchandise contributed 3% to total revenues in 2007 and 2% in 2006. Sale of merchandise grew by 28% (₱326 million) to ₱1.5 billion from ₱1.2 billion in 2006, wherein sale of manufactured transformers leaped by 43%.

### *Sale of real estate*

Revenue from sale of real estate is derived from sale of industrial lots of First Philippine Industrial Park (FPIP) in Batangas. Sale of real estate contributed less than 1% to total revenues in 2007 and in 2006. Sale of real estate increased by 61% (₱110 million) to ₱291 million as a result of the increase in industrial lots sold by FPIP from 9.6 hectares 2006 against 13.7 hectares in 2007.

### **Costs and expenses**

FPHC's consolidated cost and expenses totaled ₱45.3 billion. This is lower by 4% (₱1.7 billion) compared to the previous year's ₱47.1 billion.

The following table sets out the contribution of each of the components of cost and expenses as a percentage of the Company's total cost and expenses for 2007 and 2006:

| For the year ended December 31        |                 |             |                 |             |                     |            |
|---------------------------------------|-----------------|-------------|-----------------|-------------|---------------------|------------|
|                                       | 2007            |             | 2006            |             | Increase (decrease) |            |
|                                       | Amount          | %           | Amount          | %           | Amount              | %          |
| (amounts in MM ₱, except percentages) |                 |             |                 |             |                     |            |
| Operations and maintenance            | ₱ 34,574        | 76%         | ₱ 38,610        | 82%         | ₱ (4,036)           | -10%       |
| Toll operations                       | 2,421           | 6%          | 2,438           | 5%          | (17)                | -1%        |
| Contracts and services                | 1,390           | 3%          | 831             | 2%          | 559                 | 67%        |
| Merchandise sold                      | 1,227           | 3%          | 978             | 2%          | 249                 | 25%        |
| Real estate sold                      | 135             | 0%          | 96              | 0%          | 39                  | 41%        |
| General and administrative expense    | 5,590           | 12%         | 4,128           | 9%          | 1,462               | 35%        |
| <b>Total</b>                          | <b>₱ 45,337</b> | <b>100%</b> | <b>₱ 47,081</b> | <b>100%</b> | <b>₱ (1,744)</b>    | <b>-4%</b> |

The Company's costs and expenses comprise of:

#### *Operations and maintenance*

Power plant operations and maintenance (O&M) expenses include fuel charges, pipeline charges, fixed and variable O&M charges, start-up costs and Net Dependable Capacity bonuses paid to Siemens Operations as O&M contractor for Santa Rita and San Lorenzo. Cost of power plant operations and maintenance accounts for 76% of total cost and expenses in 2007 and 82% in 2006.

Cost of power plant operations and maintenance decreased by 10% (₱4.0 billion) to ₱34.6 billion. Aside from the strengthening of the peso, the decrease in cost of power plant operations and maintenance was brought about by the lower fuel charges. Fuel charges in 2006 were comparatively higher as a result of the use of liquid fuel during the Malampaya outage, wherein liquid fuel used averaged at \$11.7/GJ, vis-à-vis \$8.54/GJ in 2007. Moreover, the gas plants were able to recover the banked gas totaling \$15.9 million given that both plants were able to consume the required take-or-pay quantity for 2007.

#### *Toll operations*

Cost of toll operations include service fees to Tollways Management Corporation, as O&M contractor for the NLE and Subic-Tipo Road, and amortization expense of the Roads and Tollways in operations. Cost of toll operations accounts for about 6% of total cost and expenses in 2007 and 5% in 2006. Cost of toll operations at ₱2.4 billion, was basically flat vis-à-vis last year (-1%).

### *Contracts and services*

Cost of contracts and services pertains to contract costs, which include all direct materials, labor costs and indirect costs related to contract performance. Provision for estimated losses on uncompleted contracts, likewise, form part of the cost of contracts and services. Such provision is recognized in the period in which the loss is determined. Cost of contracts and services accounts for 3% of total cost and expenses for 2007 and 2% in 2006. Cost of contracts and services increased by 67% (₱559 million) to ₱1.4 billion as a consequence of the increase in construction revenues of FBI.

### *Merchandise sold*

Cost of merchandise sold pertains to costs which are related to the manufacture of products. Cost of merchandise sold accounts for 3% of total cost and expenses in 2007 and 2% in 2006. Cost of merchandise sold increased by 25% (₱249 million) to ₱1.2 billion, due to the increase in manufacturing cost of Philec and Fedcor, as a consequence of the increase in revenues, as well as the general increase in cost of raw materials, particularly silicon steel and copper wires.

### *Real estate sold*

Cost of real estate sold is determined on the basis of the acquisition cost of the land plus its full development costs, which include estimates of costs for future development work. Cost of real estate sold accounts for less than 1% of total cost and expenses in 2007 and in 2006. Cost of real estate sold increased by 41% (₱39 million) to ₱135 million, due to higher lot area sold this year.

### *General and administrative expenses*

General and administrative expenses include depreciation and amortization, salaries and wages, taxes and license fees, insurance premiums and professional fees, repairs and maintenance, transportation and travel, rentals, and office supplies, among others. General and administrative expenses account for 12% of total cost and expenses in 2007 and 9% in 2006. General and administrative expenses increased by 35%, ₱1.5 billion, to ₱5.6 billion. The increased was primarily due to payment of documentary stamp taxes on loans and personnel expenses.

### **Finance costs**

Finance costs comprise principally of interest expense on debt facilities of the Parent (through the Special Purpose Vehicles), Power Generation and Roads & Tollways Subsidiaries. Finance costs decreased by 8% (₱609 million) to ₱6.7 billion from ₱7.3 billion year-ago level, inspite of the increase in loans. The lower interest cost was brought about by the prepayment of the Santa Rita loans in February 2007. Proceeds of the additional loans obtained by FPHC and First Gen were received during the latter part of 2007.

### **Construction revenue and construction costs**

Under PAS 11, Construction Contracts, contract revenue should be measured based on fair value of the consideration received or receivable. Since MNTC has subcontracted the construction to outside contractor, the construction revenues recognized is equal to the construction cost. Such construction revenue and its corresponding cost went down by 77% (₱173 million) to ₱52 million.

### **Finance Income**

Finance income decreased by 41%, ₱1.3 billion, to ₱1.9 billion due to lower cash balance during the period.

### **Foreign exchange gain (loss)**

Foreign exchange gain or loss arose primarily from the restatement of dollar-denominated transactions. Foreign exchange gain for the period increased by 232% (₱1.5 billion) to ₱2.2 billion, due to translation adjustments on foreign exchange transactions mainly pertaining to FPHC as the weighted average foreign exchange rate between Philippine peso and US dollar improved.

**A portion of earnings this period and prior year came from non-recurring gains: Gain on sale of investments in shares of stock and gain on dilution.**

### **Gain on sale of investment in shares of stock**

During the year, the Parent Company sold a total of 140,000 shares of its investments in SiRF Technology Holdings, Inc. (SiRF) realizing a gain of ₱44 million. This is, however, lower by 92% (₱491 million) compared to the previous year's gain of ₱535 million, wherein FPHC sold a total of 380,000 shares.

### **Gain on dilution**

On February 10, 2006, First Gen successfully completed the Initial Public Offering (Offering) of 180,910,900 common shares in the Philippines. The proceeds from the Offering amounted to ₱9.0 billion. The common shares of First Gen are now listed and traded on the First Board of the Philippine Stock Exchange. As a result of this Offering, the equity interest of FPHC in First Gen was reduced from 88.44% to 67.05% from which FPHC recognized a gain on dilution amounting to ₱2.7 billion.

### **Other income (net)**

Other income represents management fees and others (like rent, dividends and miscellaneous income). Other income decreased by 14% (₱62 million) to ₱392 million, mainly due to previous year's unrealized fair value gains on investment held for trading.

### **Income before income tax**

As a result of the foregoing, income before income tax contracted by 23% (₱3.9 billion) to ₱13.0 billion from ₱16.9 billion last year.

### **Provisions for (Benefit from) Income Tax**

The Group reported a provision for income tax of ₱1.3 billion for the year, almost flat vis-à-vis last year (+1%). Of the total provision, ₱1.7 million pertains to current provision for income tax, which registered an increase of 327% (₱1.3 billion) due mainly to the end of the income tax holiday of FGPC. Deferred benefit from income tax amounted to ₱416 million, a reversal of the previous year's ₱896 deferred provision for income tax. This resulted from the differences between the treatment of taxes under Functional Currency Reporting (FCR) which First Gen and its major subsidiaries adopted in 2005. While the financial statements are presented in US Dollars for financial reporting purposes, based on the latest BIR requirements, companies that have adopted the FCR are obliged to continue presenting their financial statements, preparing their tax returns, and computing and paying their tax liabilities in Philippine pesos.

### **Net income**

Net income decreased by 25% (₱3.9 billion) to ₱11.7 billion primarily due to previous year's non-recurring gains: gain from dilution of equity interest in First Gen and reversal of Meralco's provisions.

### **Net income attributable to Equity holders of the Parent**

Of the total net income, Net income attributable to Equity holders of the Parent amounted to ₱4.5 billion. This is lower by 49% (₱4.3 billion) compared to the previous year's ₱8.8 billion, for the same reasons cited above.

## Minority Interest

PFRS requires changes in the presentation of minority interests in the consolidated balance sheets and consolidated statements of income. Minority Interests is now presented as a footnote in the Statement of income and as part of Equity in the consolidated Balance Sheets.

Minority interest increased by 5% (₱0.4 billion) to ₱7.2 billion primarily due to the minority shareholders' share in EDC's net income.

## Earnings per share for Net income attributable to Equity holders of the Parent

Basic earnings per share is at ₱7.641, while Diluted earnings per share is at ₱7.541, both lower against the previous year by 50%. The decrease in EPS for the period was attributed to the lower net income.

## DECEMBER 31, 2006 COMPARED TO DECEMBER 31, 2005

### Results of Operations

#### Revenue

FPHC's consolidated revenues totaled ₱63.7 billion for the year ended December 31, 2006. This is higher by 16% (₱8.9 billion) compared to the previous year.

The following table sets out the contribution of each of the components of revenues as a percentage of the Company's total revenue for December 31, 2006 and 2005:

|                                  | For the year ended December 31        |             |                 |             | Increase (decrease) |            |
|----------------------------------|---------------------------------------|-------------|-----------------|-------------|---------------------|------------|
|                                  | 2006                                  |             | 2005            |             | Amount              | %          |
|                                  | (amounts in MM ₱, except percentages) |             |                 |             |                     |            |
| Sale of electricity              | ₱ 51,176                              | 80%         | ₱ 45,485        | 83%         | ₱ 5,691             | 13%        |
| Toll operations                  | 5,705                                 | 9%          | 5,104           | 9%          | 601                 | 12%        |
| Contracts and services           | 1,326                                 | 2%          | 1,402           | 3%          | (76)                | -5%        |
| Equity in earnings of associate  | 4,163                                 | 7%          | 1,568           | 2%          | 2,595               | 165%       |
| Sale of merchandise              | 1,184                                 | 2%          | 861             | 2%          | 323                 | 38%        |
| Revenue from sale of real estate | 181                                   | 0%          | 407             | 1%          | (226)               | -56%       |
| Total                            | <u>₱ 63,735</u>                       | <u>100%</u> | <u>₱ 54,827</u> | <u>100%</u> | <u>₱ 8,908</u>      | <u>16%</u> |

The company's revenues comprise of:

#### *Sale of electricity*

The Company's revenue from the sale of electricity is derived primarily from the sale of electricity to Meralco pursuant to the 25-year Power Purchase Agreements (PPAs) between Meralco and each of the generation subsidiaries. Under these terms of the PPAs, Meralco is obligated to take or pay 83% of Santa Rita's and San Lorenzo's respective Net Dependable Capacity (NDC). Moreover, the newly-acquired Pantabangan-Masiway hydropower facility was turned-over to First Gen on November 18, 2006, and started contributing revenue thereafter. Revenue from sale of electricity accounts for 80% of total revenues in 2006 and 83% in 2005.

Revenue from sale of electricity increased by 13% (₱5.7 billion) to ₱51.2 billion from ₱45.5 billion in 2005, due to the increase in average prices of natural gas (from \$6.82/GJ in 2005 to \$8.35/GJ in 2006 for Sta. Rita and from \$6.9/GJ to \$8.35/GJ for San Lorenzo), use of liquid fuel (resulting from the scheduled 27-day



maintenance outage of the Malampaya platform) and increase in fuel consumption (due to the slight increase in combined average dispatch levels for both plants). In addition, the Pantabangan-Masiway hydropower facility contributed \$13.1 million (₱672 million) in revenues.

#### *Toll operations*

Revenue from toll operations is derived from the use of the motoring public of the North Luzon Expressway (NLE) and Subic-Tipo Road. Revenue from toll operations is the second revenue driver, contributing 9% of total revenues in 2006 and in 2005. Revenues from toll operations improved by 12% (₱601 million) to ₱5.7 billion from ₱5.1 billion against last year. The increase was brought about by the increase during the year in the traffic volume for Class 1 & 2 in the open system and for Class 2 & 3 in closed system.

#### *Contracts and services*

Revenue from contracts and services is primarily derived from construction contracts, engineering projects and pipeline shipment of fuel and other petroleum products. Revenue from contracts and services accounts for 2% of total revenues in 2006 and 3% in 2005.

Revenues from contracts and services decreased by 5% (₱76 million) to ₱1.3 billion, due to the current period's lull in major construction projects for First Balfour Inc. (FBI) (wherein bulk of previous year's revenues pertains to The Manansala project). The decrease in revenues of FBI was mitigated by the higher revenues posted by First Philippine Industrial Corp. (FPIC) – as a result of the tariff increase.

#### *Equity in net earnings of associates*

This represents the Company's share in the consolidated net income of, among others, Meralco, First Private Power Corporation, Rockwell Land Corporation and First Sumiden Circuits, Inc.

Equity in net earnings of associates registered an increase of 165% (₱2.6 billion) to ₱4.2 billion from ₱1.6 billion last year. The increase was brought about by the higher income posted by the associates: (1) Meralco registered a net income (attributable to equity holders of the Parent) of ₱13.7 billion, a complete reversal from the previous year's ₱350 million net loss. The positive growth was mainly due to the reversal of all accumulated provision for probable losses from 2004 to 2006 amounting to ₱15.7 billion (₱10.2 billion net of tax) as a result of the en banc decision by the Supreme Court on December 6, 2006 setting aside an adverse Court of Appeals (CA) ruling on Meralco's tariff unbundling; (2) First Gen's BPPC earned a net income of \$24.9 million, up against the \$20.0 million income last year, and, (3) Rockwell Land's net income reached ₱369.3 million, up against the ₱288.5 million net income last year.

#### *Sale of Merchandise*

Revenue from sale of merchandise is derived from the sale of power and distribution transformers. Sale of merchandise contributed 2% to total revenues in 2006 and in 2005. Sale of merchandise grew by 38% (₱323 million) to ₱1.2 billion from ₱0.9 billion in 2005. Philec's revenues, at ₱1.0 billion, reached its highest level ever. The increase in customer base fueled the increase in sale of merchandise.

#### *Sale of real estate*

Revenue from sale of real estate is derived from sale of industrial lots of First Philippine Industrial Park (FPIP) in Batangas. Sale of real estate contributed less than 1% to total revenues for 2006 and 1% in 2005. Sale of real estate decreased by 56% (₱226 million) to ₱181 million due to lower sale of industrial lots in FPIP from 144,824 square meters in 2005 to only 96,592 in 2006.

#### **Costs and expenses**

FPHC's consolidated cost and expenses totaled ₱47.1 billion. This is higher by 14% (₱5.8 billion) compared to the previous year's ₱41.2 billion.

The following table sets out the contribution of each of the components of cost and expenses as a percentage of the Company's total cost and expenses for 2006 and 2005:

|                                    | For the year ended December 31        |             |                 |             | Increase (decrease) |            |
|------------------------------------|---------------------------------------|-------------|-----------------|-------------|---------------------|------------|
|                                    | 2006                                  |             | 2005            |             | Amount              | %          |
|                                    | (amounts in MM ₱, except percentages) |             |                 |             |                     |            |
| Operations and maintenance         | ₱ 38,610                              | 82%         | ₱ 32,682        | 79%         | ₱ 5,928             | 18%        |
| Toll operations                    | 2,438                                 | 5%          | 2,129           | 5%          | 309                 | 15%        |
| Contracts and services             | 831                                   | 2%          | 984             | 2%          | (153)               | -16%       |
| Merchandise sold                   | 978                                   | 2%          | 720             | 3%          | 258                 | 36%        |
| Real estate sold                   | 96                                    | 0%          | 176             | 1%          | (80)                | -45%       |
| General and administrative expense | 4,128                                 | 9%          | 4,553           | 11%         | (425)               | -9%        |
| <b>Total</b>                       | <b>₱ 47,081</b>                       | <b>100%</b> | <b>₱ 41,244</b> | <b>100%</b> | <b>₱ 5,837</b>      | <b>14%</b> |

The Company's costs and expenses comprise of:

#### *Operations and maintenance*

Power plant operations and maintenance (O&M) expenses include fuel charges, pipeline charges, fixed and variable O&M charges, start-up costs and Net Dependable Capacity bonuses paid to Siemens Operations as O&M contractor for Santa Rita and San Lorenzo. Cost of power plant operations and maintenance accounts for 82% of total cost and expenses in 2006 and 79% in 2005.

As an offshoot to the revenue increase, cost of power plant operations and maintenance increased by 18% (₱5.9 billion) to ₱38.6 billion in 2006. The increase in average prices of natural gas and use of liquid fuel brought about the increase in cost of power plant operations and maintenance.

#### *Toll operations*

Cost of toll operations include service fees to Tollways Management Corporation, as O&M contractor for the NLE and Subic-Tipo Road, and amortization expense of the Roads and Tollways in operations. Cost of toll operations accounts for 5% of total cost and expenses in 2006 and in 2005. Cost of toll operations at ₱2.4 billion is higher by 15% against the prior year due to higher revenues.

#### *Contracts and services*

Cost of contracts and services pertains to contract costs, which include all direct materials, labor costs and indirect costs related to contract performance. Provision for estimated losses on uncompleted contracts, likewise, form part of the cost of contracts and services. Such provision is recognized in the period in which the loss is determined. Cost of contracts and services accounts for 2% of total cost and expenses for 2006 and 2005. As a consequence of the decrease in revenues, cost of contracts and services decreased by 16% (₱153 million) to ₱831 million, again due to dearth in major construction projects for FBI.

#### *Cost of Merchandise sold*

Cost of merchandise sold pertains to costs which are related to the manufacture of products. Cost of merchandise sold accounts for 2% of total cost and expenses in 2006 and 2005. Cost of merchandise sold increased by 36% (₱258 million) to ₱978 million in 2006 from ₱720 million in 2005, due to the increase in manufacturing cost of Philec and Fedcor, as a consequence of the increase in revenues, as well as the general increase in cost of raw materials, particularly silicon steel and copper wires.

### *Cost of real estate sold*

Cost of real estate sold is determined on the basis of the acquisition cost of the land plus its full development costs, which include estimates of costs for future development work. Cost of real estate sold accounts for less than 1% of total cost and expenses in 2006 and about 1% in 2005. Cost of real estate sold decreased by 45% (₱80 million) to ₱96 million, again due to lower sales.

### *General and administrative expenses*

General and administrative expenses include depreciation and amortization, salaries and wages, taxes and license fees, insurance premiums and professional fees, repairs and maintenance, transportation and travel, rentals, and office supplies, among others. General and administrative expenses account for 9% of total cost and expenses in 2006 and 11% in 2005.

General and administrative expenses decreased by 9% (₱425 million) to ₱4.1 billion due to: among others, (1) previous year's one-time payment by FGP for income taxes assessed on liquidated damages received from Siemens amounting to \$1.9 million; (2) lower professional fees with the resolution of FGPC and FGP's disputes with Siemens and the gas sellers; and, (3) cancellation of excise taxes on natural gas effective November 2005.

### **Finance costs**

Finance costs comprise principally of interest expense on debt facilities of the Parent (through the Special Purpose Vehicles), Power Generation and Roads & Tollways Subsidiaries. Finance costs increased by 35% (₱1.9 billion) to ₱7.3 billion from ₱5.5 billion year-ago level. Aside from the annual interest on existing loans, the higher finance costs was brought about by: the \$27.3 million interest on Annual Deficiencies on gas take-or-pay obligations following the settlement of the dispute with the gas sellers; the full year effect of the interest on the \$5.0 billion bond issued in June 2005 by First Gen; and, the write-off of previously deferred debt issuance costs amounting to \$3.9 million related to the undrawn KfW facility of FGPC and ₱350 million related to the refinancing transaction of MNTC. The KfW facility was cancelled on March 2006 following the Settlement Agreement between FGPC and Siemens, while the partial prepayment and restructuring of MNTC's US Dollar-denominated long-term debt (using proceeds of a ₱5.5 billion FXCN issue) was entered into on November 8, 2006.

### **Construction revenue and construction costs**

Under PAS 11, Construction Contracts, contract revenue should be measured based on fair value of the consideration received or receivable. Since MNTC has subcontracted the construction to outside contractor, the construction revenues recognized is equal to the construction cost. Such construction revenue and its corresponding cost went down by 86% (₱1.3 billion million) to ₱225 million.

### **Finance income**

Finance income represents interest on the Group's cash balances. Finance income increased by 202% (₱2.2 billion) to ₱3.3 billion due to higher average balance of cash and cash equivalents of First Gen (resulting from the proceeds of its IPO and Settlement Agreement with Siemens) and cash flow from operations of MNTC.

### **Foreign exchange gain (loss)**

Foreign exchange gain or loss arose primarily from the restatement of dollar-denominated transactions. Foreign exchange gain for the period rose by 9% (₱52 million) to ₱656 million, due to translation adjustments

on foreign exchange transactions mainly pertaining to FPIDC as the weighted average foreign exchange rate between Philippine peso and US dollar improved (US\$1:Php 51.3289 from US\$1:Php 55.0851 last year).

**A portion of earnings this period and prior year came from non-recurring gains: Gain on sale of investments in shares of stock and gain on dilution.**

#### **Gain on sale of investment in shares of stock**

During the year, the Parent Company sold a total of 380,000 shares of its investments in SiRF Technology Holdings, Inc. (SiRF) realizing a gain of ₱535 million. This is, however, lower by 10% (₱59 million) compared to the previous year's gain of ₱594 million, wherein FPHC sold a total of 464,631 shares.

#### **Gain on dilution**

On February 10, 2006, First Gen successfully completed the Initial Public Offering (Offering) of 180,910,900 common shares in the Philippines. The proceeds from the Offering amounted to ₱9.0 billion. The common shares of First Gen are now listed and traded on the First Board of the Philippine Stock Exchange. As a result of this Offering, the equity interest of FPHC in First Gen was reduced from 88.44% to 67.05% from which FPHC recognized a gain on dilution amounting to ₱2.7 billion. FPHC's equity interest in First Gen as of December 31, 2006 is at 66.78%.

#### **Other income**

Other income represents management fees and others (like rent, dividends and miscellaneous income). Other income decreased by 17% (₱92 million) to ₱454 million, due primarily to the decrease in annual management fees that First Gen receives from BPPC. The decrease resulted from the negotiated terms and conditions of the Management Contract between First Gen and BPPC. The new contract took effect on January 1, 2006 and valid until July 2010.

#### **Income before income tax**

As a result of the foregoing, income before income tax grew by 54% (₱5.9 billion) to ₱16.9 billion from ₱11.0 billion in 2005.

#### **Provisions for (Benefit from) Income Tax**

The Group reported a provision for income tax of ₱1.3 billion for the year, significantly higher (by 429% or ₱1.1 billion) compared to last year. Of the total provision, ₱406 million pertains to current provision for income tax, which registered an increase of 184% (₱263 million) due to the increase in the taxable income as well as the income tax rate from 32% to 35%. Deferred provision for income tax amounted to ₱896 million higher by 770% (₱793 million) against last year. The higher provision resulted from the differences between the treatment of taxes under Functional Currency Reporting (FCR) which First Gen and its major subsidiaries adopted in 2005. While the financial statements are presented in US Dollars for financial reporting purposes, based on the latest BIR requirements, companies that have adopted the FCR are obliged to continue presenting their financial statements, preparing their tax returns, and computing and paying their tax liabilities in Philippine pesos.

#### **Net income**

Net income increased by 46% (₱4.9 billion) to ₱15.6 billion, primarily due to improvement in earnings of our subsidiaries (mainly, First Gen) and associates (particularly Meralco) and gains from dilution of our equity interest in First Gen.

### **Net income attributable to Equity holders of the Parent**

Of the total net income, Net income attributable to Equity holders of the Parent amounted to ₱8.8 billion. This is higher by 59% (₱3.2 billion) compared to the previous year's ₱5.5 billion, for the same reasons cited above.

### **Minority Interest**

PFRS requires changes in the presentation of minority interests in the consolidated balance sheets and consolidated statements of income. Minority Interests is now presented as a footnote in the Statement of income and as part of Equity in the consolidated Balance Sheets.

Minority interest increased by 32% (₱1.6 billion) to ₱6.8 billion in 2006 from ₱5.2 billion in 2005 primarily due to the dilution of our shareholdings in First Gen. Minority interest in First Gen represents around 33% of its total outstanding capital stock.

### **Earnings per share for Net income attributable to Equity holders of the Parent**

Basic earnings per share is at ₱15.243, while Diluted earnings per share is at ₱15.079. These represents an increase of 54% and 55%, respectively. The increase in EPS for the period was attributed to the significant growth in the bottom line, again due to the improvement in the earnings of our subsidiaries and associates, as well as from the gain from dilution of our equity interest in First Gen.

## PART III – CONTROL AND COMPENSATION INFORMATION

### Item 9. Directors and Executive Officers of the Registrant

#### Board of Directors

AUGUSTO ALMEDA-LOPEZ  
CESAR B. BAUTISTA  
THELMO Y. CUNANAN  
JOSE P. DE JESUS  
PETER D. GARRUCHO, JR.  
OSCAR J. HILADO  
ELPIDIO L. IBAÑEZ  
EUGENIO L. LOPEZ III  
FEDERICO R. LOPEZ  
MANUEL M. LOPEZ  
OSCAR M. LOPEZ  
ARTEMIO V. PANGANIBAN  
VICENTE T. PATERNO  
ERNESTO B. RUFINO, JR.  
WASHINGTON Z. SYCIP

#### Executive/Corporate Officers

|                                    |   |                                                                          |
|------------------------------------|---|--------------------------------------------------------------------------|
| Mr. Oscar M. Lopez                 | - | Chairman of the Board & Chief Exec. Officer                              |
| Mr. Augusto Almeda-Lopez           | - | Vice Chairman of the Board                                               |
| Mr. Elpidio L. Ibañez              | - | President & Chief Operating Officer                                      |
| Mr. Francis Giles B. Puno          | - | Senior Vice Pres., Treasurer & Chief Finance Officer                     |
| Mr. Federico R. Lopez              | - | Managing Director for Energy, Senior Vice<br>President & Asst. Treasurer |
| Mr. Arthur A. De Guia              | - | Managing Director for Manufacturing &<br>Portfolio Investments Group     |
| Mr. Fiorello R. Estuar             | - | Head of Infrastructure Business Development                              |
| Mr. Benjamin K. Liboro             | - | Senior Vice President                                                    |
| Mr. Danilo C. Lachica              | - | Senior Vice President                                                    |
| Mr. Richard B. Tantoco             | - | Senior Vice President                                                    |
| Ms. Perla R. Catahan               | - | Vice President & Comptroller                                             |
| Mr. Ramon T. Pagdagdagan           | - | Vice President & Internal Auditor                                        |
| Mr. Anthony M. Mabasa              | - | Vice President                                                           |
| Mr. Leonides U. Garde              | - | Vice President                                                           |
| Mr. Ricardo B. Yatco               | - | Vice President                                                           |
| Mr. Hector Y. Dimacali             | - | Vice President                                                           |
| Mr. Victor Emmanuel B. Santos, Jr. | - | Vice President                                                           |
| Mr. Oscar R. Lopez, Jr.            | - | Vice President                                                           |
| Mr. Robert C. Chan                 | - | Vice President                                                           |
| Mr. Rodrigo E. Franco              | - | Vice President                                                           |
| Mr. Benjamin R. Lopez              | - | Vice President                                                           |
| Mr. Ariel C. Ong                   | - | Vice President                                                           |
| Ms. Elizabeth M. Canlas            | - | Vice President                                                           |
| Mr. Enrique I. Quiason             | - | Corporate Secretary & Compliance Officer                                 |
| Mr. Rodolfo R. Waga, Jr.           | - | Vice President, Asst. Corp. Secretary &<br>Asst. Compliance Officer      |

### **Independent Directors**

**Amb. Cesar B. Bautista**  
**Mr. Oscar J. Hilado**  
**Chief Justice Artemio V. Panganiban**  
**Mr. Vicente T. Paterno**  
**Mr. Washington SyCip**

Directors and executive/corporate officers hold office for a period of one (1) year and until such time when their successors are elected and have qualified.

### **BOARD OF DIRECTORS**

**OSCAR M. LOPEZ**  
77 Years Old, Filipino

Oscar M. Lopez has been Chairman and Chief Executive Officer of the Company since 1986. He is the Chairman of the Executive Committee, Nomination and Election Committee, Investment and Finance Committee, and the Compensation and Remuneration Committee of the Company. Mr. Lopez is the Chairman of the Board of Directors of Benpres, Lopez, Inc., First Gen, MNTC, TMC, First Balfour, First Philec, FPIC, FPIDC, FPII, FPIP, and FSCI, among others. Before joining the Company, he was the President of Benpres from 1973 to 1986. He studied at the Harvard College and graduated cum laude (Bachelor of Arts) in 1951. He finished his Masters of Public Administration at the Littauer School of Public Administration, also at Harvard in 1955. He has been part of the Lopez group in a directorship and executive capacity for the last five (5) years. Mr. Lopez is likewise a director in ABS-CBN Broadcasting Corporation ("ABS-CBN").

**AUGUSTO ALMEDA-LOPEZ**  
79 Years Old, Filipino

Augusto Almeda-Lopez has been a Director of the Company since 1986 and Vice-Chairman since 1993. He is a member of the Company's Executive Committee and Chairman of the Chairman's Compensation and Remuneration Committee. Mr. Almeda-Lopez is also the Chairman of the Board of ADTEL, Inc. and ACRIS Corporation, Vice Chairman of ABS-CBN and a Director of FPIC, FEDCOR, Philec, Bayantel, Skyvision Corp., Radio Communications of the Phils., Inc. and a Trustee of ABS-CBN Foundation, Inc. He graduated with an Associate in Arts degree from Ateneo de Manila and a Bachelor of Laws degree from the University of the Philippines. He placed fourth in the 1952 Bar Exams. He has been part of the Lopez group in a directorship and executive capacity for the last five (5) years.

**THELMO Y. CUNANAN**  
69 Years Old, Filipino

Thelmo Y. Cunanan has been a Director of the Company since October 2004. He is also a member of the Investment and Finance Committee of the Company. Mr. Cunanan is a retired Lieutenant General of the Armed Forces of the Philippines. He was an Ambassador Extraordinary & Plenipotentiary to the Royal Kingdom of Cambodia and served as the President & CEO of the Philippine National Oil Company ("PNOC"). He is currently the Chairman of the Social Security System. He graduated with a Bachelor of Science degree in Military Art & Engineering from the Philippine Military Academy in 1957 and the U.S. Military Academy in 1961. He finished his Masters in Business Administration at the University of the Philippines. He has been part of the Lopez group in a directorship and executive capacity within the last five (5) years. He is likewise a director of the Union

Bank of the Philippines.

**JOSE P. DE JESUS**  
73 Years Old, Filipino

Jose P. De Jesus sits as member of the Investment and Finance Committee. He is also the President & Chief Executive Officer of MNTC since 2000. Mr. De Jesus was Executive Vice President of Philippine Long Distance Telephone Co. from 1993 to 1999 and Chairman of the Manila Waterworks & Sewerage System from 1992 to 1993. He was Secretary of the Department of Public Works & Highways from January 1990 up to February 1993. He graduated with an AB Economics degree and Master of Arts in Social Psychology from the Ateneo de Manila University. He pursued his Graduate Studies in Human Development at the University of Chicago in 1968. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**PETER D. GARRUCHO, JR.**  
63 Years Old, Filipino

Peter D. Garrucho, Jr. was the Managing Director of the Company from 1994 to 2008. He has been a member of the Board for the same period. He is a member of the Audit Committee and Investment and Finance Committee. Mr. Garrucho was former Vice Chairman & Chief Executive Officer of First Gen, and the First Gas companies. He was also formerly Secretary of the Department of Trade & Industry (1991-1992) and of the Department of Tourism (1989-1990). He has likewise served as Executive Secretary & Adviser on Energy Affairs in the Office of the President of the Philippines in 1992. Prior to joining government in June 1989, he was President of C.C. Unson Co., Inc., which he joined in 1981 after serving as a Full Professor at the Asian Institute of Management. He has an AB-BSBA degree from De La Salle University (1966) and an MBA degree from Stanford University (1971). He has been part of the Lopez group in an executive capacity for the last five (5) years. Mr. Garrucho is likewise a director of ABS-CBN.

**OSCAR J. HILADO**  
Independent Director  
70 Years Old, Filipino

Oscar J. Hilado has been a Director of the Company since 1996. He sits as Chairman of the Audit Committee and a member of the Nomination and Election Committee. Mr. Hilado is the Chairman and Chief Executive Officer of the Philippine Investment Management ("PHINMA"), Inc. He is also the President of Union Cement Corp. and Atlas Cement Corp. He is currently Chairman of the Board of Bacnotan Consolidated Industries, Inc., Union Cement Corp., Phinma Property Holdings Corp. and Microtel Development Corp., among others, and Vice Chairman of Trans Asia Oil & Energy Development Corp., Trans Asia Power Generation Corp., Bacnotan Steel Industries, Inc. and Bacnotan Industrial Park Corp. He graduated with Highest Honors and with a Gold Medal for General Excellence and a Bachelor of Science in Commerce Degree from De La Salle College (Bacolod). He pursued his Degree of Masters in Business Administration at the Harvard Graduate School of Business Administration from 1960-1962. Mr. Hilado is a Certified Public Accountant. He has been part of the Lopez group in a directorship capacity within the last five (5) years. Mr. Hilado is likewise an independent director of A. Soriano Corporation.



**ELPIDIO L. IBAÑEZ**  
57 Years Old, Filipino

Elpidio L. Ibañez has been a Director of the Company since 1988 and was promoted to the position President & Chief Operating Officer in May 1994, a position which he holds up to the present. He was an Executive Vice President from 1987 to 1994. He was Vice President from 1985 to 1987. Mr. Ibañez is the Chairman of the Board of Trustees of the Retirement Fund and the Employee Stock Purchase Plan Board of Administrators as well as member of the Executive Committee and Chairman's Compensation Committee. He is Chairman of the Board of First Batangas Hotel Corporation and the President of FPUF. He is also a Director of various FPHC subsidiaries and affiliates such as First Balfour, First Philec, FPIC, FPIDC, FPIP, MNTC, Philec and STSI. He graduated with an AB Economics Degree from Ateneo de Manila University. He pursued his MBA at the University of the Philippines in 1975. He has been part of the Lopez group in an executive capacity for the last five (5) years. Mr. Ibañez is likewise a director in First Gen and City Resources.

**EUGENIO LOPEZ III**  
55 Years Old, Filipino

Eugenio L. Lopez III is a director and member of the Investment and Finance Committee. He is also the Chairman of the Board of ABS-CBN and has held this position since December 10, 1997. He joined ABS-CBN in 1986 as Finance Director before he became General Manager in 1988 and thereafter President in 1993. He worked as General Manager of the MIS group, Crocker National Bank in San Francisco, USA. Mr. Lopez is a recipient of various Philippine broadcasting industry awards. Mr. Lopez served as Director of ABS-CBN from 1986 to 1997 and as Chairman and Chief Executive Officer since 1997. He graduated with a Bachelor of Arts degree in Political Science from Bowdoin College and has a Masters degree in Business Administration from Harvard Business School. He has been part of the Lopez group in a directorship capacity within the last five (5) years.

**FEDERICO R. LOPEZ**  
46 Years Old, Filipino

Federico R. Lopez was promoted to Senior Vice President last December 2007. He was appointed Managing Director for Energy in February 2008. He also sits as member of the Company's Investment and Finance Committee. He has been a Vice President and Assistant Treasurer of the Company since 1993. He is the President & Chief Executive Officer of First Gen and sits on the board of First Gen's various subsidiaries. He is currently the President of First Philippine Conservation, Inc. He is also a member of the Board of Directors of various subsidiaries such as First Balfour, FEDCOR, FPIC, MNTC, Philec, FGRI, ABS-CBN and BPPC. He was an Assistant Vice President from October 1, 1990 to February 2, 1994. He graduated with a Bachelor of Arts Degree with a Double Major in Economics & International Relations (Cum Laude) from the University of Pennsylvania in 1983. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**MANUEL M. LOPEZ**  
65 Years Old, Filipino

Manuel M. Lopez has been a Director of the Company since 1992. Mr. Lopez is the Chairman & Chief Executive Officer of Meralco. He is also the Chairman of Rockwell and the Philippine Commercial Capital, Inc. He is also a Director of ABS-CBN, Benpres, FPPC and Inaec Development Corp. He was an Executive Vice President of Benpres from 1973 to 1986 and of AFISCO Insurance Corp. from 1975 to 1982. He graduated with a Bachelor of Science Degree in Business Administration from the University of the East in 1967. He

has been part of the Lopez group in an executive and directorship capacity for the last five (5) years.

**VICENTE T. PATERNO**

Independent Director  
82 Years Old, Filipino

Vicente T. Paterno has been a Director of the Company since 1993. Mr. Paterno is a member of the Nomination and Election Committee, the Compensation and Remuneration Committee and Chairman's Compensation and Remuneration Committee. He is the Founding Chairman of Philippine Seven Corp. since 1982 and the Chairman of Phil-Seven Holdings Corp. since 2000. He served as a Senator from July 1987 to June 1992 and Chairman of the Committee on Economic Affairs. He likewise served as Deputy Executive Secretary for Energy, Office of the President, from April 1986 to February 1987. He was Chairman and President of the PNOC from March 1986 to February 1987 and served as Minister of Public Highways in July 1979 until he resigned in November 1980. He graduated with a Bachelor of Science in Mechanical Engineering Degree from the University of the Philippines and pursued his Master of Business Administration (with Distinction) at the Harvard University. He has been part of the Lopez group in a directorship capacity within the last five (5) years. Mr. Paterno is likewise an independent director of both Benpres and First Philippine Infrastructure, Inc.

**ERNESTO B. RUFINO, JR.**

66 Years Old, Filipino

Ernesto B. Rufino, Jr. was the Chief Finance Officer/Treasurer, and a Senior Vice President of the Company until his retirement in 2007. He sits as member of the newly constituted Risk Management Committee. He is also the Chairman & Chief Executive Officer of Health Maintenance, Inc. and the President of STSI. He was a Director of the Company from 1986 until 2001. He was re-elected Director of the Company on January 30, 2003 and has occupied that position since then. He is also the Chairman & President of Zyloid Management, Inc. and a Director of First Balfour, First Philec, FPIP, FPUF, Inaac Development Corp., Philec, and Trust International Paper Corp. Before joining the Company, he served as the President of Merchants Investments Corp. and Chairman & CEO of Mever Films, Inc. He has an AB, BSBA degree from De La Salle University and an MBA degree from Harvard University. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**WASHINGTON Z. SYCIP**

Independent Director  
86 Years Old, American

Washington Z. Sycip has been a Director since 1997. Mr. Sycip also sits as member of the Company's Audit Committee, Nomination and Election Committee, and the Compensation and Remuneration Committee. Mr. Sycip is the Founder of the SGV group, auditors and management consultants, with operations throughout East Asia, and advisor to Arthur Andersen. He is the Chairman of the Board of Trustees and Board of Governors of the Asian Institute of Management. He was Chairman of the Euro-Asia Centre, INSEAD Fountainbleau from 1981 to 1988 and President of the International Federation of Accountants from 1982 to 1985. He graduated with a Bachelor of Science in Commerce degree (Summa Cum Laude) and a Master of Science in Commerce degree (Meritissimus) from the University of Santo Tomas, Philippines. He pursued his Master of Science in Commerce at Columbia University, New York and was admitted to the Beta Gamma Sigma, Honorary Business Society. He has been part of the Lopez group in a directorship capacity within the last five (5) years. Mr. Sycip is likewise Chairman of MacroAsia Corporation and an independent director of Benpres, Meralco, Belle

Corporation and Highlands Prime, Inc.

**CESAR B. BAUTISTA**

Independent Director

70 Years Old, Filipino

Cesar B. Bautista is a member of the Risk Management Committee. He was an Ambassador Extraordinary & Plenipotentiary to the United Kingdom of Great Britain and Northern Island, Republic of Ireland and Republic of Iceland. He was a Permanent Representative to the United Nations International Maritime Organization and a Special Presidential Envoy to Europe. Ambassador Bautista served as Secretary of the Department of Trade and Industry for five years. He served as Chairman of the Board of Investments, Export Development Council, Industry and Development Council, WTO/AFTA Advisory Commission, the National Development Corp., the Presidential Committee on National Museum Development and Cabinet Committee on Tariff and Related Matters, Economic Growth Areas/Zones, etc. He was President and Chairman of Philippine Refining Company Inc.-Unilever for eight years. He graduated with a degree in Bachelor of Science in Chemical Engineering from the University of the Philippines and pursued his Master's Degree in Chemical Engineering at the Ohio State University. His business experience for the last five (5) years includes the positions held above. Mr. Bautista is likewise an independent director of Asian Terminals, Inc., ABS-CBN and First Philippine Infrastructure, Inc. He assumed office as a director of FPHC last June 29, 2007.

**ARTEMIO V. PANGANIBAN**

Independent Director

71 Years Old, Filipino

Artemio V. Panganiban was the Chief Justice of the Philippines from 2005 to 2006. He was Justice of the Supreme Court from 1995 to 2005. He is a columnist of the Philippine Daily Inquirer, and acts as Adviser, Consultant or Independent Director of several business, civic, non-government and religious groups. He graduated in Associate in Arts with Highest Honors from the Far Eastern University in 1956 and was the Most Outstanding Student in 1960. He was 6th placer in the 1960 Bar Examinations with a grade of 89.55 percent. Chief Justice Panganiban is also an independent director of GMA Network, Inc. He assumed office as an independent director of FPHC last July 5, 2007 and is Chairman of the Risk Management Committee.

**KEY EXECUTIVE OFFICERS**

**ARTHUR A. DE GUIA**

55 Years Old, Filipino

Arthur A. de Guia has been the Managing Director for Manufacturing and Portfolio Investments since he joined the Company in June 1997. He is currently the President of First Philec and FSRI. He is also a member of the Board of Directors of various FPHC subsidiaries and affiliates. He worked as a Manufacturing Director for the Malaysian Operations of Colgate-Palmolive Company from 1994 to 1997. He graduated Cum Laude with a Bachelor of Science in Electrical Engineering degree from the Mapua Institute of Technology in 1973. He pursued his Master of Engineering in Industrial Management degree at the Asian Institute of Technology (Thailand) from 1974 to 1975 and his Doctor of Engineering in Industrial Engineering degree from the University of California (Berkeley) from 1979 to 1983. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**FIORIELLO R. ESTUAR**  
69 Years Old, Filipino

Fiorello R. Estuar is the Head of the Infrastructure Business Development of FPHC. He has been the Vice Chairman and Chief Executive Officer of First Balfour since November 2006. He was President of Maynilad Water Services from 2004 up to June 2007. He also served as President of First Philippine Balfour Beatty, Inc. from 2001 to 2004, and as a Board Member of Security Land Corporation from 2004 to 2006. He was Head of Agency of four major government agencies, namely, NIA, PNCC, ESF and DPWH from 1980 to 1991. He earned his PhD degree in Civil Engineering at the age of 27 while serving as a faculty and research staff at Lehigh University USA from 1960 to 1965. He was also a faculty member at the U.P. Graduate School of Engineering from 1968 to 1970. He has been part of the Lopez group in an executive capacity within the last five (5) years.

**BENJAMIN K. LIBORO**  
57 Years Old, Filipino

Benjamin K. Liboro has been a Senior Vice President since 2005 and was a Vice President of the Company since 1987. He is currently a Director of First Philec, First Philippine Lending Corp., Philec, Sibulan Ice Plant & Cold Storage, Inc. and Delbros, Inc. He was an Assistant Vice President from 1981 to 1986. He finished his Bachelor of Arts in Economics degree from the Ateneo de Manila University in October 1971 and pursued his Master of Science in Business Administration degree at the University of London in June 1975. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**DANILO C. LACHICA**  
53 Years Old, American

Danilo C. Lachica has been a Senior Vice President of the Company since July 2005. He was a Vice President from May 1999 until June 2005. He was President of FSCI October 1, 2007. He is a Director & Managing Director for Electronics of First Philec, Philec and FEDCOR. He is currently President of First Philec Solar Corporation. He graduated with a B.S. in Electrical Engineering degree from the University of the Philippines and pursued his M.B.A. at the San Jose State University, San Jose, California, U.S.A. He is currently taking up his D.B.A. degree at De La Salle University. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**RICHARD B. TANTOCO**  
41 Years Old, Filipino

Richard B. Tantoco was promoted to Senior Vice President last December 2007. He has been a Vice President of the Company since May 1997. He is currently Executive Vice President and Chief Operating Officer of First Gen. He is also a director and officer of First Gen subsidiaries and affiliates. Prior to joining FPHC, he worked as a Brand Manager with Procter and Gamble Philippines and as a member of the consulting firm Booz Allen and Hamilton, Inc. based in New York. He has a BS in Business Management degree from the Ateneo de Manila University where he graduated with honors and an MBA in Finance from the Wharton School of Business of the University of Pennsylvania. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**FRANCIS GILES B. PUNO**  
43 Years Old, Filipino

Francis Giles B. Puno was appointed Chief Finance Officer and Treasurer of FPHC in October 2007, and was promoted to Senior Vice

President in December 2007. He was Vice President since he joined the Company in June 1997. He is currently Executive Vice President & Chief Finance Officer of First Gen. He is also a director and officer of the First Gen subsidiaries and affiliates. Before joining FPHC, he worked with The Chase Manhattan Bank as Vice President for Global Power. He has a Bachelor of Science degree in Business Management from the Ateneo de Manila University and a Master of Management degree from Northwestern University's Kellogg Graduate School of Management. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**PERLA R. CATAHAN**  
54 Years Old, Filipino

Perla R. Catahan has been a Vice President and Comptroller of the Company since 1994. She is a Director of First Philec, Philec and STSI. She is also the comptroller of various FPHC subsidiaries. She was an Assistant Vice President of the Comptrollership group from 1986 to 1994. She graduated Magna Cum Laude with a Bachelor of Science in Commerce (Major in Accounting) degree from the Philippine College of Commerce in 1974 and pursued her Master in Business Management degree at the Asian Institute of Management in 1983. She has been part of the Lopez group in an executive capacity for the last five (5) years.

**ANTHONY M. MABASA**  
48 Years Old, Filipino

Anthony M. Mabasa has been a Vice President of the Company since 1994. He is currently the President of TMC and a Director of FEDCOR. He was President of FPIC from 2000 to 2003, an Executive Vice President of First Balfour from 1998 to 1999 and President & Chief Operating Officer of ECCO-Asia from August 1994 to October 1999. He earned a degree in Bachelor of Science in Commerce Major in Management of Financial Institutions from the De La Salle University in 1979. He pursued his Master in Business Administration degree at the University of the Philippines in 1994. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**LEONIDES U. GARDE**  
50 Years Old, Filipino

Leonides U. Garde has been a Vice President of the Company since 1994. He was an Assistant Vice President from 1991 to 1993. He is currently the President & Chief Operating Officer of First Philec and a Director of Philec. He earned a degree in BSME from the University of the Philippines in 1979 and pursued his MBA at the Ateneo Graduate School of Business from 1981 to 1984. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**RICARDO B. YATCO**  
53 Years Old, Filipino

Ricardo B. Yatco has been a Vice President of the Company since 1996. He is currently the President of FGRI. Prior to this posting, he was a Vice President of FPIC. He earned a degree in BS Industrial Management Engineering from the De La Salle University from 1972 to 1977 and pursued his MBA at the University of San Francisco from 1980 to 1982. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**HECTOR Y. DIMACALI**  
57 Years Old, Filipino

Hector Y. Dimacali has been a Vice President of the Company since April 1997. He is currently the President of FPIP. He was also a Director and President of FSRI in 1997. He is also a Director of First Philec and First Batangas Hotel Corp. He was an Assistant Vice

President from December 1994 to March 31, 1997. He earned a degree in B.S.E.E. from the University of the Philippines in 1973. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**VICTOR EMMANUEL B. SANTOS, JR.**  
40 Years Old, Filipino

Victor Emmanuel B. Santos, Jr. has been Vice President since March 30, 2001. He is currently Vice President and Compliance Officer of First Gen and Vice President of FGP. Before joining FPHC, he worked as Director for Global Markets at Enron Singapore. He earned his MBA in Finance at Fordham University, New York in 1995. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**OSCAR R. LOPEZ, JR.**  
49 Years Old, Filipino

Oscar R. Lopez, Jr. has been Vice President since May 2001. He is currently the Head of the Administration Department of FPHC. He is currently the President of INAEC Development Corp. and First Philippine Development Corp. and is a Director of First Philec. He has been with the Company since October 1996. He went to college at the De La Salle University and attended the EMBA Program of the Asian Institute of Management. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**ROBERT C. CHAN**  
60 Years Old, Filipino

Robert C. Chan has been Vice President since May 2001. He is a Director and Managing Director for Electricals of First Philec and is the President of First Philippine Power Systems. He has been the President of Philec since 1995 and of FEDCOR since 2000. He was Executive Vice President from 1994 to 1995 and Vice President-Marketing from 1987 to 1994 of Philec. He earned a degree in Bachelor of Science in Electrical Engineering from the Mapua Institute of Technology in 1970 and pursued his Masters in Business Administration at the University of the Philippines from 1982 to 1984. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**RODRIGO E. FRANCO**  
48 Years Old, Filipino

Rodrigo E. Franco has been Vice President since April 2003. Mr. Franco came from JP Morgan Chase Bank where he worked for 20 years in Planning & Financial Management and Corporate Finance. Mr. Franco is part of FPHC's finance team and is presently the Chief Operating Officer, Executive Vice President, Treasurer & Chief Finance Officer of MNTC. He earned a degree in Bachelor of Science in Management Engineering from the Ateneo de Manila University in 1981. He attended Ateneo de Manila University's Graduate School of Business from 1983 to 1988. He has been part of the Lopez group in an executive capacity within the last five (5) years.

**BENJAMIN R. LOPEZ**  
38 Years Old, Filipino

Benjamin R. Lopez is a Vice President and Head of Corporate Communications. He has been with FPHC since October 1993. He was assigned to Rockwell in May 1995 where he held various posts in Business Development, Sales and Marketing. Prior to his recall to FPHC in June 2004, he was a Vice President for Project Development of Rockwell. He was promoted to Vice President of FPHC in November 2006. He is also a member of the Board of Directors of various subsidiaries such as First Philec, Philec, MHE-Demag (P), Inc. and FEDCOR. He graduated with a Bachelor of Arts degree in International Affairs in 1992 from the George Washington University. He pursued his Executive Masters in Business Administration degree at the Asian Institute of Management in 2001. He has been part of the Lopez group in an executive capacity for the last five (5) years. He is likewise a regular director of City Resources.

**RAMON T. PAGDAGDAGAN**  
49 Years Old, Filipino

Ramon T. Pagdagdagan is a Vice President & Head of Internal Audit since August 2007. He has been with FPHC since October 1994. He was the MIS Manager from Oct. 1994 to February 1997 and the Asst. Vice President of Comptrollership group from March 1997 until March 2000. He was Assistant Vice President of the Internal Audit group from April 2000 until July 2007. He was assigned to Maxidata, Inc. as Assistant Comptroller from July 1993 to September 1994. He graduated with a Bachelor of Science degree in Commerce-Accounting from the Polytechnic University of the Philippines in 1980. He pursued his Executive Masters in Business Administration degree at the Asian Institute of Management from 1999 to 2000. He has been part of the Lopez group in an executive capacity for the last five (5) years.

**ARIEL C. ONG**  
46 Years Old, Filipino

Ariel C. Ong joined First Philec as a fulltime consultant in 2007. He was elected as Vice President of FPHC last September 6, 2007 and is seconded to First Philec as a Senior Vice President. He has over twenty years experience in plant general management and end to end supply chain leadership as well as project management and business process engineering. Prior to joining First Philec, he was Regional Vice President / General Manager and Supply Chain Head for Southeast Asia of Avon Products - Asia Pacific Supply Chain. He is a Mechanical Engineer and obtained his Master of Science in Engineering (Energy) from the University of the Philippines in 1990.

**ELIZABETH M. CANLAS**  
56 Years Old, Filipino

Elizabeth M. Canlas has been a Vice President of the company since November 2007. She was Assistant Vice President for Human Resource Management Group from 1995-2007. She is currently a core group member of the Lopez Group's Corporate HR, HR Council, CSR (Corporate Social Responsibility) Council and the Lopez Lifelong Wellness team. She is the chair of the HR professional development committee of the HR Council and the functional head of the Human Resource Officers' Committee of the First Holdings' Group HRs. She is also the Managing Editor of *Tanglaw*, the official publication of the First Holdings Group of Companies. She has been part of the Lopez group in an executive capacity for the last five (5) years.

**ENRIQUE I. QUIASON**  
47 Years Old, Filipino

Enrique I. Quiason has been the Corporate Secretary of the Company since 1993. He is a Senior Partner of the Quiason Makalintal Barot Torres & Ibarra Law Firm. He is also the Corporate Secretary of Benpres and Assistant Corporate Secretary of ABS-CBN. He is also the Corporate Secretary and Assistant Corporate Secretary of various subsidiaries or affiliates of FPHC and Benpres. He graduated with B.S. Business Economics degree in 1981 and with Bachelor of Laws degree in 1985 from the University of the Philippines. He pursued a degree in LL.M. Securities Regulation at Georgetown University in 1991. He has been part of the Lopez group in a legal advisory capacity for the last five (5) years.

**RODOLFO R. WAGA, JR.**  
48 Years Old, Filipino

Rodolfo R. Waga, Jr. has been a Vice President of the Company since May 2001 and is the Assistant Corporate Secretary of the Company. He is also the Corporate Secretary and Assistant Corporate Secretary of various FPHC subsidiaries and affiliates. He graduated Magna Cum Laude with a Bachelor of Arts degree Major in Economics from the Xavier University (Ateneo de Cagayan) in 1979 and a Bachelor of Laws degree from the University of the Philippines in 1983. He completed the academic requirements for his EMBA at the Asian Institute of Management. He has been part of the Lopez group in an executive capacity for the last five (5) years.

(2) Identity of Significant Employees

The Company considers all its employees to be significant partners and contributors to the business.

(3) Family Relationships

- a) Oscar M. Lopez and Manuel M. Lopez are brothers.
- b) Ernesto B. Rufino, Jr. is the brother-in-law of Oscar M. Lopez. His sister, Mrs. Consuelo Rufino-Lopez, is the wife of Oscar M. Lopez.
- c) Federico R. Lopez, Oscar R. Lopez, Jr. and Benjamin R. Lopez are the sons of Oscar M. Lopez.
- d) Eugenio L. Lopez III is the nephew of Oscar M. Lopez and Manuel M. Lopez.



(4) Involvement in Certain Legal Proceedings

With respect to the last five (5) years and up to the date of this report:

- (a) The Company is not aware of any bankruptcy proceedings filed by or against any business of which a director, person nominated to become a director, or executive officer or control person of the registrant is a party or of which any of their property is subject.
- (b) The Company is not aware of any conviction by final judgment in a criminal proceeding, domestic or foreign, or being subject to a pending criminal proceeding, domestic or foreign, of any of its directors, person nominated to become a director, executive officers or control person.
- (c) The Company is not aware of any order, judgment or decree not subsequently reversed, superseded or vacated, by any court of competent jurisdiction, domestic or foreign, permanently or temporarily enjoining, barring, suspending or otherwise limiting the involvement of a director, person nominated to become a director, executive officer or control person in any type of business, securities, commodities or banking activities.
- (d) The Company is not aware of any findings by a domestic or foreign court of competent jurisdiction (in a civil action), the Commission or comparable foreign body, or a domestic or foreign exchange or electronic marketplace or self regulatory organization, that any of its director, person nominated to become a director, executive officer, or control person has violated a securities or commodities law.

## Item 10. Compensation of Directors and Executive Officers

| Name and Principal Position                                                 | Year | Salary     | Bonus      | Other Compensation |
|-----------------------------------------------------------------------------|------|------------|------------|--------------------|
| Oscar M. Lopez – Chairman of the Board & CEO                                |      |            |            |                    |
| Elpidio L. Ibañez – Director, President & COO                               |      |            |            |                    |
| Ernesto B. Rufino, Jr. - Director, Senior Vice President & CFO <sup>1</sup> |      |            |            |                    |
| Arthur A. De Guia – Managing Director – MPIG                                |      |            |            |                    |
| Benjamin K. Liboro – Senior Vice President                                  |      |            |            |                    |
| TOTAL <sup>2</sup>                                                          |      |            |            |                    |
| (Estimated)                                                                 | 2008 | 84,016,618 | 56,011,078 | 0                  |
| (Actual)                                                                    | 2007 | 80,360,252 | 86,935,492 | 0                  |
| (Actual)                                                                    | 2006 | 77,514,966 | 74,694,806 | 0                  |
| All other directors                                                         |      |            |            |                    |
| (Estimated)                                                                 | 2008 | 0          | 30,000,000 | 0                  |
| (Actual)                                                                    | 2007 | 0          | 29,445,000 | 0                  |
| (Actual)                                                                    | 2006 | 0          | 27,680,000 | 0                  |
| All other officers                                                          |      |            |            |                    |
| (Estimated)                                                                 | 2008 | 34,875,315 | 23,250,209 | 0                  |
| As a Group unnamed                                                          |      |            |            |                    |
| (Actual)                                                                    | 2007 | 58,698,741 | 45,622,018 | 0                  |
| (Actual)                                                                    | 2006 | 62,154,192 | 46,332,637 | 0                  |
|                                                                             |      |            |            |                    |
|                                                                             |      |            |            |                    |

<sup>1</sup> Mr. Ernesto B. Rufino, Jr. retired on October 31, 2007

<sup>2</sup> Includes projected movements of personnel who would qualify.

### Compensation of Directors

- (A) Standard Arrangements. Directors receive a per diem of ₱20,000 for every board and committee meeting. Under the Company's By-Laws, directors may receive up to a maximum of Three Fourths (3/4) of One Percent (1%) of the Company's annual profits or net earnings as may be determined by the Chairman of the Board and the President.
- (B) Other Arrangements. The Company does not have any other arrangements pursuant to which any director is compensated directly or indirectly for any service provided as a director.

### Employment Contracts and Termination of Employment and Change-in-Control Arrangements

- (A) All employees of the Company, including officers, sign a standard engagement contract which states their compensation, benefits and privileges. Under the Company's By-Laws, officers and employees may receive not more than Two and Three Fourths (2 ¾ %) Percent of the Company's annual profits or net earnings as may be determined by the Chairman of the Board and the President. The Company maintains a qualified, non-contributory trusteed pension plan covering substantially all employees.
- (B) The Company does not have any compensatory plan or arrangement resulting from the resignation, retirement, or any other termination of an executive officer's employment with the Company or its subsidiaries or from a change in control of the Company or a change in an executive officer's responsibilities following a change-in-control except for such rights as may have already vested under the Company's Retirement Plan or as may be provided for under its standard benefits.

## Options Outstanding

The Company has an existing Executive Stock Option Plan (ESOP) which is based on compensation. The ESOP entitles the directors and senior officers to purchase up to 10% of the Company's authorized capital stock on the offering years at a pre-set purchase price with payment and other terms to be defined at the time of the offering. The outstanding options are held as follows:

| Name                   | No. of Shares | Date of Grant | Exercise Price | Market Price at Date of Grant |
|------------------------|---------------|---------------|----------------|-------------------------------|
| *Oscar M. Lopez        |               | Various       | Various        | Various                       |
| Ernesto B. Rufino, Jr. |               | Various       | Various        | Various                       |
| Benjamin K. Liboro     |               | Various       | Various        | Various                       |
| Arthur A. De Guia      |               | Various       | Various        | Various                       |
| Elpidio L. Ibañez      |               | Various       | Various        | Various                       |
| Sub-Total              | 6,116,902     |               |                |                               |
| All Other Officers     | 1,907,595     |               |                |                               |
| Total                  | 8,024,497     |               |                |                               |
| *Top Five              |               |               |                |                               |

## Item 11. Security Ownership of Certain Beneficial Owners and Management

### A. Security Ownership of Beneficial Owners (as Of December 31, 2007)

| Title of Class  | Name and Address Record/Beneficial Owner                                                        | Amount and Nature of Record/Beneficial Ownership (indicate by 'r' or 'b') | Percent of Class |
|-----------------|-------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------|------------------|
| Common          | Benpres Holdings Corp.*<br>5/F Benpres Bldg.<br>Meralco Avenue cor. Exchange Road<br>Pasig City | 254,121,719 r                                                             | 43.12%           |
| Common-Filipino | PCD Nominee Corporation**                                                                       | 109,351,848 r                                                             | 18.55%           |
| Non-Filipino    | G/F Makati Stock Exchange<br>6767 Ayala Avenue, Makati City                                     | 163,248,670 r                                                             | 27.70%           |

\* the owner to the extent of 43.12% is Benpres Holdings Corporation. The Chairman and Chief Executive Officer of Benpres Holdings Corporation is Oscar M. Lopez.

\*\* participants owning more than 5% of the company's voting securities under PCD Nominee Corporation :

|                                                                                                                                                      | No. of Shares | Percent of Shareholdings |
|------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|--------------------------|
| The Hongkong & Shanghai Banking Corp.<br>Custody & Clearing Dept.<br>30/F Discovery Suites<br>25 ADB Ave., Ortigas Ctr., Pasig City 1650<br>Filipino | 0             | 18.55%                   |

|                                                                      |            |        |
|----------------------------------------------------------------------|------------|--------|
| Non-Filipino                                                         | 91,254,400 | 27.70% |
| Standard Chartered Bank<br>6756 Ayala Avenue Makati City             | 47,069,104 | 7.99%  |
| Social Security System<br>SSS Bldg., East Ave., Diliman, Quezon City | 55,222,163 | 9.37%  |

#### B. Security Ownership of Management

| <i>Title of Class</i> | <i>Name and Address<br/>Record/Beneficial Owner</i> | <i>Amount and Nature<br/>of Record/Beneficial<br/>Ownership (indicate<br/>by 'r' or 'b')</i> | <i>Percent<br/>of Class</i> |
|-----------------------|-----------------------------------------------------|----------------------------------------------------------------------------------------------|-----------------------------|
| Common                | Oscar M. Lopez                                      | 5,277,955 r                                                                                  | 0.88700378%                 |
| Common                | Elpidio L. Ibañez                                   | 910,377 r                                                                                    | 0.15445960%                 |
| Common                | Ernesto B. Rufino, Jr.                              | 1,142,765 r                                                                                  | 0.19388784%                 |
| Common                | Peter D. Garrucho, Jr.                              | 353,172 r                                                                                    | 0.05992112%                 |
| Common                | Arthur A. De Guia                                   | 697,128 r                                                                                    | 0.11827860%                 |
| Common                | Shares owned by other directors and officers        | 4,339,664 r                                                                                  | 0.73629141%                 |

Attached as Annex "A" is a complete summary of the ownership of shares in the Company by all of its officers and directors as of December 31, 2007.

#### Voting Trust Holders of 5% or More

There are no voting trust holders of 5% or more of FPHC's securities.

#### Changes in Control

There has been no change of control of the registrant since the beginning of its fiscal year.

#### Item 12. Certain Relationships and Related Transactions

Enterprises and individuals that directly, or indirectly through one or more intermediaries, control, or are controlled by, or under common control with the Company, including holding companies, and fellow subsidiaries are related entities of the Company. Associates and individuals owning, directly or indirectly, an interest in the voting power of the Company that gives them significant influence over the enterprise, key management personnel, including directors and officers of the Company and close members of the family of these individuals and companies associated with these individuals also constitute related entities. Transactions between related parties are accounted for at arm's-length prices or on terms similar to those offered to non-related entities in an economically comparable market.

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

The significant transactions with associates and other related parties at market prices in the normal course of business, and the related outstanding balances are disclosed below and in Note 30 to the consolidated financial statements.

On December 23, 2002, First Philippine Holdings Corp. and Benpres Holdings Corporation entered into a Memorandum of Agreement and Deed of Assignment for the modification of the ownership structure of First Philippine Infrastructure Development Corporation, the Lopez Group's holding company for Manila North Tollways Corporation shares. Pursuant to the MOA, FPHC acquired from BHC the latter's interest in FPIDC of about P1.1 billion.

In January 2008, First Philippine Holdings Corporation acquired its partner's (Union Fenosa International, S.A.) interest in the joint venture company, First Philippine Union Fenosa, Inc.

In December 2007, the Company acquired the shares of Meralco Pension Fund in Manila Electric Company (Meralco), amounting to about 6.6% of the outstanding capital stock of Meralco.

In May 2007, the Company, with Company consolidated all its manufacturing and related businesses (Philippine Electric Corporation, First Electro Dynamics Corporation, First Sumiden Circuits, Inc. and First Sumiden Realty) in First Philippine Electric Corporation ("First Philec", formerly FPHC Land), a 100%-owned subsidiary of the Company.

#### **PART IV – CORPORATE GOVERNANCE**

FPHC's commitment to sound corporate governance remains on track since its adoption of a Manual on Corporate Governance on 1 January 2003. FPHC had previously adopted a Manual on Anti-Money Laundering as well. Good governance continues as the linchpin to advance FPHC's corporate commitments to all of its stakeholders. As stated in the Manual, corporate governance is an indispensable component of "sound strategic business management to improve the economic and commercial prosperity of the corporation and enhance shareholder value."

It has entrusted the company's governance in the capable hands of individuals of proven competence, probity and integrity supported by structures that have been created for this purpose. These individuals have been chosen as members of FPHC's standing committees.

FPHC's Board of Directors are: Mr. Oscar M. Lopez (Chairman), Mr. Augusto Almeda-Lopez (Vice Chairman), Mr. Elpidio L. Ibañez (President), Mr. Thelmo Y. Cunanan, Mr. Peter D. Garrucho, Jr., Mr. Oscar J. Hilado, Mr. Jose P. De Jesus, Mr. Eugenio Lopez III, Mr. Manuel M. Lopez, Mr. Vicente T. Paterno, Mr. Washington Z. Sycip, Mr. Federico R. Lopez and Mr. Ernesto B. Rufino, Jr.

The nomination and election committee passes upon the nomination and election of directors. The nomination and election committee composed of the following: Mr. Oscar M. Lopez as Chair, and all the independent directors, namely, Mr. Oscar J. Hilado, Mr. Vicente T. Paterno and Mr. Washington Z. Sycip, as members selects the directors and passes upon their qualifications as board members, to insure a mix of proficient directors who can add value and "bring prudent judgment to bear on the decision making process". It then presents its recommendations/findings to the Board for the latter's approval.

The compensation and remuneration committee which oversees having an appropriate rewards system is composed of the following: Mr. Oscar M. Lopez (Chairman), Mr. Washington Z. Sycip and Mr. Vicente T. Paterno. The policy is to promote a culture that supports enterprise and innovation, with suitable performance related rewards that help motivate management and the employees to be effective and productive.

With respect to the Chairman's compensation and remuneration, the committee which reviews the same is composed of Mr. Augusto Almeda-Lopez (Chairman), Mr. Washington Z. Sycip and Mr. Vicente T. Paterno.

The Audit Committee which evaluates financial and accounting matters is composed of the following: Mr. Oscar J. Hilado (Chairman), Mr. Peter D. Garrucho, Jr. and Mr. Washington Z. Sycip. This committee, among other things, has the duty to ensure that transparency in the financial management system in place and likewise aims to ensure the integrity of the same. The committee's work is enhanced by the assistance of external and internal auditors.

First Holdings has an Internal Audit Group (IAG) headed by a vice president with a manpower complement of eight senior and junior audit personnel, all Certified Public Accountants and most of whom are Certified Internal Auditors. The IAG reports to the Board through the Audit Committee.

The IAG provides assurance and consulting functions for First Holdings and its subsidiaries in the areas of internal control, corporate governance and risk management. Its Internal Audit Activities are all in accordance with the International Standards for Professional Practice of Internal Auditing (ISPPA).

Considering the company's principal focus on finding appropriate financing and business prospects, First Holdings has also constituted a finance and investment committee composed of Mr. Oscar M. Lopez (Chairman), Mr. Thelmo Y. Cunanan, Mr. Peter D. Garrucho, Jr., Mr. Eugenio Lopez III, Mr. Federico R. Lopez and Mr. Jose P. De Jesus. It is tasked, among others, to review investment objectives and strategies, fund raising, major capital expenditures, investment opportunities as well as divestments.

Last December 13, 2007, the Company constituted a risk management committee headed by Chief Justice Artemio V. Panganiban as Chairman with Mr. Ernesto B. Rufino, Jr. and Ambassador Cesar B. Bautista, as members. The risk management committee has the following primary functions: (a) oversee the formulation and establishment of an enterprise-wide risk management system; (b) review, analyze and recommend the policy, framework, strategy, method and/or system of or used by the company to manage risks, threats or liabilities; and (c) review and assess the likelihood and magnitude of the impact of material events on the company and/or to recommend measures, responses or solutions to avoid or reduce risks or exposures.

For added transparency, the company presently has one board observer during board meetings. Previously, two (2) board observers had been allowed to sit in the board as creditors' representatives. In any event, complete, prompt and timely disclosures of material information have been made by the company to the Exchange and to the SEC for the benefit of the investing public.

The law only requires a company to have two (2) independent directors. First Holdings has five (5) such directors and the need for their office is likewise enshrined in its by-laws. Their presence results in a higher level of discourse during board deliberations, providing the body with the benefit of their broader, as well as more impartial viewpoints.

Atty. Enrique I. Quiason has been designated as Compliance Officer and Atty. Rodolfo R. Waga, Jr. as Asst. Compliance Officer, specifically for corporate governance. Both are FPHC's Corporate Secretary and Assistant Corporate Secretary, respectively.

Among the current governance compliance steps made by the company are: the annual submission of a certification dated 14 February 2008 reporting to the SEC the corporation's, its directors', officers' and employees' compliance with the leading practices and principles on good governance as embodied in the company's Manual, a secretary's certificate dated 29 January 2008 on the record of attendance at board meetings and the relevant certification by all of its independent directors on their qualifications which was filed last December 18, 2006 as required under the SEC Notice dated 20 October 2006.

Based on the foregoing, it is evident that FPHC's structures and people for sound corporate governance are all well in place.

FPHC likewise implements corporate excellence initiatives both at the parent and subsidiary levels such as ISO certification, Environment, Safety and Health programs, Risk Management, Six Sigma and Knowledge Management, the Oscar M. Lopez Award for Performance Excellence and the Lopez Achievement Award, among others.

## **CORPORATE CODE OF CONDUCT**

To further flesh out its commitment to good governance, FPHC adopted a Corporate Code of Conduct in August 2005. The Corporate Code of Conduct (Code) reiterates the values and principles instilled by its founder and carried on by the company, namely: nationalism, integrity, entrepreneurship and innovation, teamwork and a strong work ethic. The Code embodies the principles and guidelines for the conduct of the business of the company and in dealing with its shareholders, customers, joint venture partners, suppliers/service providers, the government, creditors and employees. The Code also affirms the company's commitment to pursue civic, charitable, and social projects and undertakings.



April 3, 2008

SECURITIES AND EXCHANGE COMMISSION  
SEC Building, EDSA Greenhills  
Mandaluyong City, Metro Manila

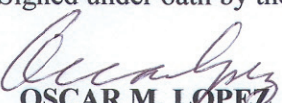
The management of First Philippine Holdings Corporation (the Company) is responsible for all information and representations contained in the consolidated financial statements as of December 31, 2007 and 2006 and for the three years in the period ended December 31, 2007. The consolidated financial statements have been prepared in accordance with Philippine Financial Reporting Standards and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the Company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls; and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.


The Board of Directors reviews the consolidated financial statements before such statements are approved and submitted to the stockholders of the Company.

SyCip Gorres Velayo & Co., the independent auditors appointed by the stockholders, has examined the consolidated financial statements of the Company in accordance with Philippine Standards on Auditing and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to the Stockholders and the Board of Directors.

Signed under oath by the following:

  
**OSCAR M. LOPEZ**  
Chairman of the Board  
& Chief Executive Officer


  
**ELPIDIO L. IBANEZ**  
President &  
Chief Operating Officer

  
**FRANCIS GILES B. PUNO**  
Treasurer, Senior Vice President &  
Chief Financial Officer

SUBSCRIBED AND SWORN to before me this APR 03 day of 2008, affiants exhibited to me their Community Tax Certificate Nos. as follows:

|                       | <u>CTC No.</u> | <u>Date/Place Issued</u> |
|-----------------------|----------------|--------------------------|
| Oscar M. Lopez        | 23697851       | 1-24-08/Pasig City       |
| Elpidio L. Ibanez     | 23740711       | 2-22-08/Pasig City       |
| Francis Giles B. Puno | 23739946       | 2-21-08/Pasig City       |

Doc. No. 46 ;  
Page No. 1 ;  
Book No. 1 ;  
Series of 2008.

  
**CATHERINE U. LEE**  
Notary Public for Pasig City  
Commission No. 87 until Dec. 2009  
Roll of Atty. No. 47554  
PTR No. 4340673/ 01.09.08/ Pasig City  
IBP No. 739916/ 01.02.08/ Quezon City  
P.O. Box No. 12457 Ortigas Center, Pasig City  
Exchange Road, Ortigas Center, Pasig City

4th Floor, Benpres Building, Exchange Road cor. Meralco Avenue 1600, Pasig City, Philippines  
Telephone: (632) 631-80-24, (632) 449-60-00, Fax No.: (632) 631-40-89





## **Report of the Audit Committee**

The Audit Committee's roles and responsibilities are defined in the Corporate Governance Manual of First Philippine Holdings Corporation (FPHC). It assists the Board of Directors in fulfilling its oversight responsibility to the shareholders relating to: a) financial statements; b) financial reporting process and systems of internal controls; and c) audit plan, scope, and performance of independent auditors. We confirm that:

1. An Independent Director chairs the Audit Committee;
2. We had five (5) meetings during the year, all of which were in-person meetings;
3. We have reviewed and disclosed FPHC's quarterly unaudited financial statements and year-end audited financial statements with Management and SyCip Gorres Velayo & Co., the independent auditor of FPHC. These activities were performed in the following context:
  - The management has the primary responsibility for the financial statements and the financial reporting process; and
  - That SyCip Gorres Velayo & Co. is responsible for expressing an opinion on the conformity of FPHC's consolidated financial statements with the Philippine Reporting Standards
4. We have discussed and approved the overall scope of SyCip Gorres Velayo & Co.'s engagement and have also discussed the results of its audit;
5. For the year ended December 31, 2007, FPHC has not engaged its independent auditor, SyCip Gorres Velayo & Co. to do other audit related or non-audit services aside from the conduct of year-end financial audit; and
6. The Board has created a Risk Management Committee tasked to monitor key risks of the company and evaluate the manner in which the risks are being assessed and managed, and to review benchmarks for major financial exposures from such risks.

Based on the reviews and discussions undertaken, and subject to the limitations on our roles and responsibilities referred to above, the Audit Committee recommends to the Board of Directors that the audited financial statements be included in the Annual Report for the year ended December 31, 2007 for filing with the Securities and Exchange Commission (SEC) and the Philippine Stock Exchange (PSE). We are also recommending to the Board of Directors the re-appointment of SyCip Gorres Velayo & Co. as First Philippine Holdings Corporation's independent auditor for 2008 based on the review of its performance and qualifications.

3 April 2008

  
**OSCAR J. HILADO**  
Chairman

  
**WASHINGTON Z. SYCIP**  
Member

  
**PETER D. GARRUCHO, JR.**  
Member

## INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors  
First Philippine Holdings Corporation  
6th Floor, Benpres Building  
Exchange Road corner Meralco Avenue, Pasig City

We have audited the accompanying financial statements of First Philippine Holdings Corporation (FPHC) and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2007 and 2006, and the consolidated statements of income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2007, and a summary of significant accounting policies and other explanatory notes.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Auditors' Responsibility

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

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

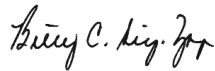
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the consolidated financial statements present fairly, in all materials respects, the financial position of First Philippine Holdings Corporation and Subsidiaries as of December 31, 2007 and 2006, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2007 in accordance with Philippine Financial Reporting Standards.

Without qualifying our opinion, we draw attention to Notes 11 and 17 to the consolidated financial statements. As discussed in Note 11, Manila Electric Company (MERALCO), an associate accounted for under the equity method, has pending realty tax assessments and local franchise tax cases. To address these possible liabilities, MERALCO filed an application with the Energy Regulatory Commission for a recovery mechanism which is pending approval. Further, as discussed in Note 17, on October 28, 2005, the Toll Regulatory Board directed Manila North Tollways Corporation (MNTC, a 67.1%-owned subsidiary of First Philippine Infrastructure, Inc., which is in turn 50.04%-owned by FPHC) to defer the imposition of value-added tax (VAT) on toll fees. Thus, MNTC deferred and continues to defer the imposition of VAT from the motoring public. MNTC, together with other toll road operators, is in discussion with the concerned government agencies on the issue of VAT. The final outcome of these matters cannot be presently determined, and no provision for any additional liability that may result from these uncertainties has been made in the consolidated financial statements. Management's position on each the foregoing is discussed in Notes 3 and 17.

SYCIP GORRES VELAYO & CO.



Partner

CPA Certificate No. 57794

SEC Accreditation No. 0098-AR-1

Tax Identification No. 102-100-627

PTR No. 0017640, January 3, 2008, Makati City

April 14, 2008

# First Philippine Holdings Corporation and Subsidiaries

## Consolidated Balance Sheets

December 31

2006  
(As Restated -  
Note 2)

2007

(In Millions)

### ASSETS

#### Current Assets

|                                                        |                |         |
|--------------------------------------------------------|----------------|---------|
| Cash and cash equivalents (Notes 7 and 35)             | <b>₱14,823</b> | ₱32,249 |
| Trade and other receivables - net (Notes 8, 34 and 35) | <b>16,300</b>  | 12,719  |
| Inventories (Note 9)                                   | <b>5,209</b>   | 1,817   |
| Other current assets (Notes 10 and 35)                 | <b>7,102</b>   | 3,304   |
| Total Current Assets                                   | <b>43,434</b>  | 50,089  |

#### Noncurrent Assets

|                                                          |                 |          |
|----------------------------------------------------------|-----------------|----------|
| Concession receivables (Notes 35 and 36)                 | <b>34,695</b>   | —        |
| Investments at equity and deposits (Notes 11, 32 and 35) | <b>38,197</b>   | 18,331   |
| Investment properties - net (Note 14)                    | <b>2,586</b>    | 2,589    |
| Property, plant and equipment - net (Notes 4, 5 and 12)  | <b>33,036</b>   | 36,189   |
| Goodwill (Note 5 and 15)                                 | <b>44,210</b>   | 620      |
| Intangible assets (Notes 5 and 16)                       | <b>26,653</b>   | 18,911   |
| Pension asset (Note 29)                                  | <b>418</b>      | 320      |
| Deferred tax assets (Note 30)                            | <b>6,946</b>    | 848      |
| Other noncurrent assets - net (Notes 5, 17, 34 and 35)   | <b>9,372</b>    | 9,677    |
| Total Noncurrent Assets                                  | <b>196,113</b>  | 87,485   |
|                                                          | <b>₱239,547</b> | ₱137,574 |

### LIABILITIES AND EQUITY

#### Current Liabilities

|                                                                                                                           |                |        |
|---------------------------------------------------------------------------------------------------------------------------|----------------|--------|
| Loans payable (Notes 18, 34 and 35)                                                                                       | <b>₱18,368</b> | ₱10    |
| Trade payables and other current liabilities (Notes 19, 34 and 35)                                                        | <b>12,816</b>  | 10,818 |
| Income tax payable (Note 30)                                                                                              | <b>611</b>     | 274    |
| Current portion of:                                                                                                       |                |        |
| Obligations to Gas Sellers (Notes 34 and 35)                                                                              | <b>2,053</b>   | 1,823  |
| Deferred payment facility with Power Sector Assets and<br>Liabilities Management Corporation (PSALM)<br>(Notes 34 and 35) | <b>353</b>     | 372    |
| Long-term debt (Notes 21, 34 and 35)                                                                                      | <b>5,147</b>   | 8,351  |
| Royalty fee payable (Notes 23 and 34)                                                                                     | <b>456</b>     | —      |
| Obligation to power contractors (Notes 22, 34 and 35)                                                                     | <b>247</b>     | —      |
| Total Current Liabilities                                                                                                 | <b>40,051</b>  | 21,648 |

(Forward)

|                                                                                                     | <b>December 31</b>   |                                   |
|-----------------------------------------------------------------------------------------------------|----------------------|-----------------------------------|
|                                                                                                     | <b>2007</b>          | 2006<br>(As Restated -<br>Note 2) |
|                                                                                                     | <i>(In Millions)</i> |                                   |
| <b>Noncurrent Liabilities</b>                                                                       |                      |                                   |
| Bonds payable (Note 20)                                                                             | <b>₱4,974</b>        | ₱4,931                            |
| Long-term debt - net of current portion (Notes 21, 34 and 35)                                       | <b>92,810</b>        | 33,850                            |
| Deferred payment facility with PSALM - net<br>of current portion (Notes 5c, 34 and 35)              | <b>2,538</b>         | 3,424                             |
| Obligations to Gas Sellers - net of current portion<br>(Notes 34 and 35)                            | <b>694</b>           | 2,789                             |
| Royalty fee payable - net of current portion (Notes 23 and 34)                                      | <b>1,278</b>         | -                                 |
| Obligation to power plant contractors (Notes 22, 34 and 35)                                         | <b>96</b>            | -                                 |
| Deferred tax liabilities (Note 30)                                                                  | <b>4,761</b>         | 2,520                             |
| Retirement benefit liability (Note 29)                                                              | <b>1,247</b>         | 253                               |
| Other noncurrent liabilities (Notes 24, 34 and 35)                                                  | <b>4,258</b>         | 2,929                             |
| Total Noncurrent Liabilities                                                                        | <b>112,656</b>       | 50,696                            |
| <b>Equity Attributable to Equity Holders of the Parent</b>                                          |                      |                                   |
| Common stock (Notes 25 and 26)                                                                      | <b>5,894</b>         | 5,806                             |
| Preferred stock                                                                                     | <b>2,000</b>         | -                                 |
| Subscriptions receivable (Note 25)                                                                  | <b>(4)</b>           | (4)                               |
| Parent company preferred shares held<br>by a consolidated subsidiary                                | <b>(2,000)</b>       | -                                 |
| Capital in excess of par value (Note 25)                                                            | <b>3,627</b>         | 3,531                             |
| Unrealized fair value gains on available-for-sale<br>investments (Note 11)                          | <b>26</b>            | 20                                |
| Share in unrealized fair value gains on available-for-sale<br>investments of an associate (Note 11) | <b>19</b>            | 8                                 |
| Cumulative translation adjustments                                                                  | <b>(7,509)</b>       | (962)                             |
| Share in cumulative translation adjustments of an associate                                         | <b>169</b>           | 53                                |
| Retained earnings (Note 25)                                                                         | <b>31,383</b>        | 28,084                            |
| Total Equity Attributable to Equity Holders of the Parent                                           | <b>33,605</b>        | 36,536                            |
| <b>Minority Interests</b>                                                                           | <b>53,235</b>        | 28,694                            |
| Total Equity                                                                                        | <b>86,840</b>        | 65,230                            |
|                                                                                                     | <b>₱239,547</b>      | ₱137,574                          |

*See accompanying Notes to Consolidated Financial Statements.*

# First Philippine Holdings Corporation and Subsidiaries

## Consolidated Statements of Income

### Years Ended December 31

|                                                                      | 2007           | 2006<br>(As Restated -<br>Note 2) | 2005<br>(As Restated -<br>Note 2) |
|----------------------------------------------------------------------|----------------|-----------------------------------|-----------------------------------|
| <i>(In Millions, Except Per Share Data)</i>                          |                |                                   |                                   |
| <b>REVENUE</b>                                                       |                |                                   |                                   |
| Sale of electricity                                                  | ₱49,492        | ₱51,176                           | ₱45,485                           |
| Toll operations                                                      | 5,491          | 5,705                             | 5,104                             |
| Contracts and services                                               | 2,043          | 1,326                             | 1,402                             |
| Equity in earnings of associates (Note 11)                           | 1,690          | 4,163                             | 1,568                             |
| Sale of merchandise                                                  | 1,510          | 1,184                             | 861                               |
| Sale of real estate                                                  | 291            | 181                               | 407                               |
|                                                                      | <b>60,517</b>  | <b>63,735</b>                     | <b>54,827</b>                     |
| <b>COST AND EXPENSES</b> (Notes 26, 27 and 28)                       |                |                                   |                                   |
| Operations and maintenance                                           | 34,574         | 38,610                            | 32,682                            |
| Toll operations                                                      | 2,421          | 2,438                             | 2,129                             |
| Contracts and services                                               | 1,390          | 831                               | 984                               |
| Merchandise sold                                                     | 1,227          | 978                               | 720                               |
| Real estate sold                                                     | 135            | 96                                | 176                               |
| General and administrative expenses                                  | 5,590          | 4,128                             | 4,553                             |
|                                                                      | <b>45,337</b>  | <b>47,081</b>                     | <b>41,244</b>                     |
|                                                                      | <b>15,180</b>  | <b>16,654</b>                     | <b>13,583</b>                     |
| <b>FINANCE COSTS</b> (Notes 11, 18, 20, 21 and 29)                   | <b>(6,729)</b> | <b>(7,338)</b>                    | <b>(5,455)</b>                    |
| <b>CONSTRUCTION REVENUE</b>                                          | <b>52</b>      | <b>225</b>                        | <b>1,569</b>                      |
| <b>CONSTRUCTION COSTS</b>                                            | <b>(52)</b>    | <b>(225)</b>                      | <b>(1,569)</b>                    |
| <b>FINANCE INCOME</b> (Notes 27 and 28)                              | <b>1,934</b>   | <b>3,281</b>                      | <b>1,086</b>                      |
| <b>GAIN ON DILUTION</b>                                              | <b>–</b>       | <b>2,653</b>                      | <b>–</b>                          |
| <b>FOREIGN EXCHANGE GAIN - Net</b>                                   | <b>2,178</b>   | <b>656</b>                        | <b>604</b>                        |
| <b>GAIN ON SALE OF INVESTMENT IN SHARES<br/>OF STOCK</b> (Note 11)   | <b>44</b>      | <b>535</b>                        | <b>594</b>                        |
| <b>OTHER INCOME</b> (Note 28)                                        | <b>392</b>     | <b>454</b>                        | <b>546</b>                        |
| <b>INCOME BEFORE INCOME TAX</b>                                      | <b>12,999</b>  | <b>16,895</b>                     | <b>10,958</b>                     |
| <b>PROVISION FOR (BENEFIT FROM)<br/>INCOME TAX</b> (Notes 30 and 33) |                |                                   |                                   |
| Current                                                              | 1,735          | 406                               | 143                               |
| Deferred                                                             | (416)          | 896                               | 103                               |
|                                                                      | <b>1,319</b>   | <b>1,302</b>                      | <b>246</b>                        |
| <b>NET INCOME</b> (Note 31)                                          | <b>₱11,680</b> | <b>₱15,593</b>                    | <b>₱10,712</b>                    |

(Forward)

|                                                                                                         | <b>Years Ended December 31</b>              |                                   |                                   |
|---------------------------------------------------------------------------------------------------------|---------------------------------------------|-----------------------------------|-----------------------------------|
|                                                                                                         | <b>2007</b>                                 | 2006<br>(As Restated -<br>Note 2) | 2005<br>(As Restated -<br>Note 2) |
|                                                                                                         | <i>(In Millions, Except Per Share Data)</i> |                                   |                                   |
| <b>Attributable To</b>                                                                                  |                                             |                                   |                                   |
| Equity holders of the Parent                                                                            | <b>₱4,475</b>                               | ₱8,754                            | ₱5,514                            |
| Minority interests                                                                                      | <b>7,205</b>                                | 6,839                             | 5,198                             |
|                                                                                                         | <b>₱11,680</b>                              | ₱15,593                           | ₱10,712                           |
| <b>Earnings Per Share for Net Income Attributable to<br/>the Equity Holders of the Parent (Note 31)</b> |                                             |                                   |                                   |
| Basic                                                                                                   | <b>₱7.641</b>                               | ₱15.243                           | ₱9.877                            |
| Diluted                                                                                                 | <b>7.541</b>                                | 15.079                            | 9.712                             |

*See accompanying Notes to Consolidated Financial Statements.*

# First Philippine Holdings Corporation and Subsidiaries

## Consolidated Statements of Changes in Equity

### (For the Years Ended December 31, 2007, 2006 and 2005)

|                                                                     | Attributable to Equity Holders of the Parent |            |                                               |                    |                                                                                     |            |                                                   |           |                                                                               |           | Minority Interests | Total Equity |                                                                                                                              |           |
|---------------------------------------------------------------------|----------------------------------------------|------------|-----------------------------------------------|--------------------|-------------------------------------------------------------------------------------|------------|---------------------------------------------------|-----------|-------------------------------------------------------------------------------|-----------|--------------------|--------------|------------------------------------------------------------------------------------------------------------------------------|-----------|
|                                                                     | Common Stock<br>(Notes 25 and 26)            |            | Subscriptions<br>Receivable -<br>Common Stock |                    | Parent<br>Company<br>Preferred<br>Shares<br>Held by a<br>Consolidated<br>Subsidiary |            | Capital in<br>Excess of<br>Par Value<br>(Note 25) |           | Unrealized<br>Fair Value<br>Gains on<br>Available-<br>for-Sale<br>Investments |           |                    |              | Share in<br>Unrealized<br>Fair Value<br>Gains on<br>Available-<br>for-Sale<br>Investments<br>of an<br>Associate<br>(Note 11) |           |
|                                                                     | Issued                                       | Subscribed | Preferred<br>Stock<br>(Note 25)               | Preferred<br>Stock | Stock                                                                               | Subsidiary | (Note 25)                                         | (Note 11) | (Note 11)                                                                     | (Note 11) |                    |              | (Note 11)                                                                                                                    | (Note 11) |
| Balance at January 1, 2007                                          | P5,800                                       | P6         | (P4)                                          | P-                 | P-                                                                                  | P3,531     | P20                                               | P8        | (P962)                                                                        | P53       | P27,427            | P35,879      | P28,219                                                                                                                      | P64,098   |
| Effect of early adoption of IFRIC 12 (Note 2)                       | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | 657                | 657          | 475                                                                                                                          | 1,132     |
| As restated                                                         | 5,800                                        | 6          | (4)                                           | -                  | -                                                                                   | 3,531      | 20                                                | 8         | (962)                                                                         | 53        | 28,084             | 36,536       | 28,694                                                                                                                       | 65,230    |
| Net losses on cash flow hedge                                       | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | (23)                                                                          | -         | -                  | (23)         | (15)                                                                                                                         | (38)      |
| Foreign currency translation adjustments                            | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | 7,088                                                                         | 116       | -                  | 7,204        | (806)                                                                                                                        | 6,398     |
| Fair value gains on available-for-sale investments                  | -                                            | -          | -                                             | -                  | -                                                                                   | -          | 6                                                 | 11        | -                                                                             | -         | -                  | 17           | 12                                                                                                                           | 29        |
| Total income and expense for the year recognized directly in equity | -                                            | -          | -                                             | -                  | -                                                                                   | -          | 6                                                 | 11        | 7,065                                                                         | 116       | -                  | 7,198        | (809)                                                                                                                        | 6,389     |
| Net income for the year                                             | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | 4,475              | 4,475        | 7,205                                                                                                                        | 11,680    |
| EDC minority interest before business combination (Note 5)          | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | (13,612)                                                                      | -         | -                  | (13,612)     | 20,552                                                                                                                       | 6,940     |
| Total recognized income and expense for the year                    | -                                            | -          | -                                             | -                  | -                                                                                   | -          | 6                                                 | 11        | (6,547)                                                                       | 116       | 4,475              | (1,939)      | 26,948                                                                                                                       | 25,009    |
| Issuances during the year                                           | 89                                           | (89)       | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | -                  | -            | 60                                                                                                                           | 60        |
| Subscriptions and related premium                                   | -                                            | 88         | -                                             | 5,000              | (3,000)                                                                             | -          | 74                                                | -         | -                                                                             | -         | -                  | 162          | -                                                                                                                            | 162       |
| Share-based payments                                                | -                                            | -          | -                                             | -                  | -                                                                                   | -          | 22                                                | -         | -                                                                             | -         | 22                 | -            | -                                                                                                                            | 22        |
| Cash dividends - P2 a share                                         | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | (1,176)            | (1,176)      | (2,467)                                                                                                                      | (3,643)   |
| Balance at December 31, 2007                                        | P5,889                                       | P5         | (P4)                                          | P-                 | (P3,000)                                                                            | P3,627     | P26                                               | P19       | (P7,509)                                                                      | P169      | P31,383            | P33,605      | P53,235                                                                                                                      | P86,840   |
| Balance at January 1, 2006                                          | P5,696                                       | P12        | (P4)                                          | P-                 | P-                                                                                  | P3,422     | P20                                               | P5        | P379                                                                          | (P78)     | P19,882            | P29,334      | P20,128                                                                                                                      | P49,462   |
| Effect of early adoption of IFRIC 12 (Note 2)                       | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | 602                | 602          | 405                                                                                                                          | 1,007     |
| As restated                                                         | 5,696                                        | 12         | (4)                                           | -                  | -                                                                                   | 3,422      | 20                                                | 5         | 379                                                                           | (78)      | 20,484             | 29,936       | 20,533                                                                                                                       | 50,469    |
| Net gains on cash flow hedge                                        | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | 10                                                                            | -         | -                  | 10           | 23                                                                                                                           | 33        |
| Foreign currency translation adjustments                            | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | (1,351)                                                                       | 131       | -                  | (1,220)      | 1,299                                                                                                                        | 79        |
| Fair value gains on available-for-sale investments                  | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | 3         | -                                                                             | -         | -                  | 3            | -                                                                                                                            | 3         |
| Total income and expense for the year recognized directly in equity | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | 3         | (1,341)                                                                       | 131       | -                  | (1,207)      | 1,322                                                                                                                        | 115       |
| Net income as previously reported                                   | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | 8,699              | 8,699        | 6,769                                                                                                                        | 15,468    |
| Effect of early adoption of IFRIC 12 (Note 2)                       | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | -         | -                                                                             | -         | 55                 | 55           | 70                                                                                                                           | 125       |
| As restated                                                         | -                                            | -          | -                                             | -                  | -                                                                                   | -          | -                                                 | 3         | (1,341)                                                                       | 131       | 8,754              | 7,547        | 8,161                                                                                                                        | 15,708    |

(Forward)



Attributable to Equity Holders of the Parent

|                                                                     | Common Stock<br>(Notes 25 and 26) |            | Subscriptions -<br>Common Stock<br>(Note 25) |                              | Preferred Stock |                                   | Subscription -<br>Preferred Stock                                                   |                                                   | Parent<br>Company<br>Preferred<br>Shares<br>Held by a<br>Consolidated<br>Subsidiary        |                                                       | Capital in<br>Excess of<br>Par Value<br>(Note 25)                                       |                                   | Unrealized<br>Fair Value<br>Gains on<br>Available-<br>for-Sale<br>Investments<br>(Note 11) |         | Share in<br>Cumulative<br>Translation<br>Adjustments<br>of an<br>Associate<br>(Note 11) |         | Retained<br>Earnings<br>(Note 25) |         | Total<br>Equity |
|---------------------------------------------------------------------|-----------------------------------|------------|----------------------------------------------|------------------------------|-----------------|-----------------------------------|-------------------------------------------------------------------------------------|---------------------------------------------------|--------------------------------------------------------------------------------------------|-------------------------------------------------------|-----------------------------------------------------------------------------------------|-----------------------------------|--------------------------------------------------------------------------------------------|---------|-----------------------------------------------------------------------------------------|---------|-----------------------------------|---------|-----------------|
|                                                                     | Issued                            | Subscribed | Common Stock<br>(Note 25)                    | Preferred Stock<br>(Note 25) | Preferred Stock | Subscription -<br>Preferred Stock | Parent<br>Company<br>Preferred<br>Shares<br>Held by a<br>Consolidated<br>Subsidiary | Capital in<br>Excess of<br>Par Value<br>(Note 25) | Unrealized<br>Fair Value<br>Gains on<br>Available-<br>for-Sale<br>Investments<br>(Note 11) | Cumulative<br>Translation<br>Adjustments<br>(Note 11) | Share in<br>Cumulative<br>Translation<br>Adjustments<br>of an<br>Associate<br>(Note 11) | Retained<br>Earnings<br>(Note 25) | Minority<br>Interests                                                                      |         |                                                                                         |         |                                   |         |                 |
| Total recognized income and expense for the year                    | ₱-                                | ₱-         | ₱-                                           | ₱-                           | ₱-              | ₱-                                | ₱-                                                                                  | ₱-                                                | ₱-                                                                                         | ₱-                                                    | ₱-                                                                                      | ₱-                                | ₱-                                                                                         | ₱-      | ₱-                                                                                      | ₱-      | ₱-                                | ₱-      | ₱15,708         |
| Issuances during the year                                           | 104                               | (104)      | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | -       | -               |
| Subscriptions and related premium                                   | -                                 | 98         | -                                            | -                            | -               | -                                 | -                                                                                   | 59                                                | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | 157     | 157             |
| Share-based payments                                                | -                                 | -          | -                                            | -                            | -               | -                                 | 50                                                                                  | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | 50      | 50              |
| Cash dividends - ₱2 a share                                         | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | (1,154) | (1,154)         |
| Balance at December 31, 2006                                        | 104                               | (6)        | -                                            | -                            | -               | -                                 | 109                                                                                 | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | (947)   | (947)           |
| Balance at January 1, 2005                                          | ₱5,800                            | ₱6         | (₱4)                                         | -                            | ₱-              | ₱-                                | ₱3,531                                                                              | ₱20                                               | ₱8                                                                                         | ₱53                                                   | ₱36,536                                                                                 | ₱28,694                           | ₱8,754                                                                                     | ₱7,547  | ₱8,161                                                                                  | ₱15,708 | ₱65,230                           | ₱65,230 |                 |
| Effect of early adoption of IFRIC 12 (Note 2)                       | ₱5,475                            | ₱67        | (₱4)                                         | -                            | ₱-              | ₱-                                | ₱3,229                                                                              | ₱15                                               | ₱5                                                                                         | (₱91)                                                 | ₱26,419                                                                                 | ₱8,207                            | ₱16,110                                                                                    | ₱26,419 | ₱8,207                                                                                  | ₱44,626 | ₱44,626                           |         |                 |
| As restated                                                         | -                                 | -          | -                                            | -                            | -               | -                                 | 3,229                                                                               | 15                                                | 5                                                                                          | (91)                                                  | 27,016                                                                                  | 402                               | 597                                                                                        | 27,016  | 18,609                                                                                  | 45,625  | 45,625                            |         |                 |
| Net gains on cash flow hedge                                        | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | 54                                                                                      | 36                                | -                                                                                          | -       | -                                                                                       | 90      | 90                                | 90      |                 |
| Foreign currency translation adjustments                            | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | (1,288)                                                                                 | 13                                | -                                                                                          | -       | (2,908)                                                                                 | (4,183) | (4,183)                           |         |                 |
| Fair value gains on available-for-sale investments                  | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | -       |                 |
| Total income and expense for the year recognized directly in equity | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | (1,234)                                                                                 | 13                                | -                                                                                          | (1,216) | (2,872)                                                                                 | (4,088) | (4,088)                           |         |                 |
| Net income as previously reported                                   | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | 4,912   | 4,793                                                                                   | 9,705   | 9,705                             |         |                 |
| Effect of early adoption of IFRIC 12 (Note 2)                       | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | 5                                                                                       | 8       | 8                                 |         |                 |
| As restated                                                         | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | (1,234)                                                                                 | 13                                | -                                                                                          | 3,701   | 1,924                                                                                   | 5,625   | 5,625                             |         |                 |
| Total recognized income and expense for the year                    | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | (1,234)                                                                                 | 13                                | -                                                                                          | 3,701   | 1,924                                                                                   | 5,625   | 5,625                             |         |                 |
| Issuances during the year                                           | 221                               | (221)      | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | -       | -                                 | -       |                 |
| Subscriptions and related premium                                   | -                                 | 166        | -                                            | -                            | -               | -                                 | 137                                                                                 | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | 303     | 303                               | 303     |                 |
| Share-based payments                                                | -                                 | -          | -                                            | -                            | -               | -                                 | 56                                                                                  | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | 56      | 56                                | 56      |                 |
| Cash dividends - ₱2 a share                                         | -                                 | -          | -                                            | -                            | -               | -                                 | -                                                                                   | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | (1,140) | (1,140)                           | (1,140) |                 |
| Balance at December 31, 2005                                        | 221                               | (55)       | -                                            | -                            | -               | -                                 | 193                                                                                 | -                                                 | -                                                                                          | -                                                     | -                                                                                       | -                                 | -                                                                                          | -       | -                                                                                       | (781)   | (781)                             | (781)   |                 |
| Balance at December 31, 2006                                        | ₱5,696                            | ₱12        | (₱4)                                         | -                            | ₱-              | ₱-                                | ₱3,422                                                                              | ₱20                                               | ₱5                                                                                         | (₱78)                                                 | ₱29,936                                                                                 | ₱20,533                           | ₱20,484                                                                                    | ₱29,936 | ₱20,533                                                                                 | ₱50,469 | ₱50,469                           |         |                 |

See accompanying Notes to Consolidated Financial Statements.

# First Philippine Holdings Corporation and Subsidiaries

## Consolidated Statements of Cash Flows

### Years Ended December 31

|                                                                                | 2007            | 2006<br>(As Restated -<br>Note 2) | 2005<br>(As Restated -<br>Note 2) |
|--------------------------------------------------------------------------------|-----------------|-----------------------------------|-----------------------------------|
| <i>(In Millions)</i>                                                           |                 |                                   |                                   |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                    |                 |                                   |                                   |
| Income before income tax                                                       | <b>₱12,999</b>  | ₱16,895                           | ₱10,958                           |
| Adjustments for:                                                               |                 |                                   |                                   |
| Finance costs                                                                  | <b>6,729</b>    | 7,338                             | 5,455                             |
| Depreciation and amortization (Note 28)                                        | <b>3,238</b>    | 3,983                             | 4,240                             |
| Equity in net earnings of associates (Note 11)                                 | <b>(1,690)</b>  | (4,163)                           | (1,568)                           |
| Finance income                                                                 | <b>(1,934)</b>  | (3,281)                           | (1,086)                           |
| Gain on dilution                                                               | -               | (2,653)                           | -                                 |
| Net unrealized foreign exchange gain                                           | <b>(2,178)</b>  | (656)                             | (755)                             |
| Gain on sale of investment in shares of stock<br>(Note 28)                     | <b>(44)</b>     | (535)                             | (594)                             |
| Provisions for:                                                                |                 |                                   |                                   |
| Retirement cost (Note 29)                                                      | <b>496</b>      | 282                               | 242                               |
| Impairment loss and doubtful accounts                                          | <b>427</b>      | -                                 | 64                                |
| Reversal of provision for doubtful accounts                                    | <b>(48)</b>     | -                                 | -                                 |
| Unrealized fair value gain on fair value through<br>profit or loss investments | <b>(4)</b>      | (264)                             | -                                 |
| Gain on sale of property and equipment                                         | -               | (90)                              | -                                 |
| Share-based payments (Note 26)                                                 | <b>96</b>       | 50                                | 56                                |
| Excess of cost over net realizable value                                       | -               | -                                 | 28                                |
| Operating income before working capital changes                                | <b>18,087</b>   | 16,906                            | 17,040                            |
| Decrease (increase) in:                                                        |                 |                                   |                                   |
| Trade and other receivables                                                    | <b>1,680</b>    | 566                               | (2,652)                           |
| Inventories                                                                    | <b>(2,254)</b>  | 710                               | 35                                |
| Other current assets                                                           | <b>(1,479)</b>  | 324                               | (1,259)                           |
| Increase (decrease) in trade payables<br>and other current liabilities         | <b>(2,479)</b>  | 2,860                             | 962                               |
| Interest paid                                                                  | <b>(4,958)</b>  | (7,959)                           | (4,773)                           |
| Interest received                                                              | <b>1,640</b>    | 3,338                             | 967                               |
| Income tax paid                                                                | <b>(1,626)</b>  | (182)                             | (145)                             |
| Net cash provided by operating activities                                      | <b>8,611</b>    | 16,563                            | 10,175                            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                    |                 |                                   |                                   |
| Additions to:                                                                  |                 |                                   |                                   |
| Property, plant and equipment (Note 12)                                        | <b>(926)</b>    | (356)                             | (47)                              |
| Investment properties (Note 14)                                                | -               | (387)                             | (125)                             |
| Decrease (increase) in:                                                        |                 |                                   |                                   |
| Goodwill and intangible assets                                                 | <b>1,338</b>    | 1,885                             | (1,071)                           |
| Other noncurrent assets                                                        | <b>2,523</b>    | 387                               | (1,222)                           |
| Investments and deposits                                                       | <b>(19,255)</b> | (541)                             | 125                               |
| Contribution to retirement fund (Note 29)                                      | <b>(485)</b>    | (503)                             | (462)                             |
| Dividends received from associates (Note 11)                                   | <b>713</b>      | 941                               | 483                               |

(Forward)

|                                                                         | <b>Years Ended December 31</b> |                                   |                                   |
|-------------------------------------------------------------------------|--------------------------------|-----------------------------------|-----------------------------------|
|                                                                         | <b>2007</b>                    | 2006<br>(As Restated -<br>Note 2) | 2005<br>(As Restated -<br>Note 2) |
|                                                                         | <i>(In Millions)</i>           |                                   |                                   |
| Proceeds from -                                                         |                                |                                   |                                   |
| Sale of investment in shares of stock                                   | <b>₱417</b>                    | ₱541                              | ₱615                              |
| Sale of property and equipment<br>and investment properties             | <b>19</b>                      | 516                               | 311                               |
| Net assets from business acquisitions (Note 5)                          | <b>(55,572)</b>                | (2,531)                           | -                                 |
| Net cash used in investing activities                                   | <b>(71,228)</b>                | (48)                              | (1,393)                           |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                             |                                |                                   |                                   |
| Payments of borrowings from banks<br>and other financial institutions   | <b>(13,753)</b>                | (16,382)                          | (5,168)                           |
| Proceeds from:                                                          |                                |                                   |                                   |
| Borrowings from banks<br>and other financial institutions               | <b>72,862</b>                  | 6,108                             | 4,794                             |
| Additional subscriptions to and issuances<br>of shares of capital stock | <b>88</b>                      | 157                               | 303                               |
| Payments of:                                                            |                                |                                   |                                   |
| Cash dividends                                                          | <b>(3,636)</b>                 | (1,154)                           | (1,140)                           |
| Deferred payment facility with PSALM (Note 21)                          | <b>(355)</b>                   | -                                 | -                                 |
| Obligations to gas sellers (Note 35)                                    | <b>(1,293)</b>                 | (3,462)                           | -                                 |
| Increase (decrease) in other noncurrent liabilities                     | <b>(8,934)</b>                 | 7,922                             | -                                 |
| Net cash provided (used in) financing activities                        | <b>44,979</b>                  | (6,811)                           | (1,211)                           |
| <b>EFFECT OF EXCHANGE RATE CHANGES<br/>ON CASH AND CASH EQUIVALENTS</b> | <b>212</b>                     | 656                               | (235)                             |
| <b>NET INCREASE (DECREASE) IN CASH<br/>AND CASH EQUIVALENTS</b>         | <b>(17,426)</b>                | 10,360                            | 7,336                             |
| <b>CASH AND CASH EQUIVALENTS<br/>AT BEGINNING OF YEAR</b>               | <b>32,249</b>                  | 21,889                            | 14,553                            |
| <b>CASH AND CASH EQUIVALENTS<br/>AT END OF YEAR (Note 7)</b>            | <b>₱14,823</b>                 | ₱32,249                           | ₱21,889                           |

*See accompanying Notes to Consolidated Financial Statements.*

# First Philippine Holdings Corporation and Subsidiaries

## Notes to Consolidated Financial Statements

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### 1. Corporate Information

First Philippine Holdings Corporation (the Parent Company or FPHC) was registered and incorporated on June 30, 1961. Under its amended articles of incorporation, its principal activities consist of investments in real and personal properties including, but not limited to, shares of stocks, notes, securities and entities in the power generation, real estate development, roads and tollways operations, manufacturing and construction, financing and other service industries. FPHC and its subsidiaries are collectively referred to as the “First Holdings Group” or the “Company”. Except for (a) FGHC International Limited (FGHC International) and (b) FPH Fund Corporation (FPH Fund) and (c) FPH Ventures, all other subsidiaries are incorporated in the Philippines and separately registered with the Philippine Securities and Exchange Commission (SEC).

FGHC International, FPH Fund and FPH Ventures are registered in the Cayman Islands.

43.15% of FPHC is owned by Benpres Holdings Corporation (Benpres), also a publicly-listed, Philippine-based entity, majority of which owned by the Lopez family. The remaining shares are held by various shareholder groups and individuals.

The common shares of FPHC were listed beginning May 3, 1963 and have since been traded in the Philippine Stock Exchange (PSE).

The registered office address of FPHC is 6<sup>th</sup> Floor, Benpres Building, Exchange Road, corner Meralco Avenue, Pasig City.

The consolidated financial statements as of December 31, 2007 and 2006 and for each of the three years in the period then ended December 31, 2007 were approved and authorized for issuance by the Board of Directors on April 3, 2008, as reviewed and recommended for approval by the Audit Committee on the same date.

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### 2. Summary of Significant Accounting Policies

#### Basis of Preparation

The accompanying consolidated financial statements have been prepared on a historical cost convention, except for revaluation of derivative financial instruments, financial assets at fair value through profit or loss and available-for-sale investments which have been measured at fair value.

The consolidated financial statements are presented in Philippine peso, FPHC’s functional and presentation currency. All values are rounded to the nearest million peso, except when otherwise indicated.

### Basis of Consolidation

The accompanying consolidated financial statements include the financial statements of FPHC and companies, which it controls as of December 31 of each year. Control is normally evidenced when the Parent Company owns, either directly or indirectly, more than 50% of the voting rights of an entity's capital stock.

Following is a list of the subsidiaries or companies, which FPHC controls as of December 31, 2007, 2006 and 2005:

| Subsidiaries                                                                             | Principal Activity          | Percentage of Ownership |              |        |          |        |          |
|------------------------------------------------------------------------------------------|-----------------------------|-------------------------|--------------|--------|----------|--------|----------|
|                                                                                          |                             | 2007                    |              | 2006   |          | 2005   |          |
|                                                                                          |                             | Direct                  | Indirect     | Direct | Indirect | Direct | Indirect |
| <b>Power Generation and Power-related Companies</b>                                      |                             |                         |              |        |          |        |          |
| First Gen Corporation                                                                    |                             | <b>54.84</b>            | <b>11.39</b> | 51.43  | 15.35    | 68.11  | 20.33    |
| First Gen Renewables, Inc. <sup>a</sup>                                                  | Solar energy                | –                       | <b>66.23</b> | –      | 66.78    | –      | 88.44    |
| FG Bukidnon Power Corp. <sup>a</sup>                                                     | Independent power producer  | –                       | <b>66.23</b> | –      | 66.78    | –      | 88.44    |
| Unified Holdings Corporation <sup>a</sup>                                                | Investment holdings         | –                       | <b>66.23</b> | –      | 66.78    | –      | 88.44    |
| FGP Corp. (FGP) <sup>a</sup>                                                             | Independent power producer  | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| AlliedGen Power Corporation <sup>a, c</sup>                                              | Investment holdings         | –                       | <b>66.23</b> | –      | 66.78    | –      | 88.44    |
| First NatGas Power Corporation <sup>a, c</sup>                                           | Power generation            | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| First Gen Luzon Power Corp. <sup>a</sup>                                                 | Power generation            | –                       | <b>66.23</b> | –      | 66.78    | –      | 88.44    |
| First Gas Holdings Corporation <sup>a</sup>                                              | Investment holdings         | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| First Gas Power Corporation (FGPC) <sup>a</sup>                                          | Independent power producer  | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| First NatGas Supply Corporation <sup>a, c</sup>                                          | Power supply and trading    | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| First Gas Pipeline Corporation <sup>a</sup>                                              | Gas seller                  | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| FG Land Corporation <sup>a</sup>                                                         | Land holding                | –                       | <b>39.74</b> | –      | 40.07    | –      | 53.06    |
| First Gen Hydro Power Corporation <sup>a</sup>                                           | Independent power producer  | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Visayas Hydro Power Corporation <sup>a, c</sup>                                | Power generation            | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Mindanao Hydro Power Corporation <sup>a, c</sup>                               | Power generation            | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Geothermal Power Corporation <sup>a, c</sup>                                   | Geothermal power generation | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Northern Energy Corporation <sup>a, c</sup>                                    | Geothermal power generation | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Energy Solutions, Inc. <sup>a, c</sup>                                         | Power supply and trading    | –                       | <b>66.23</b> | –      | 66.78    | –      | –        |
| First Gen Premier Energy Corp. (formerly First Gen Mindanao Power Corp.) <sup>a, c</sup> | Power generation            | –                       | <b>66.23</b> | –      | –        | –      | –        |
| First Gen Prime Energy Corporation <sup>a, c</sup>                                       | Power generation            | –                       | <b>66.23</b> | –      | –        | –      | –        |

| Subsidiaries                                                                                                                | Principal Activity                                   | Percentage of Ownership |          |        |          |        |          |
|-----------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------|-------------------------|----------|--------|----------|--------|----------|
|                                                                                                                             |                                                      | 2007                    |          | 2006   |          | 2005   |          |
|                                                                                                                             |                                                      | Direct                  | Indirect | Direct | Indirect | Direct | Indirect |
| First Gen Visayas Energy Corporation <sup>a, e</sup>                                                                        | Power generation                                     | –                       | 66.23    | –      | –        | –      | –        |
| Prime Terracota Holdings Corporation (Prime Terracota)                                                                      | Investment holdings                                  | –                       | 66.23    | –      | –        | –      | –        |
| Red Vulcan Holdings Corporation (Red Vulcan) <sup>a</sup>                                                                   | Investment holdings                                  | –                       | 54.84    | –      | –        | –      | –        |
| PNOC Energy Development Corporation (PNOC-EDC) <sup>f</sup>                                                                 | Geothermal steam and power producer                  | –                       | 26.49    | –      | –        | –      | –        |
| Batangas Cogeneration Corporation (Batangas Cogen)                                                                          | Power distribution                                   | 60.00                   | –        | 60.00  | –        | 60.00  | –        |
| First Philippine Industrial Corporation (FPIC)                                                                              | Petroleum pipeline operations                        | 60.00                   | –        | 60.00  | –        | 60.00  | –        |
| First Philippine Union Fenosa, Inc. (FPUFI)                                                                                 | Investment holdings                                  | 60.00                   | –        | 60.00  | –        | 60.00  | –        |
| <b>Roads and Tollways Operations</b>                                                                                        |                                                      |                         |          |        |          |        |          |
| First Philippine Infrastructure, Inc. (FPII)                                                                                | Investment holdings                                  | 50.04                   | –        | –      | –        | –      | –        |
| First Philippine Infrastructure Development Corporation (FPIDC) <sup>b</sup>                                                | Investment holdings                                  | –                       | 50.04    | 51.00  | –        | 51.00  | –        |
| Luzon Tollways Corporation <sup>b</sup>                                                                                     |                                                      | –                       | 50.04    | –      | 51.00    | –      | 51.00    |
| Manila North Tollways Corporation <sup>b</sup>                                                                              | Tollways operation                                   | –                       | 33.58    | –      | 34.22    | –      | 34.22    |
| <b>Manufacturing</b>                                                                                                        |                                                      |                         |          |        |          |        |          |
| First Philippine Electric Corporation (First Philec)                                                                        | Manufacturer of electrical and electronic components | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| First Electro Dynamics Corporation (FEDCOR) <sup>d</sup>                                                                    | Manufacturer of transformers                         | –                       | 100.00   | 100.00 | –        | 100.00 | –        |
| First Philippine Power Systems, Inc. (FPPSI) <sup>d</sup>                                                                   | Manufacturer of dry-type transformers                | –                       | 100.00   | –      | –        | –      | –        |
| First Philec Manufacturing Corporation (FPMTC, formerly First Philippine Electronic Manufacturing Corporation) <sup>d</sup> | Manufacturer of electrical and electronic products   | –                       | 100.00   | –      | –        | –      | –        |
| Philippine Electric Corporation (PHILEC) <sup>d</sup>                                                                       | Pioneer manufacturer of distribution transformers    | –                       | 97.98    | 97.98  | –        | 97.98  | –        |
| First Philec Solar Corporation <sup>e</sup> (First Philec Solar)                                                            | Wafer slicing                                        | –                       | 80.00    | –      | –        | –      | –        |
| <b>Real Estate Development</b>                                                                                              |                                                      |                         |          |        |          |        |          |
| First Philippine Realty Development Corporation (FPRDC) <sup>g</sup>                                                        | Real property owner and developer                    | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| First Philippine Realty Corporation (FPRC, formerly Inaec Development Corporation)                                          | Real property holdings and lessor                    | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| FPHC Realty and Development Corporation (Realty) <sup>c</sup>                                                               | Real property lessor                                 | 98.00                   | –        | 98.00  | –        | 98.00  | –        |

| Subsidiaries                                                     | Principal Activity                         | Percentage of Ownership |          |        |          |        |          |
|------------------------------------------------------------------|--------------------------------------------|-------------------------|----------|--------|----------|--------|----------|
|                                                                  |                                            | 2007                    |          | 2006   |          | 2005   |          |
|                                                                  |                                            | Direct                  | Indirect | Direct | Indirect | Direct | Indirect |
| First Philippine Industrial Park, Inc. (FPIP)                    | Real estate developer                      | 70.00                   | –        | 70.00  | –        | 70.00  | –        |
| FPIP Property Developers and Management Corporation <sup>c</sup> | Building operations, management and lessor | –                       | 70.00    | –      | 70.00    | –      | 70.00    |
| FPIP Utilities Incorporated <sup>e</sup>                         | Water distribution                         | –                       | 70.00    | –      | 70.00    | –      | 70.00    |
| First Sumiden Realty, Inc. (FSRI) <sup>d</sup>                   |                                            | –                       | 60.00    | 60.00  | –        | 60.00  | –        |
| <b>Construction</b>                                              |                                            |                         |          |        |          |        |          |
| First Balfour, Inc. (First Balfour)                              | Construction and project management        | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| <b>Others</b>                                                    |                                            |                         |          |        |          |        |          |
| First Philippine Lending Corporation                             | Lending investor                           | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| Securities Transfer Services, Inc.                               | Stock transfer services                    | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| FPH Fund                                                         | Special-purpose entity of FPHC             | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| FGHC International                                               | Special-purpose entity of FPHC             | 100.00                  | –        | 100.00 | –        | 100.00 | –        |
| FPH Ventures                                                     | Special-purpose entity of FPHC             | –                       | 100.00   | –      | 100.00   | 100.00 | 100.00   |

<sup>a</sup>Through First Gen

<sup>b</sup>Through FPII in 2007

<sup>c</sup>Through FPIP

<sup>d</sup>Through First Philec in 2007

<sup>e</sup>Has not yet started operations

<sup>f</sup>Represents effective economic interest of FPHC. However, the effective voting interest of FPHC is 39.74%.

<sup>g</sup>Non-operating

Subsidiaries are fully consolidated from the date when control is transferred to the First Holdings Group and cease to be consolidated from the date when control is transferred.

The financial statements of our subsidiaries are prepared for the same reporting period as FPHC. The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events with similar circumstances. All intra-group balances, income and expenses and unrealized gains and losses resulting from intra-group transactions are eliminated in full.

Minority interest represents the portion of profit or loss and net assets not held by First Holding Group and are presented separately in the consolidated statements of income and within equity in the consolidated balance sheets, separately from equity attributable to equity holders of FPHC. This includes the equity interests in First Gen and subsidiaries (collectively referred to as “First Gen Group”), FPII and subsidiaries (collectively referred to as “FPII Group”), Batangas Cogen, FPIC, FPUFI, FPHC Realty, and FPIP and subsidiaries not held by the FPHC Group.

Acquisition of minority interests is accounted for using the parent entity extension method, whereby, the difference between the consideration and the net book value of the share in the net assets acquired is recognized in goodwill.

The proportionate amount of the fair values of identifiable assets and liabilities upon acquisition of a consolidated subsidiary and any subsequent changes in equity of a consolidated subsidiary attributable to a minority shareholder's interest are shown separately as "minority interests" in the consolidated balance sheets. A minority shareholder's interest in the results of operations of a subsidiary is shown as "minority interests" in the consolidated statement of income. Any losses applicable to a minority shareholder in a consolidated subsidiary in excess of the minority shareholder's equity in the subsidiary are charged against the minority interest to the extent that the minority shareholder has binding obligation to, and is able to, make good of the losses.

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

#### Statement of Compliance

The accompanying consolidated financial statements are prepared in compliance with Philippine Financial Reporting Standards (PFRS) as issued by the Financial Reporting Standards Council and adopted by the Philippine SEC.

References to PFRS standards include the application of Philippine Accounting Standards (PAS), Philippine Financial Reporting Standards (PFRS), and Philippine Interpretations.

#### Changes in Accounting Policies

##### a. New and Amended Standards and Philippine Interpretations Effective January 1, 2007

The accounting policies adopted are consistent with those of the previous financial year except for the adoption of the following new and amended PFRS and Philippine Interpretations, which became effective beginning January 1, 2007. Adoption of these new and amended standards and interpretations did not have any significant impact on the First Holdings Group. Additional disclosures as required under such new and amended standards and Philippine Interpretations were included in the consolidated financial statements.

- PAS 1, Amendment - "Presentation of Financial Statements - Capital Disclosure"
- PFRS 7, "Financial Instruments: Disclosures"
- Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC) 7, "Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies"
- Philippine Interpretation IFRIC 9, "Reassessment of Embedded Derivatives"
- Philippine Interpretation IFRIC 10, "Interim Financial Reporting and Impairment"



The principal effects of these changes are as follows:

- PAS 1, Amendment - “Presentation of Financial Statements - Capital Disclosure”

This amendment requires First Holdings Group to make new disclosures to enable users of the consolidated financial statements to evaluate First Holdings Group’s objectives, policies and processes for managing capital. These new disclosures are presented in Note 34.

- PFRS 7, “Financial Instruments: Disclosures”

This standard requires inclusion of certain disclosures that enable users of the consolidated financial statements to evaluate the significance of First Holdings Group’s financial instruments and the nature and extent of risks from those financial instruments. PFRS 7 requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosure about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. The Company adopted the amendment to the transitional provisions of PFRS 7, as approved by the Financial Reporting Standards Council of the Philippines, which gives transitory relief with respect to the presentation of comparative information for the new risk disclosures about the nature and extent of risks arising from financial instruments. Accordingly, the Company does not need to present comparative information for the disclosures required by paragraphs 31–42 of PFRS 7, unless the disclosure was previously required under PAS 32. Adoption of PFRS 7 resulted in additional disclosures, which are included throughout the financial statements.

- Philippine Interpretation IFRIC 7, “Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies”

This interpretation provides guidance on how to apply the requirements of PAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period, and the entity therefore restates its financial statements in accordance with PAS 39.

This interpretation does not apply to the First Holdings Group’s consolidated financial statements.

- Philippine Interpretation IFRIC 8, “Scope of PFRS 2, Share-based Payment”

This interpretation requires PFRS 2 to be applied to any arrangement in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration, which appears to be less than fair value. As the Company has not issued new share options during the year, the Interpretation has no impact on the financial position or performance of the Company.

- Philippine Interpretation IFRIC 9, “Reassessment of Embedded Derivatives”

This interpretation states that the date to assess the existence of an embedded derivative is the date the entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows.

As the First Holdings Group does not have embedded derivatives requiring separation from the host contract, the interpretation had no impact on the financial position or performance of the First Holdings Group.

- Philippine Interpretation IFRIC 10, “Interim Financial Reporting and Impairment”

This interpretation prohibits the reversal of impairment losses on goodwill and available-for-sale equity investments recognized in the interim financial reports even if impairment is no longer present at the annual balance sheet date.

As the First Holdings Group had no impairment losses previously reversed, the interpretation had no impact on the consolidated financial statements.

- b. Early adoption of Philippine Interpretation IFRIC 12, “Service Concession Arrangements”

This interpretation outlines an approach to account for public-to-private service concession arrangements whereby: (a) grantor controls or regulates what service the Company must provide with the infrastructure, to whom it must provide them, and at what price; and (b) the grantor controls, through ownership, beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement. Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole-of-life asset) is within the scope of this Interpretation if the conditions in (a) are met.

This Interpretation applies to both (a) infrastructure that the Company constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the Company access for the purpose of the service arrangement.

It provides that the operator should not account for the infrastructure as property, plant and equipment, but recognize a financial asset and/or intangible asset. A financial asset is recognized to the extent that the operator has a contractual right to receive cash from the grantor or has a guarantee from the grantor. An intangible asset is recognized to the extent that the entity has a right to charge the public for use of the asset.

The First Holdings Group has elected to early adopt Philippine Interpretation IFRIC 12 effective January 1, 2007, as it applies to the infrastructures and other assets constructed by or acquired by the First Gen Group and FPII Group.

#### First Gen Group

The provisions of Philippine Interpretation IFRIC 12 were applied to the applicable assets acquired and constructed by PNOG-EDC and Bauang Private Power Corporation (BPPC) in connection with the Geothermal Service Contracts (GSC), Steam Sales Agreements (SSA) and Power Purchase Agreements (PPA) with the Government of the Republic of the Philippines (Government) and certain of its agencies.

PNO-EDC is a 40%-owned subsidiary of First Gen through Red Vulcan while BPPC is a subsidiary of First Private Power Corporation (FPPC), which, in turn, is an associate of First Gen.

The effect of adoption of Philippine Interpretation IFRIC 12 is set out in detail in Note 6.

#### Business Combination and Goodwill

Business combinations are accounted for using the purchase accounting method. This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value.

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over First Holdings Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of First Holdings Group's cash-generating units or group of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of First Holdings Group are assigned to those units or groups of units. Each unit or group of units to which goodwill is allocated (a) represents the lowest level within First Holdings Group at which goodwill is monitored for internal management purposes and, (b) is not larger than a segment based on the primary or secondary reporting format determined in accordance with PAS 14, "Segment Reporting."

If the initial accounting for a business combination can only be determined on a provisional basis by the end of the period in which the combination is effected because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the Company accounts for the combination using those provisional values. The Company recognizes any adjustment to these provisional values as a result of completing the initial accounting within 12 months from the acquisition date. The following adjustments are thus made:

- a) The carrying amount of an identifiable asset, liability or contingent liability that is recognized or adjusted as a result of completing the initial accounting shall be calculated as if its fair value at the acquisition date had been recognized from that date.
- b) Goodwill or any gain recognized shall be adjusted from the acquisition date by an amount equal to the adjustment to the fair value at the acquisition date of the identifiable asset, liability or contingent liability being recognized or adjusted.
- c) Comparative information presented for the periods before the initial accounting for the combination is completed shall be presented as if the initial accounting had been completed from the acquisition date. This includes any additional depreciation, amortization or other profit or loss effect recognized as a result of completing the initial accounting.
- d) Where goodwill forms part of a cash-generating unit (or group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation in determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on

the relative values of the operation disposed of and the portion of the cash-generating unit retained.

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

The goodwill from investments in subsidiaries is included as a non-current asset item in the consolidated balance sheet. The goodwill on investment in an associate is included in the carrying amount of the related investment.

#### Investments in Associates

The First Holdings Group's investments in associates are accounted for under the equity method. An associate is an entity over which the First Holdings Group has significant influence and which is neither a subsidiary nor a joint venture, generally accompanying a shareholding of between 20% and 50% of the voting rights. The investments in associates are carried in the consolidated balance sheet at cost plus post-acquisition changes in the First Holdings Group's share of net assets of the associates (including share in cumulative translation adjustments) less any impairment in value.

The First Holdings Group's share in its associate's post-acquisition profits or losses is recognized in the consolidated statement of income, and its share of post-acquisition movements in the associate's equity reserves is recognized directly in equity. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

When the First Holdings Group's share in net losses of an associate equals or exceeds its interest in the associate, including any other unsecured receivables, First Holdings Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of an associate.

The consolidated statement of income reflects the First Holdings Group's share in the results of operations of the associates.

Unrealized gains arising from transactions with its associates are eliminated to the extent of the First Holdings Group's interest in the associate. Unrealized losses are eliminated similarly but only to the extent that there is no evidence of impairment of the asset transferred. The First Holdings Group's investments in associates include goodwill on acquisition, which is treated in accordance with the accounting policy for goodwill.

After application of equity method, First Holdings Group determines whether it is necessary to recognize additional impairment losses on the Group's investment in its associates. First Holdings Group determines at each balance sheet date whether there is any objective evidence that the investment in associate is impaired. If this is the case, First Holdings Group calculates the amount of impairment as being the difference between the fair value of the associate and the carrying value of investments.

The reporting dates and that of the associates are identical and the associates' accounting policies conform with those used for like transactions and events in similar circumstances. In instances where such policies differ, the financial information of such associates are adjusted to conform

with the Parent Company's accounting before the First Holding Group recognizes its share in the change in such associates' net assets.

### Financial Instruments

*Date of Recognition.* Financial instruments within the scope of PAS 39 are recognized in the consolidated balance sheet when the First Holdings Group becomes a party to the contractual provisions of the instrument. Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized using the settlement accounting date. Derivatives are recognized on trade date basis.

*Initial Recognition of Financial Instruments.* All financial instruments are initially recognized at fair value. The initial measurement of financial instruments includes transaction costs, except for securities at fair value through profit or loss (FVPL). The First Holdings Group classifies its financial assets in the following categories: financial assets at FVPL, held-to-maturity (HTM) investments, loans and receivables, or AFS investments. Financial liabilities are classified as either financial liabilities at FVPL or other financial liabilities at amortized cost. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. The First Holdings Group determines the classification of financial assets on initial recognition and, where allowed and appropriate, re-evaluates this designation at every reporting date.

*Determination of Fair Value.* The fair value of financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, option pricing models and other relevant or applicable valuation models.

*Day 1 Profit.* Where the transaction in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the First Holdings Group recognizes the difference between the transaction price and fair value (Day 1 profit) in the consolidated statement of income. In cases where there was use of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the First Holdings Group determines the appropriate method of recognizing the "Day 1 profit" amount.

*Financial Assets or Liabilities at FVPL.* Financial assets or liabilities at FVPL include financial assets and liabilities held for trading purposes and financial assets and liabilities designated upon initial recognition as at FVPL.

Financial assets and liabilities are classified as held for trading if they are acquired for the purpose of selling and repurchasing in the near term.

Derivatives are also classified under financial assets and liabilities at FVPL unless they are designated as hedging instruments in an effective hedge.

Financial assets or liabilities may be designated by management on initial recognition as at FVPL when the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis;
- The assets or liabilities are part of a group of financial assets, liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and liabilities at FVPL are recorded in the consolidated balance sheet at fair value. Subsequent changes in fair value are recognized in the consolidated statement of income. Interest earned or incurred is recorded in interest income or expense, respectively, while dividend income is recorded in "other income" when the right to receive payment has been established.

The Parent Company's investment in shares of stock of SiRF Technology Holdings, Inc. (SiRF), included in "other current asset," is designated as financial assets at FVPL.

*HTM Investments.* HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the First Holdings Group's management has the positive intention and ability to hold to maturity. Where the First Holdings Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS investments. After initial measurement, these investments are subsequently measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. Gains and losses are recognized in the consolidated statement of income when the HTM investments are derecognized and impaired, as well as through the amortization process. The effects of restatement on foreign currency-denominated HTM investments are also recognized in the consolidated statement of income.

The First Holdings Group has no HTM investments as of December 31, 2007 and 2006.

*Loans and Receivables.* Loans and receivables are financial assets with fixed or determinable payments and fixed maturities and that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified or designated as AFS investments or financial assets at FVPL. Loans and receivables are included in current assets if maturity is within 12 months from the balance sheet date. Otherwise, these are classified as non-current assets.

After initial measurement, the loans and receivables are subsequently measured at amortized cost using the effective interest method, less allowance for impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in the consolidated statement of income. The losses arising from impairment of such loans and receivables are also recognized in the consolidated statement of income.

Classified under loans and receivables are cash and cash equivalents, trade and other receivables, concession receivables, receivable from MERALCO for annual deficiency and restricted cash deposits.

*AFS Investments.* AFS investments are those non-derivative financial assets, which are designated as available-for-sale or are not classified in any of the three preceding categories. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. AFS investments are included in current assets if management intends to sell these financial assets within 12 months from balance sheet date. Otherwise, these are classified as noncurrent assets.

After initial measurement, AFS investments are subsequently measured at fair value. AFS investments are measured at fair value with gains and losses being recognized as a separate component of equity until the investments are derecognized or until the investments are determined to be impaired at which time the cumulative gain or loss previously reported in equity are included in the consolidated statement of income. Accounting of the movement in equity is presented in the consolidated statement of changes in equity.

Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be measured reliably and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, are measured at cost.

Classified under AFS investments are quoted and unquoted equity investments, government debt securities and investments in proprietary membership shares.

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

Other financial liabilities are initially recognized at fair value less direct attributable transaction costs, and have not been designated as at FPVL. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any related issue costs, discount or premium. Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized, as well as through amortization process.

Classified under other financial liabilities are loans payable, accounts payable and accrued expenses, due to stockholders and affiliates, bonds payable, long-term debt, obligations to Gas Sellers, royalty fee payable, deferred payment facility with PSALM and obligations to power plant contractors.

*Debt Issuance Costs.* Expenditures incurred in connection with the availment of long-term debt, borrowings and issuance of bonds are deferred and amortized using effective interest method over the term of the debt and bonds. Debt issuance costs are netted against the related loans and borrowings allocated correspondingly between the current and noncurrent portion. Debt issuance costs that pertain to undrawn loan facility are included in the “Other noncurrent assets” account in the consolidated balance sheet.

#### Derivative Financial Instruments and Hedge Accounting

FGP and FPH Ventures use interest rate swap agreements to manage their floating interest rate exposure on their foreign currency-denominated obligations. Accrual of interest on the receive and pay legs of the interest rate swap are recorded as adjustments to the interest expense on the related foreign currency-denominated obligations.

Derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. The fair value of interest swap agreement is determined by reference to market values for similar instruments. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the consolidated statement of income for the current year.

At the inception of a hedge relationship, the First Holdings Group formally designates and documents the hedge relationship to which the First Holdings Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an on-going basis that they actually have been highly effective throughout the financial reporting periods for which they were designated.

The First Holdings Group accounts for FGP and FPH Venture’s interest rate swap agreement as a cash flow hedge of the floating rate exposure on one of its long-term debt (see Note 21).

For the purpose of hedge accounting, derivatives can be designated as cash flow hedges or fair value hedges, depending on the type of risk exposure.

*Cash Flow Hedges.* Cash flow hedges are hedges on the exposure to variability of cash flows that are attributable to a particular risk associated with a recognized asset, liability or a highly probable forecast transaction and could affect profit or loss. The effective portion of the gain or loss on the hedging instrument is recognized directly in equity, while the ineffective portion is recognized in the consolidated statement of income.

Amounts taken to equity are transferred to the consolidated statement of income when the hedged transaction affects profit or loss, such as when hedged financial income or expense is recognized or when a forecast sale or purchase occurs. Where the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.



If the forecast transaction is no longer expected to occur, amounts previously recognized in equity are transferred to the consolidated statement of income. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognized in equity remain in equity until the forecast transaction occurs. If the related transaction is not expected to occur, the amount is recognized in the consolidated statement of income.

The First Holdings Group accounts for FGP's interest rate swap agreement as a cash flow hedge of the floating rate exposure on one of its long-term debts (see Notes 21 and 34).

As of December 31, 2007 and 2006, there are no derivatives that are designated as fair value hedges.

#### Embedded Derivatives

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and, (c) the hybrid or combined instrument is not measured at fair value with changes in fair value reported in net profit or loss.

#### Derecognition of Financial Assets and Liabilities

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

- the rights to receive cash flows from the asset have expired;
- the First Holdings Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the First Holdings Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained the risk and rewards of the asset but has transferred the control of the asset.

Where the First Holdings Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the First Holdings Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the First Holdings Group could be required to repay.

*Financial Liability.* A financial liability is derecognized when the obligation under the liability is discharged, is cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such exchange or modification is treated as a derecognition of the original

liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated statement of income.

#### Impairment of Financial Assets

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

*Financial assets carried at amortized cost.* For loans and receivables carried at amortized cost, the First Holdings Group first assesses whether an objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If there is objective evidence that impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognized, are not included in a collective assessment for impairment.

If there is objective evidence that an impairment loss on assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimate future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the assets is reduced through use of allowance account and the amount of loss is recognized in the consolidated statement of income. Interest income continues to be recognized based on the original effective interest rate of the asset.

If, in subsequent period, the amount of the estimated impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed, to the extent that the carrying value of the assets does not exceed its amortized cost at the reversal date. Any subsequent reversal of an impairment loss is reduced by adjusting the allowance account. If a future write-off is later recovered, any amount formerly charged is credited to the consolidated statement of income.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the First Holdings Group will not be able to collect all the amounts due under the original terms of the invoice. The carrying amount of trade receivable is reduced through use of allowance account. Impaired debts are derecognized when assessed as uncollectible. Likewise, for other receivables, it is also established that accounts outstanding less than one year should have no

provision but accounts outstanding over one year should have a 100% provision, which was arrived at after assessing individually significant balances. Provision for individually non-significant balances was made on a portfolio or group basis after performing the regular review of the age and status of the individual accounts and portfolio/group of accounts relative to historical collections, changes in payment terms and other factors that may affect ability to collect payments.

*AFS Investments.* For AFS investments, the First Holdings Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In case of equity investments classified as AFS, this would include a significant or prolonged decline in fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income, is removed from equity and recognized in the consolidated statement of income. Impairment losses on equity investments are not reversed in the consolidated statement of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of interest income in the consolidated statement of income. If, in subsequent period, the fair value of a debt instrument increased and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

#### Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting arrangements, and the related assets and liabilities are presented at gross amounts in the consolidated balance sheet.

#### Cash and Cash Equivalents

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

#### Trade and Other Receivables

Trade and other receivables, categorized as loans and receivables, are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the First Holdings Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows

relating to short-term receivables are not discounted if the effect of discounting is immaterial. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the consolidated statement of income. When a trade receivable is uncollectible, it is written off against the allowance account for trade and other receivables. Subsequent recoveries of amounts previously written off are recognized as income in the consolidated statement of income.

#### Inventories

Inventories, excluding land held for sale and development costs, are valued at the lower of cost or net realizable value.

Costs incurred in bringing each item of inventories to its present location and conditions are accounted for as follows:

|                                    |                                                                                                                                                                                                  |
|------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Finished goods and work in-process | – Determined on the weighted average basis; cost includes materials and labor and a proportion of manufacturing overhead costs based on normal operating capacity but excluding borrowing costs; |
| Transponders and magnetic cards    | – Cost as determined based on the first-in-first-out method;                                                                                                                                     |
| Real estate                        | – Costs include expenditures for development and improvements of the land;                                                                                                                       |
| Fuel inventories                   | – Weighted average cost of actual fuel consumed;                                                                                                                                                 |
| Raw materials                      | – Purchase cost based on weighted average cost method;                                                                                                                                           |
| Spare parts and supplies           | – Purchase cost on moving average basis.                                                                                                                                                         |

Land held for sale and the related development costs are valued at the lower of cost, which include expenditures for development and improvements, or net realizable value.

The net realizable value is determined as follows:

|                                                          |                                                                                                                        |
|----------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| Finished goods, real estate for sale and work in-process | – Selling price in the ordinary course of business, less the estimated costs of completion, marketing and distribution |
| Transponders and magnetic cards                          | – Estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale          |

- |                                         |                                                                                                                                                                                                                  |
|-----------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Fuel inventories                        | – Cost charged to the Manila Electric Company (MERALCO), under the respective PPAs Power Purchase Agreements of FGPC and FGP with MERALCO (see Note 37a), which is based on weighted average cost of actual fuel |
| Raw materials, spare parts and supplies | – Current replacement cost                                                                                                                                                                                       |

The fuel inventories are those of FGPC and FGP.

#### Property, Plant and Equipment

Property, plant and equipment, except land, are carried at cost less accumulated depreciation, amortization and any impairment in value. Land is carried at cost (initial purchase price and other cost directly attributable to such property) less any impairment in value.

The initial cost of property, plant and equipment, except land, comprises its purchase price including import duties, borrowing costs (during the construction period) and other costs directly attributable in bringing the asset to its working condition and location for its intended use. Cost also includes the cost of replacing the part of such property, plant and equipment when the recognition criteria are met and the estimated cost of dismantling and removing the asset and restoring the site.

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

The First Holdings Group identified the significant parts of its power plant assets to comply with the provisions of PAS 16, “Property, Plant and Equipment.” Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item is depreciated separately.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

|                                              |                                                |
|----------------------------------------------|------------------------------------------------|
| Buildings, other structures and improvements | 5 to 25 years                                  |
| Transportation equipment                     | 3 to 5 years                                   |
| Machinery and equipment                      | 2 to 25 years                                  |
| Leasehold improvements                       | 5 years or lease term,<br>whichever is shorter |

The useful lives and depreciation and amortization method are reviewed at each financial year-end to ensure that the periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property, plant and equipment.

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

Construction in progress represents properties under construction and is stated at cost. This includes cost of construction, equipment and other direct costs. Borrowing costs that are directly attributable to the construction of the property, plant and equipment are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are substantially completed and available for use.

#### Non-current Assets Held for Sale

Assets are classified as non-current assets held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale that should be expected to qualify for recognition as a completed sale within one year from the date of classification. Noncurrent assets classified as held for sale are measured at the lower of carrying value and fair value less costs to sell and depreciation as such assets.

#### Investment Properties

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any impairment losses.

Depreciation is computed using the straight-line method over the estimated useful lives of 5 to 20 years. The investment properties' estimated useful life and depreciation method are reviewed and adjusted, as appropriate, at each financial year-end.

Investment properties are derecognized when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognized in the consolidated statement of income in the year of retirement or disposal.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of the Company's occupation or commencement of development with a view to sale.

#### Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as of the date of acquisition. The intangible asset pertaining to the right of PNOC-EDC to charge users of the public service in connection with the service concession and related arrangements was recognized initially at the

fair value of the construction services. Following initial recognition, intangible assets are carried at cost less accumulated amortization and any impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditures are reflected in the consolidated statement of income in the year the expenditure is incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized using the straight-line method over the estimated useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and method for an intangible asset with a finite useful life is reviewed at least each financial period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the said intangible asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statement of income in the expense category consistent with the function of the intangible asset.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level. Such intangibles are not amortized. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether the indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statement of income in the period the asset is derecognized.

#### Service Concession Arrangements

Public-to-private service concession arrangements where: (a) the grantor controls or regulates services the Company must provide with the infrastructure, to whom it must provide them, and at price; and (b) the grantor controls through ownership, beneficial entitlement or otherwise any significant residual interest in the infrastructure at the end of the term of the arrangement are accounted for under the provisions of Philippine Interpretation IFRIC 12. Infrastructures used in a public-to-private service concession arrangement for its entire useful life (whole-of-life assets) are within the scope of this Interpretation if the conditions in (a) are met. This Interpretation applies to both: (a) infrastructure that the Company constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the Company access for the purpose of the service arrangement.

Infrastructures within the scope of this Interpretation are not recognized as property, plant and equipment of the First Holdings Group. Under the terms of contractual arrangements within the scope of this Philippine Interpretation, the Company acts as a service provider. The First Holdings Group constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

The First Holdings Group recognizes and measures revenue in accordance with PAS 11, "Construction contracts" and PAS 18, "Revenues" for the services it performs. If the Company performs more than one service (i.e., construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by

reference to the relative fair values of the services delivered, when the amounts are separately identifiable.

When the First Holdings Group provides construction or upgrades services, the consideration received or receivable by the Company is recognized at its fair value. The First Holdings Group accounts for revenue and costs relating to construction or upgrade services in accordance with PAS 11. Revenue from constructions contracts is recognized based on the percentage-of-completion method, measured by reference to the percentage of costs incurred to date to estimated total costs for each contract. The Company accounts for revenue and costs relating to operation services in accordance with PAS 18.

The First Holdings Group recognizes a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The company recognizes an intangible asset to the extent that it receives a right (a license) to charge users of the public service.

When the First Holdings Group has contractual obligations it must fulfill as a condition of its license (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement, it recognizes and measures these contractual obligations in accordance with PAS 37, "Provisions, Contingent Liabilities and Contingent Assets," i.e., at the best estimate of the expenditure that would be required to settle the present obligation as at the balance sheet date.

In accordance with PAS 23, "Borrowing Costs", borrowing costs attributable to the arrangement are recognized as an expense in the period in which they are incurred unless the First Holdings Group has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case, borrowing costs attributable to the arrangement are capitalized during the construction phase of the arrangement in accordance with the allowed alternative treatment provided under PAS 23.

#### Prepaid Gas

Prepaid gas (included in the "Other noncurrent assets" account in the consolidated balance sheet) consists of payments to Gas Sellers for unconsumed gas, net of adjustment. The prepaid gas is recoverable in the form of future gas deliveries in the order that it arose and can be consumed within a 10-year period. Prepaid gas arising from the respective Settlement Agreements and Payment Deferral Agreements of FGPC and FGP may be recovered until December 2014 (see Note 37g). If it should be determined at some future date that the likelihood of any amount of gas usage or delivery is remote, then the relevant amount deemed no longer realizable will be written off against profit and loss.

#### Exploration and Evaluation Assets

All costs incurred in the geological and geophysical activities such as costs of topographical, geological and geophysical studies; rights of access to properties to conduct those studies; salaries and other expenses of geologists, geophysical crews, or others conducting those studies are charged outright to expense.



If the results of initial geological and geophysical activities reveal the presence of geothermal resource that will require further exploration and drilling, subsequent exploration and drilling costs are accumulated and deferred under the "Exploration and Evaluation Assets" account included in other noncurrent assets.

These costs include the following:

- a. costs associated with the construction of temporary facilities;
- b. costs of drilling exploratory and exploratory-type stratigraphic test wells, pending determination of whether the wells can produce proven reserves; and
- c. costs of local administration, finance, general and security services, surface facilities and other local costs in preparing for and supporting the drilling activities, incurred during the drilling of exploratory wells.

After tests conducted on the drilled exploratory wells reveal that these wells cannot produce proven reserves, the capitalized costs are charged to expense except when management decides to use the unproductive wells, for recycling or waste disposal.

#### Research and Development Costs

Research costs are expensed as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortized in line with the expected future sales from the related project. Otherwise, development costs are expensed as incurred.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, or more frequently when an indication of impairment arises during the reporting year.

#### Borrowing Costs

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, including exchange differences arising from foreign currency borrowings used to finance the project to the extent that they are regarded as an adjustment to interest costs, net of interest income.

Borrowing costs are generally expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset until such time that the asset is substantially ready for its intended use or sale, which necessarily takes a substantial period of time. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized in the consolidated statement of income.

#### Provisions

Provisions are recognized when the First Holdings Group has a present obligation (legal or constructive): (a) as a result of a past event, (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (c) a reliable estimate can be made of the amount of the obligation. Where the First Holdings Group expects some or all of the provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense

relating to any provision is in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as finance cost.

The First Holdings Group recognized provisions arising from legal and/or constructive obligation associated with the cost of dismantling and removing an item of property, plant and equipment and restoring the site where it is located. The obligation occurs either when the asset is acquired or as a consequence of using the asset for the purpose of generating electricity during a particular period. A corresponding asset is recognized in property, plant and equipment. Dismantling costs are provided at the present value of expected costs to settle the obligation using estimated cash flows. The cash flows are discounted at a current pre-tax rate that reflects the risks specific to the dismantling liability. The unwinding of the discount is expensed as incurred and recognized in the consolidated statement of income as accretion expense. The estimated future costs of dismantling are reviewed annually and adjusted, as appropriate. Changes in the dismantling provision that result from a change in the current best estimate of cash flows required to settle the obligation or a change in the discount rate are added to (or deducted from) the amount recognized as the related asset.

#### Revenues

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

The following specific recognition criteria must also be met before revenue is recognized:

*Sale of Electricity.* Revenue from sale of electricity (in the case of FGP and FGPC) is based on the respective Power Purchase Agreements of FGP and FGPC qualify as leases on the basis that FGP and FGPC sell all its output to MERALCO. These agreements call for a take-or-pay arrangement where payment is made principally on the basis of the availability of the power plants and not on actual deliveries of electricity generated. These arrangements are determined to be operating leases where a significant portion of the risks and benefits of ownership of the assets are retained by FGP and FGPC.

Revenue from sale of electricity is composed of fixed capacity fees, fixed and variable operating and maintenance fees, fuel, wheeling and pipeline charges, sales tax and supplemental fees. The portion related to the fixed capacity fees and fixed operating and maintenance fees is considered as operating lease component and such fees are recognized on a straight-line basis, based on the actual net dependable capacity tested/proven, over the terms of the respective PPAs. Variable operating and maintenance fees, fuel, wheeling and pipeline charges and supplemental fees are recognized monthly based on the actual energy delivered.

Revenue from sale of electricity covered with service concession arrangements (see Note 4) is consummated whenever the electricity generated is transmitted to the transmission line of the buyer for a consideration. Sale of electricity is based on base price per kilo-Watt hour (kWh) of electricity delivered, subject to inflation adjustments and net of the portion representing collection of concession receivables and related finance income.

*Revenue from Sale of Steam.* Sale of steam by PNOC-EDC is consummated whenever the electricity generated is transmitted to the transmission line of the buyer for a consideration. Sale of steam is recognized when the steam generated or its by-product passes to the flow meters installed at the interface point for conversion by the buyer into electricity. Sales of steam is based on sales price per kWh of gross or net generation and guaranteed take-or-pay at certain percentage plant factor, subject to inflation adjustments and net of the portion representing collection of concession receivables and related finance income.

*Construction Contracts.* Revenues from construction contracts and engineered products are recognized by reference to the stage of completion of the contract activity as at the balance sheet date. Stage of completion is measured by reference to the actual cost incurred in relation to the total estimated cost of the project and/or reliance on surveys conducted by in-house engineers of work performed. When it is probable that total contract costs will exceed total contract revenue, the expected losses are recognized as an expense immediately.

*Sale of Services and Park Charges.* Revenues from pipeline services and park charges are recognized when services are rendered, while revenue for water distribution and waste water treatment are recognized on an accrual basis using the monthly meter reading of the customers' water consumption and waste water discharge respectively. Adjustments of billings for pipeline services over and above the base charges are recorded at the time of settlement with shippers. These are included under the "Services and contracts" account in the revenue section of the consolidated statements of income.

*Sale of Transponders and Magnetic Cards.* Revenue from sale of transponders and magnetic cards by MNTC is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer, normally upon delivery.

*Sale of Real Estate.* Revenue and cost from sale of completed real estate projects is accounted for using the full accrual method. The percentage of completion method is used to recognize income from sales of projects where the Company has material obligations under the sales contract to complete the project after the property is sold. Under the percentage of completion method, revenue and costs are measured principally on the basis of the ratio of actual costs incurred to date over the estimated total costs of the project.

*Toll Fees.* Revenue from toll fees is recognized upon the sale of toll tickets. Toll fees received in advance, through transponders or magnetic cards, are recognized as income upon the holders' availment of the toll road services, net of sales discounts. The unused portion of toll fees received in advance is reflected as unearned toll revenue shown under "Accounts payable and other current liabilities" in the consolidated balance sheet.

*Equity in Net Earnings (Losses).* The First Holdings Group recognizes its share in the net income (loss) of associates proportionate to the equity in the voting shares of such associates in accordance with the equity method of accounting for investments.

*Interest income.* Interest income is recognized as the interest accrues (using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset), taking into account the effective yield on the asset.

*Dividend.* Dividend income is recognized when the shareholders' right to receive the payment is established.

*Rent and Lease of Investment Properties.* Rental income and revenue from operating lease arrangements are recognized on a straight-line basis over the term of the lease.

*Guarantee fees.* Guarantee fees are recognized in accordance with the terms of the agreement.

#### Unearned Revenue

Unearned income represents payments of MERALCO for unconsumed gas in connection with the respective SAs and PDAs of FGP and FGPC, which may be availed of until December 2014, in case the actual gas consumed by the power plants in generating electricity to MERALCO exceeds their respective take-or-pay quantities at any given year.

#### Foreign Currency Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is the First Holdings Group's functional and presentation currency. All subsidiaries and associates evaluate their primary economic and operating environment and, determine their functional currency and items included in the financial statements of each entity are initially measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency rate prevailing on the period of the transaction. Monetary assets and liabilities denominated in foreign currency are restated at the functional currency closing rate of exchange prevailing at the balance sheet date. All differences are recognized in the consolidated statement of income. Nonmonetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Nonmonetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Except for First Gen Group, FSRI, FSCI, FPPC, FGH International, FPH Fund and FPH Venture, which have identified the US dollar as their functional currency. All other subsidiaries consider the Philippine peso as their functional currency. As of the reporting date, the assets and liabilities of the First Gen Group FSCI and FSRI are translated into the presentation currency of Parent Company at the closing rate at the balance sheet date and, their statements of income are translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to the "Cumulative Translation Adjustments" account in the equity section of the consolidated balance sheet. Upon disposal of any of these subsidiaries, the deferred cumulative amount recognized in equity relating to that particular subsidiary will be recognized in the consolidated statement of income.

#### Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- a. there is a change in contractual terms, other than a renewal or extension of the arrangement;
- b. a renewal option is exercised or extension granted, unless that term of the renewal or extension was initially included in the lease term;

- c. there is a change in the determination of whether fulfillment is dependent on a specified asset; or
- d. there is a substantial change to the asset.

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

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. In cases where the Company acts as a lessee, operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term. However, in cases where the Company is a lessor, the initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same bases as rental income. Contingent rents are recognized as revenue in the year in which they are earned.

#### Retirement Costs and Other Post-Retirement Benefits

The Parent Company and certain of its subsidiaries have distinct funded, noncontributory defined benefit retirement plan. PNOC-EDC also provides for post-retirement medical and life insurance benefits to its permanent employees, which are unfunded. The plans cover all permanent employees, each administered by their respective retirement committee.

The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method. Under this method, the current service cost is the present value of retirement benefits obligation in the future with respect to services rendered in the current period. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are credited to or charged against income when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans.

Past service cost is recognized as an expense, unless the changes to the retirement plans are conditional on the employees remaining in service for a specified period of time (the vesting period). In such instance, the past service costs are amortized on a straight-line basis over the average period until the benefits become vested.

The defined benefit asset or liability is comprised of the present value of the defined benefit obligation and actuarial gains and losses not recognized, reduced by past service cost not yet recognized, and the fair value of plan assets out of which the obligations are to be settled directly. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using the interest rate on government bonds that have terms to maturity approximating the terms of the related retirement obligation. If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plans or reductions in the future contributions to the plans.

If the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan, net actuarial losses of the current period and past service costs for the current period are recognized immediately to the extent that they exceed any reduction in the present value of those economic benefits. If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service costs for the current period are recognized immediately. Similarly, net actuarial gains of the current period after the deduction of past service cost of the current period exceeding any increase in the present value of the economic benefits stated in the foregoing are recognized immediately if the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period are recognized immediately.

#### Impairment of Non-Financial Assets

At each reporting date, the First Holdings Group assesses whether there is any indication that its non-financial assets (specifically, property, plant and equipment, investment properties, goodwill, intangible assets and investment accounted for using the equity method) may be impaired. When an indicator of impairment exists or when an annual impairment testing for an asset is required, the First Holdings Group makes a formal estimate of an asset's recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent from other assets or groups of assets, in which case the recoverable amount is assessed as part of the cash-generating unit to which it belongs. Where the carrying amount of an asset (or cash-generating unit) exceeds its recoverable amount, the asset (or cash-generating unit) is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset (or cash-generating unit). An impairment loss is charged to operations in the year in which it arises.

For non-financial assets, excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

The following criteria are also applied in assessing impairment of specific non-financial assets:

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

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (or group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized immediately in the consolidated statement of income. Impairment loss relating to goodwill cannot be reversed for subsequent increases in its recoverable amount in future periods. First Holdings Group performs its annual impairment test of goodwill as of December 31 of each year.

*Investment in an Associate.* After application of equity method, First Holdings Group determines whether it is necessary to recognize an additional impairment loss on its investment in an associate. First Holdings Group determines at each balance sheet date whether there is any objective evidence that the investment in an associate is impaired. If this is the case, First Holdings Group calculates the amount of impairment as being the difference between the fair value of the associate and the acquisition cost and recognizes the amount in the consolidated statement of income.

#### Treasury Shares

Own equity instruments, which are acquired (treasury shares) or issued to a consolidated subsidiary are deducted from equity. Acquired treasury shares are accounted for at weighted average cost while equity instruments issued to a consolidated subsidiary is presented as a deduction in the equity section of the consolidated balance sheet at the cost at which such instrument was issued. No gain or loss is recognized in the consolidated statement of income on the purchase, sale, re-issue or cancellation of the Parent Company's own equity instrument.

#### Share-based Payment Transactions

Certain employees (including senior executives) of the FPHC, First Gen Group and an associate (BPPC) receive remuneration in the form of share-based payment transactions. Under such circumstance, the employees render services in exchange for shares or rights over shares ("equity-settled transactions").

*Equity-settled Transactions.* The cost of equity-settled transactions with employees is measured by reference to the fair value of the stock options at the date the option is granted. The fair value is determined using the Black-Scholes-Merton Option Pricing Model, further details of which are provided in Note 26. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares ("market conditions"), if applicable.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the

consolidated statements of income for a period represents the movement in cumulative expense recognized as of the beginning and end of that period.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, an expense, as a minimum is recognized as if the terms had not been modified. An expense is recognized for any increase in the value of the transactions as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were modifications of the original award, as described in the foregoing.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share (see Note 31).

#### Income Tax

*Current Income Tax.* Tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the tax authority. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted as at the balance sheet date.

*Deferred Tax.* Deferred tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements as at the balance sheet date. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination, which at the time of the transaction affects neither accounting nor taxable profit. Deferred income tax is determined using the tax rates (and tax laws) that have been enacted or substantially enacted as at the balance sheet date and are expected to be applied when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits from excess minimum corporate income tax (MCIT) over the regular income tax, and unused net operating loss carryover (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits from MCIT and unused NOLCO can be utilized. Deferred income tax, however, is not recognized:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and



- in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and an associate.

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

Deferred tax assets and liabilities are measured at the tax rates that are applicable to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantially enacted as at the balance sheet date.

Current and deferred tax assets and liabilities relating to items recognized directly in equity are recognized in equity and not in the consolidated statement of income.

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

#### Dividends on Preferred and Common Shares of the Parent Company

Dividends on preferred and common shares are recognized as liability and deducted from equity when approved by the respective shareholders of the Parent Company and subsidiaries. Dividends for the year that are approved after the balance sheet date are dealt with as an event after the balance sheet date.

#### Earnings per Share (EPS) Attributable to the Equity Holders of the Parent Company

Basic EPS is calculated by dividing the net income (less preferred dividends, if any) for the year attributable to common shareholders by the weighted average number of common shares outstanding during the year, after giving retroactive effect to any stock dividends declared during the year.

Diluted EPS is calculated in the same manner, adjusted for the effects of any: (a) preferred dividends; and assuming that, where applicable (b) at the beginning of the year or at the time of issuance during the year, all outstanding stock options are exercised and debt instruments with potential common stock equivalent are converted to common shares and appropriate adjustments to net income are effected for the related expenses and income. Outstanding stock options will have dilutive effect under the treasury stock method only when the average market price of the underlying common share during the period exceeds the exercise price of the option.

Where the EPS effect of the assumed exercise of outstanding options has anti-dilutive effect, diluted EPS is presented the same as basic EPS with a disclosure that the effect of the exercise of the instruments is anti-dilutive.

### Segment Reporting

For purposes of financial reporting, the First Holdings Group is organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products or services. Such business segments are the bases upon which the Company reports its primary segment information. Financial information on business segments is presented in Note 4 to the consolidated financial statements. The First Holdings Group has one geographical segment and derives principally all its revenues from domestic operations.

### Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. These are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

### Events After the Balance Sheet Date

Post year-end events that provide additional information about the First Holdings Group's financial position at the balance sheet date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to consolidated financial statements when material.

### Future Changes in Accounting Policies

The First Holdings Group did not early adopt the following standards and amendments that have been approved but are not yet effective:

- PAS 1, Amendment - "Presentation of Financial Statements," effective January 1, 2009. The amendment requires the First Holdings Group to separate its changes in equity (net assets) during a period arising from transactions with owners in their capacity as owners from other changes in equity. All non-owner changes in equity are required to be presented in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income). Accordingly, components of comprehensive income are not permitted to be presented in the statement of changes in equity. The First Holdings Group will adopt PAS 1, Amendment in 2009.
- PAS 23, "Borrowing Costs," effective January 1, 2009. The standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the standard, First Holdings Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalized on qualifying assets with a commencement date after January 1, 2009. No changes will be made for borrowing costs incurred to this date that have been expensed. The First Holdings Group will adopt PAS 1, Amendment in 2009
- PFRS 8, "Operating Segments," effective January 1, 2009. PFRS 8 replaces PAS 14, "Segment Reporting," and adopts a management approach to reporting segment information. The information reported would be similar to which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the consolidated balance sheet and

consolidated statement of income and companies will need to provide explanations and reconciliations of the differences. The First Holdings Group will adopt PFRS 8 in 2009.

- Philippine Interpretation IFRIC 11, “PFRS 2 - Group and Treasury Share Transactions,” effective January 1, 2008, requires arrangements whereby an employee is granted rights to an entity’s equity instruments to be accounted for as an equity-settled scheme by the entity if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholders of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent company. The First Holdings Group will apply this interpretation in 2008.
- Philippine Interpretation IFRIC 13, “Customer Loyalty Programmes,” effective July 1, 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. Adoption of this interpretation will have no material impact to First Holdings Group since there are currently no such arrangements.
- Philippine Interpretation IFRIC 14, “The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction,” effective January 1, 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under PAS 19, “Employee Benefits.” The Company will apply this interpretation in 2008.

New and revised disclosure requirements will be included in the consolidated financial statements when the First Holdings Group adopts these standards, amendments and interpretations on their respective effectivity dates.

#### Effect of IAS 27 (Amended) “Consolidated and Separate Financial Statements”

One of the changes that IAS 27 (Amended) relates to changes in the parent company’s ownership interest in a subsidiary after control is obtained that do not result in a loss of control. Based on the amended standard, such transaction should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognized in profit or loss. IAS 27 (Amended) shall be applied for annual periods beginning on or after July 1, 2009. Earlier application is permitted only if IFRS 3 (as revised in 2008) is also applied. However, the Financial Reporting Standards Council and SEC have not yet adopted IAS 27 (Amended).

Assuming IAS 27 (Amended) is adopted, because the transition provision does not require retroactive application, the gain on dilution recognized in the 2006 consolidated statement of income related to the dilution of First Holdings’ interest in First Gen Group as a result of the latter’s public offering of its common shares, amounting to ₱2.7 billion shall not be reversed and be recognized directly in equity.

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### 3. Significant Accounting Judgments and Estimates

The preparation of consolidated financial statements in conformity with PFRS requires the First Holdings Group to make judgments, estimates and assumptions that affect the amounts reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the consolidated financial statements as they become determinable.

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.

The First Holdings Group believes that the following represents a summary of these significant judgments and estimates and related impact on and associated risks to the consolidated financial statements:

#### Judgments

*Determination of Functional Currency.* Except for the First Gen Group, FSRI, FPPC, First Sumiden Circuits, Inc. (FSCI), FGHC International, FPH Fund and FPH Ventures, the Parent Company and all other subsidiaries and associates have determined that their functional currency is the Philippine peso. The Philippine peso is the currency of the primary economic environment in which the Parent Company and all other subsidiaries and associates, except for those entities earlier mentioned, operate. The Philippine Peso is also the currency that mainly influences the sale of goods and services as well as the costs of selling such goods and providing such services. The First Gen Group, FSRI, FGHC International, FPH Fund and FPH Ventures have determined the US dollar to be their functional currency. Thus, the accounts of First Gen, FSRI, FGHC International, FPH Fund and FPH Ventures were translated to Philippine peso for the purposes of consolidation to the First Holdings Group's accounts.

*Operating Lease Commitments - First Holdings Group as Lessor.* The respective PPAs of FGP and FGPC qualify as leases on the basis that FGP and FGPC sell all their output to MERALCO and National Power Corporation (NPC), respectively. These agreements call for a take-or-pay arrangement where payment is made principally on the basis of the availability of the power plants and not on actual deliveries of electricity generated. These lease arrangements are determined to be operating leases where a significant portion of the risks and benefits of ownership of the assets are retained by FGP and FGPC. Accordingly, the power plant assets are recorded as part of the cost of property, plant and equipment and the fixed capacity fees billed and fixed operating and maintenance fees billed to MERALCO and NPC are recorded as operating revenues on straight-line basis over the terms of the PPAs.

*Operating Lease Commitments - First Holdings Group as Lessee.* The First Holdings Group has entered into commercial property leases for certain of its investment properties. The First Holdings Group has determined that it retains all the significant risks and rewards of ownership of the property and thus, accounts for such agreements as operating leases.

*Service Concession Arrangements.* In applying Philippine Interpretation IFRIC 12, the First Holdings Group has made a judgment that the GSCs of PNOC-EDC with the Department of Energy (DOE) in the following contract areas: Tongonan, Leyte; Southern Negros; Bacon-Manito (BacMan), Sorsogon; and Mt. Apo, Kidapawan and the Project Agreement of BPPC with NPC qualify under the financial asset model; while PNOC-EDC's service contract in Northern Negros Project and MNTC's Supplemental Tollways Operations Agreement (STOA) qualifies under the intangible asset model.

*Deferred Revenue on Stored Energy.* Under the addendum agreements to the PPA with NPC for United Leyte Project and GSC for BacMan projects, PNOC-EDC has a commitment to NPC for certain stored energy, representing contracted energy that NPC already paid but was not able to take. Such stored energy may be "lifted" or claimed by NPC for a certain specified period, provided that PNOC-EDC is able to generate such energy over and above the nominated energy for each given year in accordance with the related PPAs. PNOC-EDC has made a judgment based on historical information that the probability of future lifting or claim by NPC from the stored energy is remote and accordingly has not deferred any portion of the collected revenues from NPC. The stored energy commitments are however disclosed in the consolidated financial statements under the discussion on contingencies and commitments (see Note 37b).

*Input/Output Value Added Tax (VAT).* Upon effectivity of RA 9337, "Revised Tax Code," which became effective on November 1, 2005, the BIR adopted Revenue Memorandum Circular No. 52-2005 issued on September 28, 2005, which, for the first time, expressly referred to toll road operations as being subject to VAT.

The TRB, in its letter dated October 28, 2005, ordered MNTC to defer the imposition of VAT on toll fees and MNTC has deferred, and continues to defer, the imposition and collection of VAT from motorists. MNTC, together with other toll road operators, is currently discussing the issue related to VAT with the concerned government agencies.

Also in 2005, MNTC carved out the input taxes on its purchase of goods and services in 2004 that were previously recorded as part of the construction cost of the roads and tollways and, recorded such input tax, together with the input tax from 2005 purchases and onwards, as a separate "input value tax" account. In September 2005, MNTC requested for confirmation from the BIR that MNTC may claim VAT input tax credit for the passed-on VAT on its purchases of goods and services for 2003 and prior. As of April 3, 2008, confirmation by the BIR is still pending. Consequently, MNTC continues to account for the input tax from 2003 and prior years' purchases as part of the intangible assets (previously as part of property and equipment, prior to the adoption of Philippine Interpretation IFRIC 12), subject to amortization.

Management, in consultation with its legal counsel, believes that if and when the TRB authorizes the toll operators to collect VAT from motorists, it will be applied prospectively and at the same time be allowed to claim input tax against output tax. Accordingly, no VAT liability was recognized by MNTC.

Input value added tax amounted to ₱254 million and ₱258 million as of December 31, 2007 and 2006, respectively. As of December 31, 2007, input VAT pertaining to 2003 and prior years capitalized as part of intangible assets amounted to ₱239 million, net of accumulated amortization. Upon the adoption of Philippine Interpretation IFRIC 12, the carrying value of Roads and Tollways amounted to ₱14,206 million and ₱15,205 million as of December 31, 2007 and 2006, respectively,

has been presented under “Intangible Assets” account (see Note 16) in the consolidated balance sheets.

The carrying amounts of the affected assets and liabilities might change depending on the outcome of the uncertainties discussed in the foregoing. However, the First Holdings Group believes that in any event, the STOA amongst MNTC, the Government (acting by and through the TRB) and PNCC, provides the First Holdings Group legal recourse in order to protect its lawful interests in case there is a change in existing laws, which makes the performance by MNTC of its obligations materially more expensive.

*Fair Value of Financial Instruments.* Where the fair values of financial assets and financial liabilities recorded in the consolidated balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of liquidity and model inputs such as correlation and volatility for longer dated financial instruments.

#### Estimates

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

*Fair Value of Financial Assets and Liabilities.* Certain financial assets and financial liabilities are required to be carried at fair value, which requires the use of accounting estimates and judgment. While significant components of fair value measurement are determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates and volatility rates), the timing and amount of changes in fair value would differ with the valuation methodology used. Any change in the fair value of these financial assets and financial liabilities would directly affect consolidated profit and loss and consolidated equity.

Fair values of the First Holdings Group’s financial assets and liabilities are set out in Note 35.

*Impairment of Goodwill.* The First Holdings Group performs impairment review on goodwill on an annual basis or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. This requires an estimation of the value in use of the cash-generating units to which goodwill is allocated. Estimating the value in use requires us to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

No impairment loss on goodwill was recognized in the consolidated financial statements for each of the three years in the period ended December 31, 2007. The carrying values of goodwill as of December 31, 2007 and 2006 amounted to ₱44.2 billion and ₱620 million, respectively (see Note 15).

*Estimating Allowance for Doubtful Accounts.* The First Holdings Group reviews its loans and receivables at each reporting date to assess whether an allowance for impairment should be recorded in the consolidated statement of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the

level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes in the allowance.

The First Holdings Group maintains an allowance for doubtful accounts at a level that management considers adequate to provide for potential uncollectibility of its trade and other receivables, and its receivables arising from service concession arrangements. The First Holdings Group evaluates specific balances where management has information that certain amounts may not be collectible. In these cases, the First Holdings Group uses judgment, based on available facts and circumstances, and a review of the factors that affect the collectibility of the accounts including, but not limited to, the age and status of the receivables, collection experience, past loss experience and, in the case of the receivables arising from service concession arrangements, the expected net cash inflows from the concession. The review is made by management on a continuing basis to identify accounts to be provided with allowance. These specific reserves are re-evaluated and adjusted as additional information received affects the amount estimated. In addition to specific allowance against individually significant receivables, the First Holdings Group also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance is based on historical default experience.

The allowance is established by charges to income in the form of provision for doubtful accounts. The allowance for doubtful accounts amounted to ₱461 million and ₱124 million as of December 31, 2007 and 2006, respectively (see Note 8).

Receivables (including current portions of receivable from MERALCO and concession receivables) amounted to ₱16.3 billion and ₱12.7 billion as of December 31, 2007 and 2006, respectively (see Note 8).

*Estimating Net Realizable Value of Inventories.* Inventories are presented at the lower of cost or net realizable value. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realize. A review of the items of inventories is performed at each balance sheet date to reflect the accurate valuation of inventories in the consolidated financial statements.

Inventories amounted to ₱5.2 billion and ₱1.8 billion as of December 31, 2007 and 2006, respectively (see Note 9).

*Impairment of Investments in Shares of Stock.* An impairment review is performed on investments in shares of stock whenever impairment indication exists. This requires an estimation of the value in use of the associates. Estimating the value in use requires estimates of the expected future cash flows from the associates and to make use of a suitable discount rate to calculate the present value of those future cash flows.

No impairment loss on investments in shares of stock was recognized in the consolidated financial statements for the years ended December 31, 2007, 2006 and 2005. The carrying amount of investments in shares of stock as of December 31, 2007 and 2006 amounted to ₱38.2 billion and ₱18.3 billion, respectively (see Note 11).

*Impairment of AFS Investments.* The First Holdings Group treats AFS investments as impaired when there has been a significant or prolonged decline in the fair value of such investments below their cost or where other objective evidence of impairment exists. The determination of what is “significant” or “prolonged” requires judgment. The First Holdings Group treats “significant” generally as 20% or more and “prolonged” as greater than six months. In addition, First Holdings Group evaluates other factors, including normal volatility in share price for quoted equities and the future cash flows and the discount factors for unquoted equities.

AFS investments, included in the “other noncurrent asset” account, are carried at ₱36 million and ₱31 million as of December 31, 2007 and 2006, respectively (see Note 17).

*Present Value of Retirement Obligation.* The determination of the First Holdings Group’s retirement cost is dependent on certain assumptions which the management provided to the actuary to use as basis to calculate such amount. The actuarial valuation involves making assumptions on discount rates, expected returns on plan assets, future salary increases, mortality rates and future retirement increases. rates of compensation increase. In accordance with PAS 19, past service costs, experience adjustments, and effects of the changes in actuarial assumptions are deemed to be amortized over the average remaining working lives of employees. While the assumptions are reasonable and appropriate, significant differences in the First Holdings Group’s actual experience or significant changes in the assumptions may materially affect the retirement benefit obligation. Further, due to the long-term nature of the plan, such estimates are subject to significant uncertainty.

The expected rate of return on plan assets was based on the average historical premium of the fund assets. The assumed discount rates were determined using the market yields on Philippine government bonds with terms consistent with the expected employee benefit payout as at the balance sheet date. Note 29 to the consolidated financial statements details the assumptions used in the calculation.

As of December 31, 2007 and 2006, the present value of the retirement obligation of the First Holdings Group amounted to ₱5.2 billion and ₱3.0 billion, respectively. Unrecognized cumulative actuarial losses as of December 31, 2007 and 2006 amounted to ₱248 million and ₱1,118 million, respectively (see Note 29).

*Recognition of Deferred Tax Assets.* The carrying amounts of deferred tax assets at each balance sheet date are reviewed and are reduced to the extent that there are no longer sufficient taxable profits available to allow all or part of the deferred tax assets to be utilized. The First Holdings Group’s assessment of the recognition of deferred tax assets on deductible temporary differences, carryforward benefits of MCIT and NOLCO is based on the forecasted taxable income of the following reporting period. This forecast is based on the First Holdings Group’s past results and future expectations on revenues and expenses.

As of December 31, 2007 and 2006, the amount of gross deferred tax assets recognized in the consolidated balance sheets amounted to ₱6.9 billion and ₱848 million, respectively. Unrecognized gross deferred tax assets as of December 31, 2007 and 2006 amounted to ₱4.3 billion and ₱2.3 billion, respectively (see Note 30).



*Estimating Revenue and Cost of Real Estate Sales.* The Company's revenue and cost recognition policies require management to make use of estimates and assumptions that may affect the reported amounts of revenues and costs. The Company's revenue from real estate contracts recognized based on the percentage of completion method are measured principally on the basis of the ratio of actual costs incurred to date over the estimated total costs of the project. The total estimated cost of the project is determined by the Company's engineers and technical staff. At each balance sheet date, these estimates are reviewed and revised to reflect the current conditions, when necessary.

Revenues and costs from real estate sold amounted to ₱291 million and ₱135.0 million, respectively in 2007; ₱181 million and ₱96 million respectively, in 2006; and ₱407 million and ₱176 million, respectively in 2005.

*Estimating Useful Lives of Property, Plant and Equipment and, Intangible asset arising from service concession arrangements.* The First Holdings Group estimated the useful lives of the property, plant and equipment and intangible asset arising from service concession arrangements based on the periods over which the assets are expected to be available for use and on the collective assessment of industry practices, internal technical evaluation and experience with similar assets and arrangements. The estimated useful lives of property, plant and equipment and intangible asset arising from the service concession arrangements are reviewed periodically and updated, if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits in the use of these property, plant and equipment and intangible assets arising from the service concession arrangements. However, it is possible that future results of operations could be materially affected by changes in the estimates brought about by changes in the aforementioned factors. The amounts and timing of recording the depreciation for any year, with regard to the property, plant and equipment and intangible assets arising from the service concession arrangements, would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of the property, plant and equipment would increase the recorded depreciation and decrease the noncurrent assets. For purposes of determining the estimated useful life of the intangible asset arising from service concession arrangements, PNOC-EDC, in particular, included the renewal period on the basis of the constitutional and contractual provisions and its historical experience of obtaining approvals of such renewals at no significant cost.

There is no change in the estimated useful lives of property, plant and equipment during the year. The carrying values of property, plant and equipment amounted to ₱33.0 billion and ₱36.2 million as of December 31, 2007 and 2006 (see Note 12) while the carrying value of intangible asset arising from service concession arrangement as of December 31, 2007 and December 31, 2006 amounted to ₱23.9 billion and ₱16.0 billion, respectively (see Note 16).

*Impairment of Other Non-financial Assets (i.e., Investment Properties, Prepaid Gas and Prepaid Major Spare Parts).* The First Holdings Group assesses impairment on these non-financial assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the First Holdings Group considers important, which could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results;

- Significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- Significant negative industry and economic trends.

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

There is no impairment loss recognized in the consolidated financial statements for the years ended December 31, 2007, 2006 and 2005. The aggregate carrying amount of assets subjected to impairment testing amounted to ₱6.4 billion and ₱7.8 billion as of December 31, 2007 and 2006, respectively (see Notes 14 and 17).

*Exploration and evaluation costs.* Exploration and evaluation costs are capitalized in accordance with PFRS 6, "Exploration for and Evaluation of Mineral Resources." Capitalization of these costs is based, on certain instances, on management's judgment of the degree to which the expenditure can be associated with finding specific geothermal reserve. The Company determines impairment of projects based on the technical assessment of its resident scientists in various disciplines or based on management's decision not to pursue any further commercial development of its exploration projects. At December 31, 2007, the carrying amount of capitalized exploration and evaluation costs was ₱1,172 million (see Note 36).

*Asset Retirement Obligations.* Under certain Environmental Compliance Certificate (ECC) issued by the Department of Environmental and Natural Resources, the First Holdings Group, specifically, FGP and FGPC, has legal obligations to dismantle the power plant assets at the end of their useful lives. FG Bukidnon, on the other hand, has contractual obligation under the lease agreements with PSALM to dismantle its power plant assets at the end of the useful lives. The asset retirement obligations recognized represent the best estimate of the expenditures required to dismantle the power plants at the end of their useful lives. Such cost estimates are discounted using a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the liability. Each year, the asset retirement obligation is increased to reflect the accretion of discount and to accrue an estimate for the effects of inflation, with the charges being recognized in the "Finance Costs" account, presented in the consolidated statement of income. While it is believed that the assumptions used in the estimation of such costs are reasonable, significant changes in these assumptions may materially affect the recorded expense or obligations in future periods.

The contractual obligation of MNTC to restore the assets to a specified level of serviceability begins on January 1, 2008, while PNOC-EDC has estimated its asset retirement obligations to be insignificant for 2007.

Asset retirement obligations included in the property, plant and equipment account amounted to ₱36 million and ₱38 million as of December 31, 2007 and 2006, respectively (see Note 24).

*Legal Contingencies and Regulatory Assessments.* The First Holdings Group is involved in various legal proceedings and regulatory assessments as discussed in Note 37. The First Holdings Group has developed estimates of probable costs for the resolution of possible claims in consultation with the external counsels handling the Company's defense for various legal proceedings and regulatory assessments and is based upon an analysis of potential results.

The First Holdings Group, in consultation with its external legal counsel, does not believe that these proceedings will have a material adverse effect on the consolidated financial statements. However, it is possible that future results of operations could be materially affected by changes in the estimates or the effectiveness of management's strategies relating to these proceedings.

As of December 31, 2007 and 2006, total provisions for probable losses arising from contingencies, which are determinable, amounted to ₱33.2 million and ₱274.5 million, respectively. These are recognized in the consolidated financial statements in the "Other Noncurrent Liabilities" account.

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#### 4. Segment Information

Operating segments are components of the First Holdings Group that engage in business activities from which they may earn revenues and incur expenses, whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about how resources are to be allocated to the segment and assess their performances, and for which discrete financial information is available. Our operating businesses are organized and managed separately according to the nature of the products and services, with each segment representing a strategic business unit that offers different products and serves different markets.

The First Holdings Group conducts the majority of its business activities in the following areas:

- Power generation and power-related activities;
- Roads and tollways operations;
- Manufacturing; and
- Investment holdings, construction, real estate development, securities transfer services and financing, which are aggregated as "Others."

The operations of these business segments are in the Philippines.

Segment revenue, segment expenses and segment performance include transfers between business segments. The transfers are accounted for at competitive market prices charged to unrelated customers for similar products. Such transfers are eliminated in consolidation.

Segment assets and results of the segments for 2006 and 2005 have been restated to reflect the effects of the change in policies with respect to the new accounting standards.

Financial information about the business segments follows:

| 2007                                   |                                                            |                                     |                    |                                                                                           |              |              |
|----------------------------------------|------------------------------------------------------------|-------------------------------------|--------------------|-------------------------------------------------------------------------------------------|--------------|--------------|
|                                        | Power<br>Generation<br>and Power-<br>Related<br>Activities | Roads and<br>Tollways<br>Operations | Manufac-<br>turing | Investment<br>Holdings,<br>Construc-<br>tion, Real<br>Estate<br>Development<br>and Others | Eliminations | Consolidated |
| <i>(In Millions)</i>                   |                                                            |                                     |                    |                                                                                           |              |              |
| Revenue:                               |                                                            |                                     |                    |                                                                                           |              |              |
| External sales                         | ₱49,492                                                    | ₱5,499                              | ₱2,392             | ₱1,444                                                                                    | ₱-           | ₱58,827      |
| Inter-segment sales                    | -                                                          | -                                   | -                  | 40                                                                                        | (40)         | -            |
| Total revenue                          | 49,492                                                     | 5,499                               | 2,392              | 1,484                                                                                     | (40)         | 58,827       |
| Segment results:                       | 11,325                                                     | 2,483                               | 419                | (941)                                                                                     | 204          | 13,490       |
| Equity in earnings of associates       | 306                                                        | 83                                  | 37                 | 1,264                                                                                     | -            | 1,690        |
| Finance costs                          | (4,255)                                                    | (975)                               | (9)                | (1,490)                                                                                   | -            | (6,729)      |
| Finance income                         | 1,535                                                      | 115                                 | 11                 | 273                                                                                       | -            | 1,934        |
| Provision for income tax               | 1,006                                                      | 138                                 | 158                | 17                                                                                        | -            | 1,319        |
| Net income (loss)                      | 8,450                                                      | 2,196                               | 335                | 575                                                                                       | 124          | 11,680       |
| Other information:                     |                                                            |                                     |                    |                                                                                           |              |              |
| Segment assets                         | 164,553                                                    | 25,567                              | 3,189              | 93,627                                                                                    | (54,335)     | 232,601      |
| Investment in associates               | 2,309                                                      | 365                                 | 276                | 82,835                                                                                    | (47,588)     | 38,197       |
| Property, plant<br>and equipment - net | 31,947                                                     | 112                                 | 372                | 605                                                                                       | -            | 33,036       |
| Intangible assets - net                | 2,715                                                      | 23,938                              | -                  | -                                                                                         | -            | 26,653       |
| Total consolidated assets              | 171,290                                                    | 25,596                              | 3,336              | 93,660                                                                                    | (54,335)     | 239,547      |
| Segment liabilities                    | 113,282                                                    | 9,073                               | 1,490              | 26,786                                                                                    | (2,715)      | 147,916      |
| Total consolidated liabilities         | 117,543                                                    | 9,464                               | 1,533              | 26,882                                                                                    | (2,715)      | 152,707      |
| Depreciation and amortization          | 2,676                                                      | 732                                 | 51                 | 126                                                                                       | -            | 3,585        |
| Capital expenditures                   | 3,604                                                      | 156                                 | 221                | 184                                                                                       | 5            | 4,170        |

| 2006                                   |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
|----------------------------------------|------------------------------------------------------------|-------------------------------------|--------------------|-------------------------------------------------------------------------------------------|--------------|-------------------------------------------|-----------------------------------------------|-------------|
|                                        | Power<br>Generation<br>and Power-<br>Related<br>Activities | Roads and<br>Tollways<br>Operations | Manufac-<br>turing | Investment<br>Holdings,<br>Construc-<br>tion, Real<br>Estate<br>Development<br>and Others | Eliminations | Consolidated<br>as Previously<br>Reported | Effect of<br>Early<br>Adoption<br>of IFRIC 12 | As Restated |
| <i>(In Millions)</i>                   |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| Revenue:                               |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| External sales                         | ₱51,738                                                    | ₱5,709                              | ₱1,177             | ₱948                                                                                      | ₱-           | ₱59,572                                   | ₱-                                            | ₱59,572     |
| Inter-segment sales                    | -                                                          | -                                   | -                  | 39                                                                                        | (39)         | -                                         | -                                             | -           |
| Total revenue                          | 51,738                                                     | 5,709                               | 1,177              | 987                                                                                       | (39)         | 59,572                                    | -                                             | 59,572      |
| Segment results:                       | 10,900                                                     | 2,280                               | 42                 | (1,074)                                                                                   | 91           | 12,239                                    | 252                                           | 12,491      |
| Equity in earnings of<br>associates    | 446                                                        | 97                                  | 6                  | 10,562                                                                                    | (7,565)      | 3,546                                     | 617                                           | 4,163       |
| Finance costs                          | (5,074)                                                    | (1,419)                             | (3)                | (842)                                                                                     | -            | (7,338)                                   | -                                             | (7,338)     |
| Finance income                         | 2,686                                                      | 199                                 | 1                  | 395                                                                                       | -            | 3,281                                     | -                                             | 3,281       |
| Provision for income tax               | 1,134                                                      | 68                                  | 22                 | (4)                                                                                       | -            | 1,220                                     | 82                                            | 1,302       |
| Net income                             | 11,014                                                     | 1,440                               | 46                 | 2,932                                                                                     | 36           | 15,468                                    | 125                                           | 15,593      |
| Other information:                     |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| Segment assets                         | 99,856                                                     | 19,596                              | 1,495              | 49,446                                                                                    | (33,667)     | 136,726                                   | -                                             | 136,726     |
| Investment in associates               | 15,236                                                     | 124                                 | 1                  | 34,485                                                                                    | (31,515)     | 18,331                                    | -                                             | 18,331      |
| Property, plant<br>and equipment - net | 33,988                                                     | 67                                  | 63                 | 2,071                                                                                     | -            | 36,189                                    | -                                             | 36,189      |
| Roads and tollways - net               | -                                                          | 15,205                              | -                  | -                                                                                         | -            | 15,205                                    | (15,205)                                      | -           |
| Intangible assets - net                | 2,883                                                      | -                                   | -                  | -                                                                                         | -            | 2,883                                     | 16,028                                        | 18,911      |
| Total consolidated assets              | 99,870                                                     | 19,596                              | 1,586              | 49,476                                                                                    | (35,051)     | 135,476                                   | 2,097                                         | 137,574     |
| Segment liabilities                    | 25,421                                                     | 2,560                               | 897                | 8,981                                                                                     | (688)        | 37,171                                    | -                                             | 37,171      |
| Total consolidated<br>liabilities      | 50,503                                                     | 11,685                              | 897                | 8,981                                                                                     | (688)        | 71,378                                    | 966                                           | 72,344      |
| Depreciation and<br>amortization       | 3,097                                                      | 995                                 | 11                 | 132                                                                                       | -            | 4,235                                     | (252)                                         | 3,983       |
| Capital expenditures                   | 5,072                                                      | 272                                 | 38                 | 50                                                                                        | -            | 5,432                                     | -                                             | 5,432       |

|                                        | Power<br>Generation<br>and Power-<br>Related<br>Activities | Roads and<br>Tollways<br>Operations | Manufac-<br>turing | Investment<br>Holdings,<br>Construc-<br>tion, Real<br>Estate<br>Development<br>and Others | Eliminations | Consolidated<br>as Previously<br>Reported | Effect of<br>Early<br>Adoption<br>of IFRIC 12 | As Restated |
|----------------------------------------|------------------------------------------------------------|-------------------------------------|--------------------|-------------------------------------------------------------------------------------------|--------------|-------------------------------------------|-----------------------------------------------|-------------|
| <i>(In Millions)</i>                   |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| Revenue:                               |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| External sales                         | ₱46,080                                                    | ₱5,117                              | ₱875               | ₱1,187                                                                                    | ₱-           | ₱53,259                                   | ₱-                                            | ₱53,259     |
| Inter-segment sales                    | -                                                          | -                                   | -                  | 5                                                                                         | (5)          | -                                         | -                                             | -           |
| Total revenue                          | 46,080                                                     | 5,117                               | 875                | 1,192                                                                                     | (5)          | 53,259                                    | -                                             | 53,259      |
| Segment results:                       | 10,985                                                     | 1,962                               | 44                 | (939)                                                                                     | 47           | 12,099                                    | 572                                           | 12,671      |
| Equity in earnings of<br>associates    | 409                                                        | 100                                 | -                  | 3,119                                                                                     | (2,105)      | 1,523                                     | 45                                            | 1,568       |
| Finance costs                          | (3,527)                                                    | (958)                               | (3)                | (936)                                                                                     | (31)         | (5,455)                                   | -                                             | (5,455)     |
| Finance income                         | 731                                                        | -                                   | 2                  | 353                                                                                       | -            | 1,086                                     | -                                             | 1,086       |
| Provision for income tax               | 62                                                         | 17                                  | 5                  | (8)                                                                                       | -            | 76                                        | 170                                           | 246         |
| Net income                             | 8,210                                                      | 1,527                               | 32                 | 1,835                                                                                     | (1,899)      | 9,705                                     | 1,007                                         | 10,712      |
| Other information:                     |                                                            |                                     |                    |                                                                                           |              |                                           |                                               |             |
| Segment assets                         | 90,382                                                     | 21,187                              | 1,068              | 44,306                                                                                    | (31,450)     | 125,493                                   | -                                             | 125,493     |
| Investment in associates               | 12,396                                                     | 340                                 | 1                  | 28,414                                                                                    | (26,993)     | 14,158                                    | -                                             | 14,158      |
| Property, plant<br>and equipment - net | 37,441                                                     | 55                                  | 48                 | 2,109                                                                                     | -            | 39,653                                    | -                                             | 39,653      |
| Roads and tollways - net               | -                                                          | 15,931                              | -                  | -                                                                                         | -            | 15,931                                    | (15,931)                                      | -           |
| Intangible assets - net                | -                                                          | -                                   | -                  | -                                                                                         | -            | -                                         | 16,502                                        | 16,502      |
| Total consolidated assets              | 90,408                                                     | 21,187                              | 1,147              | 44,343                                                                                    | (31,450)     | 125,635                                   | 1,176                                         | 126,811     |
| Segment liabilities                    | 25,535                                                     | 2,820                               | 564                | 12,871                                                                                    | (4,228)      | 34,562                                    | -                                             | 34,562      |
| Total consolidated<br>liabilities      | 54,601                                                     | 12,361                              | 564                | 12,875                                                                                    | (4,228)      | 76,173                                    | -                                             | 76,173      |
| Depreciation and<br>amortization       | 3,490                                                      | 1,181                               | 12                 | 129                                                                                       | -            | 4,812                                     | (572)                                         | 4,240       |
| Capital expenditures                   | 1,887                                                      | 21                                  | 7                  | 115                                                                                       | -            | 2,030                                     | -                                             | 2,030       |

## 5. Business Combination

### a. Acquisition of PNOC-EDC

On October 5, 2007, First Gen and Reykjavik Energy Invest HF (REI) executed a Memorandum of Agreement (MOA) to form a joint venture company to participate in the bidding for the 60% equity stake in PNOC-EDC. Pursuant to the MOA, First Gen would own 60% of the joint venture company, and REI would own the remaining 40%. Subsequently, the parties agreed to use Red Vulcan, a wholly owned subsidiary of First Gen, as the joint venture company. REI, through its subsidiary Spalmare Holding B.V., subscribed to shares of Red Vulcan, representing 40% equity interest while Prime Terracota, another wholly owned subsidiary of First Gen, subscribed to a minimal number of shares of Red Vulcan.

On November 22, 2007, Red Vulcan was declared the winning bidder for Philippine National Oil Company (PNOC) and PNOC-EDC Retirement Fund's combined interests in PNOC-EDC, which consisted of 6.0 billion common shares and 7.5 billion preferred shares. Such common shares represent 40% economic interest in PNOC-EDC while the combined common shares and preferred shares represent 60% of the voting rights in PNOC-EDC. Red Vulcan paid the full purchase price of ₱58.5 billion on November 29, 2007.

|                                               |                      |
|-----------------------------------------------|----------------------|
|                                               | <i>(In Millions)</i> |
| EDC Shares Acquired by Cash Purchase:         |                      |
| Shares Issued, at fair value - common         | ₱58,422              |
| Shares Issued, at fair value - preferred      | 78                   |
| Cost directly attributable to the combination | 276                  |
| <u>Total Cost</u>                             | <u>₱58,776</u>       |

To fund the acquisition, First Gen raised ₱16.0 billion (\$387.5 million) and ₱1.7 billion (\$39.2 million) in bridge loans on November 26 to 28, 2007 from a consortium of local and foreign banks. In addition, Red Vulcan availed of staple financing amounting ₱29.2 billion arranged by the seller's advisors to PNOC-EDC for the transaction.

In a Deed of Assignment executed in December 2007, Spalmare sold all of its shareholdings in Red Vulcan to Prime Terracota. As a result of the transfer of the shares, the equity interest, directly and indirectly of First Gen in Red Vulcan increased from 60% to 100%. However, Spalmare has an option until February 27, 2008 to buy back its 40% shareholding in Red Vulcan. Spalmare did not exercise its option on such date.

PNOC-EDC is the Philippines' largest producer of geothermal energy. The aggregate installed capacity of PNOC-EDC's geothermal energy projects is approximately 1,198.8 megawatt (MW), of which 743.8 MW supplies steam to PNOC-EDC- or BOT Contractor-operated power plants and the remaining 455 MW supplies steam to NPC-owned power plants.

The transaction is accounted for as a business combination. At the date of initial acquisition, the fair value of identifiable assets and liabilities was provisionally determined to be as follows:

|                                   |                      |
|-----------------------------------|----------------------|
|                                   | <u>Amounts</u>       |
|                                   | <i>(In Millions)</i> |
| Cash and cash equivalents         | ₱3,204               |
| Receivables                       | 40,180               |
| AFS investments                   | 1,120                |
| Inventories                       | 1,137                |
| Other current assets              | 534                  |
| Noncurrent asset held for sale    | 1,668                |
| Property, plant and equipment     | 1,116                |
| Intangible asset                  | 8,732                |
| Exploration and evaluation assets | 1,169                |
| Deferred tax assets               | 3,201                |
| Other noncurrent assets           | 1,847                |

(Forward)

|                                                              | Amounts<br>(In Millions) |
|--------------------------------------------------------------|--------------------------|
| Accounts payable and accrued expenses                        | (₱3,300)                 |
| Income tax payable                                           | (227)                    |
| Long-term debt                                               | (23,111)                 |
| Royalty fee payable                                          | (1,688)                  |
| Obligations to power plant contractors                       | (342)                    |
| Retirement and other post-retirement liability               | (910)                    |
| Other noncurrent liabilities                                 | (329)                    |
| Net assets                                                   | 34,001                   |
| Percentage share of net assets acquired                      | 40%                      |
| Net assets acquired                                          | 13,600                   |
| Acquired voting preferred shares                             | 81                       |
| Provisional goodwill arising on acquisition<br>(see Note 15) | 45,095                   |
| <b>Total consideration</b>                                   | <b>₱58,776</b>           |

The fair value adjustments used were provisional amounts and based on the carrying values of identifiable assets and liabilities as at the date of acquisition. The fair values of the identifiable assets (including intangible assets), liabilities and contingent liabilities as at acquisition date are currently being determined.

The cash flow on acquisition is as follows:

|                                          |                |
|------------------------------------------|----------------|
| Cash outflow on acquisition:             |                |
| Cash paid (including transactions costs) | ₱58,776        |
| Less cash acquired from subsidiary       | (3,204)        |
| <b>Net cash outflow</b>                  | <b>₱55,572</b> |

From the date of acquisition, EDC has contributed ₱720 million (\$16.7 million) to the net income of the Group in 2007. If the business combination had taken place at the beginning of the year, the net income for the Group would have been ₱20,331 million (\$349.0 million) and revenue from continuing operations would have been ₱79,425 million (\$1,474.5 million).

Details of carrying values used in determining the provisional goodwill are as follows:

|                                     | Carrying Value<br>(In Millions) |
|-------------------------------------|---------------------------------|
| Net assets                          | ₱13,681                         |
| Provisional goodwill                | 45,095                          |
| <b>Cost of business combination</b> | <b>₱58,776</b>                  |

#### b. FPPII Acquisition

In September 2007, FPHC transferred all of its 15,043,635 shares in FPIDC, representing 51% equity interest in FPIDC, to FPPII, in exchange for 2,534,991,020 unissued shares in FPPII. The issuance of shares to FPHC was based on the unaudited net book value of FPIDC amounting to ₱4.97 billion as of December 31, 2007.

The goodwill from the exchange transaction was provisionally determined as the difference between fair value of the 15,043,635 FPIDC shares and fair value of the 2,534,991,020 FPII shares. The fair value of the FPII shares included the book value of shares of FPIDC, which became a subsidiary of FPII after the exchange of shares. The provisional goodwill was computed as follows:

|                                    |                      |
|------------------------------------|----------------------|
|                                    | <i>(In Millions)</i> |
| Cost of business combination (51%) | ₱3,176.0             |
| Fair value of net assets of FPII   | (3,169.1)            |
| <u>Goodwill</u>                    | <u>₱6.9</u>          |

The Company has twelve months from September 17, 2007, within which to determine the final purchase price allocation related to the foregoing acquisition.

c. Acquisition of Pantabangan-Masiway Hydro Electric Power Plant (PAHEP/MAHEP)

On September 8, 2006, FG Hydro participated and won the bid for the 112 MW PAHEP/MAHEP conducted by PSALM in connection with the privatization of NPC assets.

On October 5, 2006, following the successful bidding, FG Hydro entered into an Asset Purchase Agreement (APA) with PSALM for the purchase of the PAHEP/MAHEP facilities for a total consideration of ₱6,327 million (US\$129 million). On November 15, 2006 (the "Closing Date"), all the closing conditions for the execution of the APA were satisfied and the purchase was completed. Following the completion of the conditions precedent and the execution of the respective Certificates of Closing of FG Hydro and PSALM, the operations and maintenance of PAHEP/MAHEP was successfully transferred to FG Hydro on November 18, 2006.

Pursuant to the provisions of the APA, FG Hydro shall directly assume and agree to discharge the following as it pertains to the Purchased Assets, including but not limited to the following, among others from Closing Date:

- all rights, obligations and liabilities of PSALM arising from Operating Contracts which remain effective on or after the Closing Date;
- all rights, obligations and liabilities of PSALM arising from contracts which remain effective on or after the Closing Date, though with limitations; and
- all the rights and obligations of PSALM and/or NPC under the existing Power Supply Contracts, subject to their respective terms and conditions indicated in these contracts.

At the time of acquisition, with the initial accounting of the PAHEP/MAHEP goodwill determined provisionally, the difference between the acquisition price and preliminary fair value assigned to the identifiable tangible assets and liabilities was lumped under a goodwill account. Such provisional goodwill amounted to ₱1,764 million.

The total cost of the business combination was ₱6,327 million (\$129 million). Under the APA, 40% (₱2,531) of the total consideration was paid as an Up-Front Payment to PSALM on November 17, 2006 and the remaining 60% (the Deferred Payment Facility) will be paid in



fourteen semi-annual installments including 12% interest per annum compounded semi-annually. FG Hydro has the option to prepay the Deferred Payment Facility.

In 2007, the Company completed the valuation work for the water rights, which it had identified as the acquired intangible asset of PAHEP/MAHEP and determined goodwill amounting to ₱288 million at the time of acquisition. Accordingly, the purchase price was re-allocated as if the foregoing was identified at the time of acquisition.

The fair values of the identifiable assets of PAHEP/MAHEP were revised as follows:

|                                                        | Fair Values   | Provisional<br>Values | Adjustments |
|--------------------------------------------------------|---------------|-----------------------|-------------|
|                                                        |               | <i>(In Millions)</i>  |             |
| Property, plant and equipment<br>(see Note 12)         | ₱3,680        | ₱4,563                | (883)       |
| Water rights (see Note 16)                             | 2,359         | –                     | 2,359       |
| Goodwill arising from the<br>acquisition (see Note 15) | 288           | 1,764                 | (1,476)     |
| <b>Total consideration</b>                             | <b>₱6,327</b> | <b>₱6,327</b>         | <b>₱–</b>   |

The effect of the foregoing adjustments was accounted for retrospectively in the 2006 consolidated financial statements. However, the effect on the depreciation of property, plant and equipment and amortization of intangible asset (water rights) were charged to 2007 consolidated statement of income due to the immateriality of the amount.

The net cash flow on acquisition follows:

|                                      | Amount               |
|--------------------------------------|----------------------|
|                                      | <i>(In Millions)</i> |
| Cash outflow on acquisition:         |                      |
| Total consideration                  | ₱6,327               |
| Deferred payment facility with PSALM | (3,796)              |
| <b>Net cash outflow</b>              | <b>₱2,531</b>        |

To guarantee full, prompt, faithful and complete performance of FG Hydro's obligations in the APA, FG Hydro has executed a Performance Bond amounting to \$2.58 million or ₱106.8 million (2% of the total consideration) in the form of an irrevocable standby letter of credits. The Performance Bond which will be reduced every year equivalent to 2% of the aggregate amount of the unpaid Deferred Payment Facility with PSALM.

## 6. Effect of Adoption of Philippine Interpretation IFRIC 12

As discussed in Note 2 and as allowed by its transitional provisions, the First Holdings Group early adopted Philippine Interpretation IFRIC 12 in relation to its service concessions and related arrangements.

## Discussion of the Service Concessions and Related Agreements

### First Gen Group

#### BPPC

BPPC has an existing Fast Track Build, Operate and Transfer Project Agreement (BOT Project Agreement) with NPC for the design, financing, construction and operation of a 225 Megawatt (MW) Bunker-Fired Diesel Power Plant (see Note 36). Under the BOT Project Agreement, NPC supplies all the fuel required to generate electricity, with all electricity generated purchased by NPC. BPPC is entitled to payment of fixed capacity and operations and maintenance fees based on the nominated capacity of 225 MW, as well as energy fees from the delivery of electric power to NPC. The fixed capacity and operations and maintenance fees will be paid by NPC whether or not the energy is delivered by BPPC.

The Project Agreement is for a period of 15 years which runs up to July 2010 (Compensation period). Upon expiration of the 15-year period, BPPC shall transfer to NPC all of its rights, titles and interests in the power plant complex, free from liens created by BPPC and without any compensation.

#### PNOC-EDC

All geothermal resources in public and/or private lands in the Philippines, whether found in, on or under the surface of dry lands, creeks, rivers, lakes, or other submerged lands within the waters of the Philippines belong to the State, inalienable and imprescriptible, and their exploration, development and exploitation are governed under Presidential Decree (PD) No. 1442, "An Act to Promote the Exploration and Development of Geothermal Resources,". Under PD 1442, the Philippine Government may enter into service contracts for the exploration, development and exploitation of geothermal resources.

Pursuant to PD 1442, PNOC-EDC has entered into the following service contracts with the Government (as represented by the DOE) for the exploration, development and production of geothermal fluid for commercial utilization:

- 1) Tongonan, Leyte, dated May 14, 1981
- 2) Southern Negros, dated October 16, 1981
- 3) BacMan, Sorsogon, dated October 16, 1981
- 4) Mt. Apo, Kidapawan, Cotabato, dated March 24, 1992
- 5) Mt. Labo, Camarines Norte and Sur, dated March 19, 1994
- 6) Northern Negros, dated March 24, 1994
- 7) Mt. Cabalian, Southern Leyte, dated January 13, 1997

The exploration period under the service contracts is for a period of five years from the effective date of the GSC, renewable for another two years, if PNOC-EDC has not been in default in its exploration, financial and other work commitments and obligations and has provided a work program for the extension period acceptable to the Philippine Government. Where geothermal resource in commercial quantity is discovered during the exploration period, the service contracts remain in force for the remainder of the exploration period or any extension thereof and for an additional period of 25 years thereafter, provided that, if PNOC-EDC has not been in default in its

obligations under the contracts, the Philippine Government may grant an additional extension of 15 to 20 years.

The DOE approved the application of PNOC-EDC for the 20-year extension of the GSC for Tongonan, Palinpinon (Southern Negros) and BacMan. The 20-year extension is embodied in the fourth amendment to the GSCs dated October 30, 2003. The amendment extended the Tongonan GSC from May 15, 2011 to May 16, 2031, while the Palinpinon and BacMan GSCs are extended from October 16, 2011 to October 17, 2031.

PNOC-EDC acquires the geothermal operations materials, equipment, plants and other installations as required and necessary to carry out the geothermal operations. All materials, equipment, plants and other installations erected or placed on the contract areas of a movable nature by PNOC-EDC remain the property of PNOC-EDC, unless not removed therefrom within one year after the expiration and/or termination of the related service contract in which case, ownership will be vested with the Philippine Government.

The GSCs provide that, among other privileges, PNOC-EDC has the right to enter into agreements for the disposition of the geothermal resources produced from the contract areas, subject to the approval by the Philippine Government.

Pursuant to such right, PNOC-EDC has entered into SSAs for the sale of the geothermal resources produced from the service contract areas principally with the NPC (see Note 36d). The SSAs are for a period of 25 years and may be opened for renegotiation by either party after five years from the date of commercial operations.

EDC has also entered into PPAs with NPC for the development, construction and operation of geothermal power plants by PNOC-EDC in the service contract areas and the sale to NPC of the electrical energy generated from such geothermal power plants. The PPAs are for a period of 25 years of commercial operations and may be extended upon the request of PNOC-EDC by notice of not less than 12 months prior to the end of the contract period. The terms and conditions of any such extension are to be agreed upon by the parties.

EDC's agreements (both SSAs and PPAs) with NPC for the sale of the geothermal resources (steam) produced from the service contract areas and the sale of the electrical energy generated from the geothermal power plants contain certain provisions relating to price control in the form of a cap in PNOC-EDC's internal rate of return for specific contracts; as well as for payment by NPC of minimum guaranteed monthly remuneration and nominated capacity.

For the Northern Negros service contract, PNOC-EDC does not have agreement with NPC for the sale of the geothermal resources and electrical energy produced from the service contract area. Instead, PNOC-EDC entered into contracts with distribution utilities, electric cooperatives and other third party buyers of electricity for the sale of the electrical energy generated from the service contract.

Based on the assessment, all the GSCs of PNOC-EDC and the Project Agreement of BPPC are within the scope of Philippine Interpretation IFRIC 12 and qualify under the financial asset model except for the GSC for Northern Negros Project. The GSC for Northern Negros Project qualifies under the intangible asset model. Accordingly, the First Holdings Group recognized the consideration received or receivable in exchange for its infrastructure construction services or its

acquisition of infrastructure to be used in the arrangements as either a financial asset (concession receivables) to the extent the First Holdings Group has an unconditional contractual right to receive cash or other financial asset for its construction services from or at the direction of the grantor, or an intangible asset (concession rights) for the right to charge users of the public service.

Concession receivables are initially recognized at fair value of the construction services representing the minimum nominated capacity and guaranteed minimum remuneration pursuant to the PPAs and SSAs.

### *FPII Group*

As more fully discussed in Note 36, the Philippine Government (Grantor), acting by and through the Toll Regulatory Board (TRB), Philippine National Construction Corporation (PNCC, Franchisee) and Manila North Tollways Corporation (MNTC, Concessionaire, 67.1%-owned by FPII) executed the Supplemental Toll Operation Agreement (STOA) for the Manila-North Expressway, whereby the Government awarded the rights, obligations and privileges including the authority to finance, design, construct, operate and maintain the project roads as toll roads (Concession). Upon expiration of the concession period, MNTC shall hand-over the project roads to the Grantor without cost, free from any and all liens and encumbrances and fully operational and in good working condition, including any and all existing land required, works, toll road facilities and equipment found therein directly related to and in connection with the operation of the toll road facilities.

Based on the FPII's assessment, the concession agreement described in Note 36 is within the scope of IFRIC 12 and would qualify under the intangible asset model. As allowed by its transitional provisions, IFRIC 12 was early adopted with respect to such service concession and related arrangements. The adoption of this interpretation required the Company to recognize the roads and tollways, originally recorded as property and equipment, as an intangible asset in accordance with PAS 38, "Intangible Assets". This intangible asset is amortized using the straight-line method over the life of the concession agreement. Under the property and equipment classification, roads and tollways are depreciated over the estimated useful lives of the assets or term of concession agreement whichever is shorter. For tax purposes, the unit-of-production method of depreciation on roads and tollways was used, starting January 1, 2006 as approved by the Bureau of Internal Revenue (BIR).

MNTC also recognizes revenues and costs in accordance with PAS 11, "Construction Contracts." It measures contract revenue at the fair value of the consideration received or receivable. Since MNTC has subcontracted the construction to an outside contractor, the construction revenues recognized is equal to the construction cost.

MNTC will also recognize its contractual obligations to restore the assets to a specified level of serviceability. These contractual obligations will be recognized starting January 1, 2008 following the final turnover of the Project in October 2007. The Company, therefore, will recognize a provision following PAS 37, as the obligations arises which is as a consequence of the use of the road and therefore might be proportional to the number of vehicles using the road and increasing in measurable annual increments.

The adoption resulted in the changes to the following accounts of the consolidated financial statements as of and for the years ended December 31, 2007, 2006 and 2005:

|                                       | From First Gen*      |      |      | Increase (Decrease) in millions<br>From MNTC |          |          | Total           |          |          |
|---------------------------------------|----------------------|------|------|----------------------------------------------|----------|----------|-----------------|----------|----------|
|                                       | 2007                 | 2006 | 2005 | 2007                                         | 2006     | 2005     | 2007            | 2006     | 2005     |
|                                       | <i>(In Millions)</i> |      |      |                                              |          |          |                 |          |          |
| Concession receivable                 | <b>₱36,985</b>       | ₱-   | ₱-   | <b>₱-</b>                                    | ₱-       | ₱-       | <b>₱36,985</b>  | ₱-       | ₱-       |
| Property and equipment - net          | -                    | -    | -    | <b>(14,091)</b>                              | (15,196) | (15,934) | <b>(14,091)</b> | (15,196) | (15,934) |
| Intangible asset - net                | -                    | -    | -    | <b>15,200</b>                                | 16,028   | 15,200   | <b>15,200</b>   | 16,028   | 15,200   |
| Investment in an associate            | <b>410</b>           | 560  | 605  | -                                            | -        | -        | <b>410</b>      | 560      | 605      |
| Deferred tax liability - net          | -                    | -    | -    | <b>335</b>                                   | 241      | 171      | <b>335</b>      | 241      | 171      |
| Construction revenue                  | -                    | -    | -    | <b>45</b>                                    | 233      | 1,569    | <b>45</b>       | 233      | 1,569    |
| Construction costs                    | -                    | -    | -    | <b>(45)</b>                                  | (233)    | (1,569)  | <b>(45)</b>     | (233)    | (1,569)  |
| Cost of services                      | -                    | -    | -    | <b>276</b>                                   | 252      | 572      | <b>276</b>      | 252      | 572      |
| Share in net earnings of an associate | <b>(99)</b>          | (30) | 5    | -                                            | -        | -        | <b>(99)</b>     | (30)     | 5        |
| Provision for deferred tax            | -                    | -    | -    | <b>83</b>                                    | 79       | 171      | <b>83</b>       | 79       | 171      |
| Net income                            | <b>(149)</b>         | (44) | 8    | <b>193</b>                                   | 169      | -        | <b>44</b>       | 125      | 8        |
| Retained earnings, beginning of year  | <b>359</b>           | 403  | 395  | <b>773</b>                                   | 604      | 604      | <b>1,132</b>    | 1007     | 999      |

\*Consists of the impact from early adoption of IFRIC 12 by PNOC-EDC (subsidiary) and BPPC (associate).

## 7. Cash and Cash Equivalents

This account consists of:

|                       | 2007                 | 2006    |
|-----------------------|----------------------|---------|
|                       | <i>(In Millions)</i> |         |
| Cash on hand          | <b>₱7</b>            | ₱1      |
| Cash in banks         | <b>1,937</b>         | 5,210   |
| Short-term placements | <b>12,879</b>        | 27,038  |
|                       | <b>₱14,823</b>       | ₱32,249 |

Cash in banks earns interest at the prevailing bank deposit rates. Short-term placements are made for varying periods of up to three months depending on the immediate cash requirements of the First Holdings Group, and earn interest at the prevailing short-term placement rates.

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## 8. Trade and Other Receivables

This account consists of:

|                                                                      | 2007                 | 2006    |
|----------------------------------------------------------------------|----------------------|---------|
|                                                                      | <i>(In Millions)</i> |         |
| Trade (see Notes 34 and 35)                                          | <b>₱10,807</b>       | ₱9,778  |
| Current portion of receivables from Meralco<br>for annual deficiency | <b>2,299</b>         | 2,042   |
| Concession receivables - current<br>(see Notes 34 and 36)            | <b>2,200</b>         | -       |
| Cost of estimated earnings in excess of billings                     | <b>108</b>           | 82      |
| Others                                                               | <b>1,347</b>         | 899     |
|                                                                      | <b>16,761</b>        | 12,801  |
| Less allowance for doubtful accounts                                 | <b>461</b>           | 82      |
|                                                                      | <b>₱16,300</b>       | ₱12,719 |

In 2007, the First Holdings Group's provision and reversal of doubtful accounts amount to ₱427 million and ₱48 million, respectively. Allowance for doubtful accounts pertain to trade receivables.

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## 9. Inventories

This account consists of:

|                           | 2007                 | 2006   |
|---------------------------|----------------------|--------|
|                           | <i>(In Millions)</i> |        |
| At cost:                  |                      |        |
| Fuel inventories          | <b>₱3,380</b>        | ₱35    |
| Real estate               | <b>952</b>           | 1,079  |
| Work in process           | <b>104</b>           | 230    |
| Finished goods            | <b>83</b>            | 77     |
| At net realizable value:  |                      |        |
| Raw materials             | <b>395</b>           | 299    |
| Spare parts and supplies: | <b>219</b>           | 18     |
| In-transit                | <b>76</b>            | 79     |
|                           | <b>₱5,209</b>        | ₱1,817 |

The cost of raw materials amounted to ₱422 million in 2007 and ₱332 million in 2006. The cost of Spare parts and supplies amounted to ₱230 million in 2007 and ₱19 million in 2006.

Spare parts and supplies consist of consumables, which are issued to operations or production. Such issuances are charged to operations.

## 10. Other Current Assets

This account consists of:

|                                                                   | 2007                 | 2006          |
|-------------------------------------------------------------------|----------------------|---------------|
|                                                                   | <i>(In Millions)</i> |               |
| Prepaid expenses                                                  | <b>₱1,998</b>        | ₱2,356        |
| Noncurrent assets held for sale                                   | <b>1,673</b>         | —             |
| AFS investments                                                   | <b>1,178</b>         | —             |
| Share in current assets of joint venture<br>(see Notes 13 and 35) | <b>1,080</b>         | 124           |
| Input VAT                                                         | <b>254</b>           | 258           |
| FVPL investments                                                  | <b>83</b>            | 275           |
| Restricted cash deposits (see Notes 21 and 35)                    | —                    | 103           |
| Others                                                            | <b>836</b>           | 188           |
|                                                                   | <b>₱7,102</b>        | <b>₱3,304</b> |

Noncurrent assets held for sale consist of several parcels of land held by PNOC-EDC which are located in Fort Bonifacio, Taguig City. On November 13, 2007, the BOD of EDC approved resolution No. 115, series of 2007, whereby it has signed an Agreement to sell such properties to PNOC. The sale is expected to be consummated within 12 months from December 31, 2007. There are no known liabilities directly associated with the disposal of such assets held for sale.

FVPL investments consist of investments in shares of stock of SiRF technology Holdings, Inc. (SiRF) which are held for trading. The fair value SiRF shares of stock is based on the quoted price as traded in the US stock market. Unrealized fair value gains on this investment amounted to ₱2.2 million and ₱264.0 million in 2007 and 2006, respectively.

## 11. Investments Equity and Deposits

The First Holdings Group's associates, all incorporated in the Philippines, consist of the following:

| Associate                               | Principal Activity      | Percentage of Ownership |       |
|-----------------------------------------|-------------------------|-------------------------|-------|
|                                         |                         | 2007                    | 2006  |
| FPPC and Subsidiary                     | Power generation        | <b>40.00</b>            | 40.00 |
| FSCI                                    | Semiconductors          | <b>40.00</b>            | 40.00 |
| Panay Electric Company (Panay Electric) | Power distribution      | <b>30.00</b>            | 30.00 |
| MERALCO and Subsidiaries                | Power distribution      | <b>24.45</b>            | 17.68 |
| Rockwell Land Corporation<br>(ROCKWELL) | Real estate development | <b>24.50</b>            | 24.50 |

On December 22, 2007, FPHC acquired the 6.6% interest in the outstanding common stock of MERALCO from the Meralco Pension Fund. The 6.6% interest consists of 37,625,625 Class "A" common stock and 28,793,321 Class "B" common stock for a total consideration of ₱8.3 billion. FPHC paid for the consideration in three tranches from July 17, 2007 (date of execution of a Memorandum of Agreement) through December 22, 2007. The unpaid balance during the

payment period was subject to interest at 6% per annum. Total interest paid amounted to ₱106.9 million and is recorded as “finance costs” in the 2007 consolidated statement of income. As of December 31, 2007, the goodwill included as part of the cost of investment was provisionally determined as the difference between the acquisition price and FPHC’s share in net assets of MERALCO. Final adjustment for the purchase price allocation will be done in 2008.

On July 5, 2007, FPHC and Union Fenosa Internacional, S.A. (Union Fenosa) signed a Memorandum of Agreement, whereby FPHC agreed to purchase all of Union Fenosa’s 40% economic and voting interest in FPUFI for a total consideration of \$250 million. Such interest consists of 19,090,400 shares of redeemable stock and 24,798 shares of common stock in FPUFI. FPHC currently owns 60% of the equity of FPUFI.

FPUFI owns 253,093,270 common shares of MERALCO as of December 31, 2007. FPHC has deposited a total of ₱9,974 million (\$220 million) as of December 31, 2007. The balance of ₱1,238, million (\$30 million) was paid on January 23, 2008. The rights to the FPUFI shares were transferred to FPHC upon closing of the transaction in January 2008 and delivery by Union Fenosa of the duly endorsed stock certificates to FPHC.

With the foregoing completed acquisitions, the total direct and indirect interest of FPHC in MERALCO is 33.38%.

This account consists of:

|                                                     | 2007                 | 2006           |
|-----------------------------------------------------|----------------------|----------------|
|                                                     | <i>(In Millions)</i> |                |
| Investments in shares of stock                      | ₱27,948              | ₱17,706        |
| Deposits for future investments - net (see Note 32) | 10,249               | 625            |
|                                                     | <b>₱38,197</b>       | <b>₱18,331</b> |

The details of the investments in shares of stock follow:

|                                              | 2007                 | 2006           |
|----------------------------------------------|----------------------|----------------|
|                                              | <i>(In Millions)</i> |                |
| Investments in associates - at equity:       |                      |                |
| Acquisition cost of investments              |                      |                |
| Balance at beginning of year                 | ₱20,703              | ₱20,847        |
| Additions                                    | 9,741                | (38)           |
| Disposals                                    | (418)                | (10)           |
| Foreign currency translation adjustment      | -                    | (96)           |
| Balance at end of year                       | <b>30,026</b>        | 20,703         |
| Accumulated equity in net losses:            |                      |                |
| Balance at beginning of year                 | (3,196)              | (6,996)        |
| Equity in net earnings of associates         | 1,690                | 4,163          |
| Dividends received                           | (713)                | (941)          |
| Effect of Philippine Interpretation IFRIC 12 | -                    | 617            |
| Foreign currency translation adjustments     | (8)                  | (39)           |
| (Total Carried Forward)                      | <b>(2,227)</b>       | <b>(3,196)</b> |



|                                                                                                  | 2007                 | 2006            |
|--------------------------------------------------------------------------------------------------|----------------------|-----------------|
|                                                                                                  | <i>(In Millions)</i> |                 |
| (Total Brought Forward)                                                                          | <b>(₱2,227)</b>      | <b>(₱3,196)</b> |
| Share in cumulative translation adjustments of an associate:                                     |                      |                 |
| Balance at beginning of year                                                                     | 53                   | (78)            |
| Foreign currency translation adjustments                                                         | 77                   | 131             |
| Balance at end of year                                                                           | <b>130</b>           | <b>53</b>       |
| Share in unrealized fair value gains on available-for-sale investments of an associate           |                      |                 |
| Balance at beginning of year                                                                     | 12                   | 5               |
| Change in share in unrealized fair value gains on available-for-sale investments during the year | 7                    | 7               |
| Balance at end of year                                                                           | <b>19</b>            | <b>12</b>       |
|                                                                                                  | <b>27,948</b>        | <b>17,572</b>   |
| Others - at fair value                                                                           | -                    | 134             |
|                                                                                                  | <b>₱27,948</b>       | <b>₱17,706</b>  |

The carrying values of the First Holdings Group's investments in associates follow:

|                | 2007                 | 2006           |
|----------------|----------------------|----------------|
|                | <i>(In Millions)</i> |                |
| MERALCO        | <b>₱23,193</b>       | <b>₱13,613</b> |
| ROCKWELL       | <b>1,616</b>         | <b>1,556</b>   |
| FPPC           | <b>1,490</b>         | <b>1,231</b>   |
| FSCI           | <b>253</b>           | <b>144</b>     |
| Panay Electric | <b>243</b>           | <b>257</b>     |
| Others         | <b>1,153</b>         | <b>905</b>     |
|                | <b>₱27,948</b>       | <b>₱17,706</b> |

The fair value of the MERALCO shares as of December 31, 2007 and 2006 was ₱30.7 billion and ₱14.6 billion, respectively, while those of ROCKWELL, FPPC, FSCI and Panay Electric are not determinable since there is no publicly quoted price available for such shares.

Following are the condensed financial information of First Holdings Group's significant associates namely, MERALCO, ROCKWELL and FPPC and subsidiary. Such information represents the equivalent to their equity ownership of the Company:

|                     | 2007                 |                     | 2006           |                     |
|---------------------|----------------------|---------------------|----------------|---------------------|
|                     | Current Assets       | Current Liabilities | Current Assets | Current Liabilities |
|                     | <i>(In Millions)</i> |                     |                |                     |
| MERALCO             | <b>₱11,385</b>       | <b>₱12,196</b>      | <b>₱8,300</b>  | <b>₱8,484</b>       |
| ROCKWELL            | <b>1,751</b>         | <b>432</b>          | <b>1,317</b>   | <b>306</b>          |
| FPPC and subsidiary | <b>741</b>           | <b>160</b>          | <b>739</b>     | <b>490</b>          |

|                      | 2007           |                   | 2006         |                   |
|----------------------|----------------|-------------------|--------------|-------------------|
|                      | Total Assets   | Total Liabilities | Total Assets | Total Liabilities |
| <i>(In Millions)</i> |                |                   |              |                   |
| MERALCO              | <b>₱44,214</b> | <b>₱30,762</b>    | ₱30,855      | ₱21,843           |
| ROCKWELL             | <b>3,010</b>   | <b>1,386</b>      | 2,338        | 774               |
| FPPC and subsidiary  | <b>2,113</b>   | <b>1,012</b>      | 1,855        | 570               |
| Revenue              |                |                   |              |                   |
|                      | 2007           |                   | 2006         | 2005              |
| <i>(In Millions)</i> |                |                   |              |                   |
| MERALCO              | <b>₱49,069</b> |                   | ₱33,731      | ₱30,811           |
| ROCKWELL             | <b>871</b>     |                   | 706          | 625               |
| FPPC and subsidiary  | <b>1,034</b>   |                   | 1,097        | 1,140             |
| Cost and Expenses    |                |                   |              |                   |
|                      | 2007           |                   | 2006         | 2005              |
| <i>(In Millions)</i> |                |                   |              |                   |
| MERALCO              | <b>₱47,580</b> |                   | ₱32,635      | ₱30,072           |
| ROCKWELL             | <b>674</b>     |                   | 564          | 514               |
| FPPC and subsidiary  | <b>363</b>     |                   | 380          | 466               |
| Net Income (Loss)    |                |                   |              |                   |
|                      | 2007           |                   | 2006         | 2005              |
| <i>(In Millions)</i> |                |                   |              |                   |
| MERALCO              | <b>₱919</b>    |                   | ₱2,420       | (₱61.88)          |
| ROCKWELL             | <b>117</b>     |                   | 86           | 71                |
| FPPC and subsidiary  | <b>509</b>     |                   | 510          | 412               |

Following are information about and major transactions of significant associates:

#### I. MERALCO

##### General

MERALCO distributes power under separate franchises granted by the Philippine Government. On March 24, 2003, the ERC granted MERALCO a Provisional Authority to continue to operate electric services in the cities of Manila, San Juan, Las Piñas, Quezon, Malabon, Makati, Caloocan, Pasay, Mandaluyong and Parañaque and the municipality of Navotas. On June 9, 2003, RA 9209 was signed into law granting MERALCO a 25-year franchise to construct, operate and maintain an electric distribution system. RA 9209 consolidated 50 previously held franchises of MERALCO covering 25 cities and 86 municipalities in Metro Manila and six surrounding provinces.

MERALCO is subject to the rate-making regulations and policies of the ERC. The ERC replaced the Energy Regulatory Board (ERB) under RA 9136, otherwise known as the Electric Power Industry Reform Act (EPIRA) of 2001.

MERALCO, as a distribution utility, is subject to the rate-making regulations and regulatory policies of the ERC. MERALCO's billings to customers are itemized or "unbundled." The adjustment of each bill component is governed by corresponding mechanisms, promulgated and enforced by the ERC, such as:

| Unbundled Bill Component                                | Mechanism                                                                                                                                                                                                                                                                                                             |
|---------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Generation and System Loss Charges                      | <ul style="list-style-type: none"> <li>▪ Guidelines for the Automatic Adjustment of Generation Rates and System Loss Rates by Distribution Utilities, as Amended (AGRA)</li> </ul>                                                                                                                                    |
| Transmission Charge                                     | <ul style="list-style-type: none"> <li>▪ Guidelines for the Adjustment of Transmission Rates by Distribution Utilities (TRAM)</li> <li>▪ Rules for Calculation of the Over or Under Recovery in the Implementation of Transmission Rates and the Corresponding System Loss Rates by Distribution Utilities</li> </ul> |
| Distribution Charge, Supply Charge, and Metering Charge | <ul style="list-style-type: none"> <li>▪ Rules for the Setting of Distribution Wheeling Rates (RDWR)</li> </ul>                                                                                                                                                                                                       |
| CERA                                                    | <ul style="list-style-type: none"> <li>▪ Implementing Rules for the Incremental Currency Exchange Rate Adjustment (ICERA)</li> </ul>                                                                                                                                                                                  |
| Lifeline Rate/Subsidy                                   | <ul style="list-style-type: none"> <li>▪ Guidelines for the Calculation of the Over or Under Recovery in the Implementation of Lifeline Rates by Distribution Utilities</li> </ul>                                                                                                                                    |
| Inter-class subsidy                                     | <ul style="list-style-type: none"> <li>▪ Guidelines for a "True-Up" Mechanism of the Over or Under Recovery in the Implementation of Inter-class Cross Subsidy Removal by Distribution Utilities</li> </ul>                                                                                                           |

The status of MERALCO's rate cases follows:

a. First Performance-Based Rate (PBR) Application

In accordance with the ERC's RDWR, MERALCO, along with two other distribution utilities (Dagupan Electric Corporation and Cagayan Electric Power and Light Company), filed its first PBR application last September 1, 2006.

The RDWR, formerly known as the Distribution Wheeling Rate Guidelines (DWRG), embodies a new rate-fixing scheme more popularly known as performance-based rate-making, or PBR. Under the return on rate base (RORB) methodology, utility tariffs are based on historical costs plus a reasonable rate of return. On the other hand, the PBR scheme sets tariffs according to forecasts of operational performance and of capital and operating expenditures. The RDWR also employs a penalty/reward mechanism depending on a utility's actual performance.

On August 31, 2007, the ERC issued its Final Determination, which set forth its evaluation of MERALCO's annual revenue requirement and approved the performance incentive scheme and price control arrangements that will apply to MERALCO during the Second Regulatory Period (from July 1, 2008 to June 30, 2011). The approved Maximum Annual Prices (MAP) are ₱1.167 per kWh, ₱1.260 per kWh, ₱1.361 per kWh, and ₱1.471 per kWh for the regulatory years 2008, 2009, 2010, and 2011, respectively. (A regulatory year begins in July and ends in June of the following year. Thus, the 2008 regulatory year begins on July 1, 2007 and ends on June 30, 2008.)

On September 17, 2007, MERALCO filed with the ERC a Motion for Reconsideration (MR) and Clarification that includes an appeal for a higher Weighted Average Cost of Capital (WACC) or a mechanism that would allow for a reopening of the ERC's determination should there be material changes in the components of the WACC computation. The ERC utilized a common WACC of 12.80% for MERALCO, Dagupan Electric Corporation, and Cagayan Electric Power and Light Company. MERALCO proposed a WACC of 15.63%.

In the same Motion, MERALCO likewise asked ERC to provide additional allowances for employee pension/benefit costs and working capital for purchased power costs. On October 11, 2007, the Parent Company also filed a Supplemental Motion for Reconsideration of the Side Constraint conditions approved in the ERC's final determination.

Through an Order released December 18, 2007, the ERC denied MERALCO's MR. On the WACC, the ERC reaffirmed the 12.80% WACC used in its final determination, but it also said that it may "allow for the adjustment of the WACC during the Second Regulatory Period should material changes between later figures and that calculated at the start of the regulatory period arise." The ERC, thus, suggested a modification to the RDWR to allow for a reopening of the approved rates should there be material changes in the WACC and in operating and maintenance expenditures during the Second Regulatory Period.

On January 11, 2008, MERALCO filed an application for the approval of its proposed translation of the MAP for regulatory year 2008 into different rate schedules for its various customer segments. Hearings related to the application were held on February 18 and 19, 2008 and terminated on March 6, 2008. Following the completion of various submissions, the case will be deemed submitted for decision by the ERC.

b. Ten Applications for Recovery of Generation Costs

During the period in which the AGRA mechanism was suspended by the ERC, MERALCO filed ten separate applications for the full recovery of generation costs, including VAT, for the supply months of August 2006 to May 2007, as follows:

| Case Numbers                 | Date Filed         | Supply Month   | Billing Month  | Under (Over) Recovery |             |
|------------------------------|--------------------|----------------|----------------|-----------------------|-------------|
|                              |                    |                |                | Generation Cost       | System Loss |
| <i>(Amounts in Millions)</i> |                    |                |                |                       |             |
| 2006-052RC                   | September 26, 2006 | August 2006    | September 2006 | ₱568                  | ₱55         |
| 2006-062RC                   | October 23, 2006   | September 2006 | October 2006   | 873                   | 114         |
| 2006-076RC                   | December 12, 2006  | October 2006   | November 2006  | 1,372                 | 90          |
| 2006-001RC                   | January 2, 2007    | November 2006  | December 2006  | 2,021                 | 219         |
| 2006-038RC                   | February 13, 2007  | December 2006  | January 2007   | 3,560                 | 294         |
| 2006-078RC                   | March 8, 2007      | January 2007   | February 2007  | (413)                 | (31)        |
| 2006-101RC                   | April 3, 2007      | February 2007  | March 2007     | (196)                 | 18          |
| 2006-120RC                   | May 17, 2007       | March 2007     | April 2007     | 1,755                 | 129         |
| 2006-123RC                   | June 1, 2007       | April 2007     | May 2007       | 2,143                 | 302         |
| 2006-135RC                   | July 23, 2007      | May 2007       | June 2007      | 996                   | 105         |
|                              |                    |                |                | ₱12,679               | ₱1,295      |

On January 18, 2008, the ERC issued an Order allowing MERALCO to collect the amount of ₱8,829 million through a ₱0.1662 per kWh charge on its billings to customers.

In the same Order, the ERC directed MERALCO to refund to its customers the amount refunded by Philippine Electric Market Corporation (PEMC) relative to the Net Settlement Surplus (NSS) in order to mitigate the impact of the increase in its generation cost. The NSS was estimated at ₱2,812 million. The amount is to be refunded through a ₱0.1614 per kWh credit to customers' bills beginning February 2008 and will continue until the ₱2,812 million is fully refunded.

The decision on the remaining ₱3,850 million, representing the balance of MERALCO's generation cost under-recoveries, is still pending at the ERC. In addition, MERALCO is also expecting the ERC to decide on its pending applications for recovery of system loss adjustments amounting to ₱1,295 million.

c. Generation Rate Adjustment Mechanism (GRAM) Case

In its March 2003 Decision on MERALCO's rate unbundling, the ERC directed MERALCO to discontinue implementing the Purchased Power Adjustment (PPA) clause in its tariffs. Instead, subsequent changes in the Parent Company's generation charge would be covered by the ERC's GRAM rules.

Under the GRAM rules promulgated by the ERC in February 2003, a distribution utility was required to file a deferred generation cost accounting application, setting forth its calculations of the generation rate. The GRAM rules neither require the publication of the application prior to its filing with the ERC nor the conduct of formal hearings thereon.

MERALCO made three filings under the GRAM rules and, with the replacement of GRAM by an AGRA mechanism starting November 2004, it also made a final GRAM filing to account for all generation costs prior to November 2004.

The ERC's approval of its second GRAM filing was questioned before the Supreme Court of the Philippines (SC) by a group of electricity consumers. According to their petition, MERALCO and the ERC failed to comply with Sec. 4(e), Rule 3 of EPIRA's Implementing Rules and Regulations (IRR), which required publication, notice, and hearing of application prior to issuance of the second GRAM Order.

In a Decision dated February 2, 2006, the SC ruled that strict compliance to Sec. 4(e), Rule 3 of the EPIRA IRR is jurisdictional and applies to GRAM. Accordingly, the ERC's second GRAM Order was declared void and set aside. On February 20, 2006, the ERC and MERALCO filed separate motions asking the SC to reconsider its decision. However, through a Resolution promulgated last August 16, 2006, the MRs filed by the ERC and the MERALCO were denied with finality by the SC.

MERALCO was thereby directed to refund to affected customers the amount of ₱0.1327 per kWh "reckoned from when the same was charged and collected." Accordingly, MERALCO recognized the GRAM to be refunded amounting to ₱827 million as of December 31, 2006. In 2007, the Parent Company refunded ₱745 million to its customers. MERALCO will be filing an application with ERC for the recovery of the total GRAM refund amounting to ₱827 million.

d. Unbundling Rate Case Filed with the SC

On April 14, 2000, MERALCO filed with the ERB an application for a ₱0.30 per kWh rate increase.

In accordance with Section 36 of RA No. 9136, MERALCO filed a petition for its unbundled rate charges with the ERC on December 26, 2001. On June 17, 2002, the ERC issued an Order consolidating its ₱0.30 per kWh rate increase petition (ERC Case No. 2001-646) with its unbundling petition (ERC Case No. 2001-900) in order to simplify and expedite the resolution of the rate cases. All records and proceedings of the rate increase application were deemed consolidated with that of the unbundling. The hearings on the consolidated petitions were terminated on December 19, 2002.

On March 30, 2003, the ERC issued an Order approving its unbundled tariffs that resulted in a total increase of ₱0.17 per kWh over May 2003 levels, after giving effect to the reduction of rates ordered by the SC in April 2003. This consisted of ₱0.0835 per kWh increase reflecting higher generation and transmission charges and ₱0.0865 per kWh increase in MERALCO-related charges (distribution, supply and metering). The tariff increase was implemented in June 2003.

On August 4, 2003, certain consumer and civil society groups filed with the Court of Appeals (CA) a "Petition for Review" of the ERC's ruling. On July 22, 2004, the CA set aside the ERC's ruling on MERALCO's rate unbundling and remanded the case back to the ERC. According to the CA, the ERC should have asked the Commission on Audit (COA) to audit the books of MERALCO. The ERC and MERALCO subsequently filed

separate motions asking the CA to reconsider its decision. On January 24, 2005, the CA denied the motions, thus, the ERC and MERALCO elevated the case to the SC.

In an En Banc Decision promulgated on December 6, 2006, the SC set aside and reversed the CA ruling saying that a COA audit was not a prerequisite in the determination of a utility's rates. Under PAS 37, if it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the obligation should be reversed. The reversal of such provision should be recognized prospectively as required by PAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors." Accordingly, in 2006, MERALCO reversed the entire provision for probable losses related to this case amounting to ₱15,725 million.

However, while the SC affirmed the ERC's authority in rate-fixing, the SC also recognized the potential social impact of the matter. Thus, the SC directed the ERC to request COA to undertake a complete audit of the books, records and accounts of MERALCO. On January 15, 2007, in compliance with the SC's directive, the ERC requested the COA to conduct an audit of the books, records, and accounts of MERALCO.

As of April 11, 2008, MERALCO is neither aware of any MR that has been filed regarding the SC's Decision nor of any reply by COA that was received by ERC on the latter's request for an audit of its books.

e. Rate Increase Application dated May 31, 2005

On May 31, 2005, MERALCO filed an application with the ERC (ERC Case No. 2005-028) seeking to adjust its rate by an average of ₱0.1476 per kWh based on (a) an independent appraisal of its 2004 assets appraised at an exchange rate of ₱56.267:US\$1.00; (b) its 2004 audited financial statements; and (c) its WACC for 2004.

On July 13, 2007, MERALCO filed a motion at the ERC to withdraw its ₱0.1476 per kWh rate petition on the ground that the Final Determination by ERC in its PBR Application docketed as ERC Case No. 2006-045 would effectively supersede whatever decision that would be rendered by it in connection with the ₱0.1476 per kWh application, considering that both cases would result in adjustment in the distribution wheeling rates of MERALCO. The ERC has not yet made a ruling on the motion to withdraw.

f. SC Decision on the ₱0.167 per kWh Refund

Following the SC's final ruling that directed MERALCO to refund affected customers ₱0.167 per kWh covering the billing period from February 1994 to April 30, 2003, the ERC approved the release of the refund in four phases. The last phase, Phase IV (for non-residential accounts), is ongoing.

g. Time-Of-Use (TOU) Rate Application

In an Order dated June 27, 2007, the ERC provisionally approved MERALCO's retail TOU rate application. MERALCO refiled its TOU application on April 16, 2007 in compliance with an April 2005 directive from the ERC for all distribution utilities (DUs) to file TOU tariffs.

Under MERALCO's TOU rate application, it will utilize four pricing blocks (peak/off-peak for Monday to Saturday and peak/off-peak for Sunday), and initially make the program available to Non-Industrial Service and Industrial Service (NIS/IS) customers with a minimum demand of 750 kWh and residential customers with a minimum monthly consumption of 2,000 kWh.

Together with MERALCO's Customer Choice Program, the provision of retail TOU tariffs seeks to provide its end-users a variety of rate options to better manage the generation component of the electric bill. As of December 31, 2007, generation-related charges accounted for about two-thirds of the overall average rate to end-users.

On the same date, the BOD likewise approved the declaration of cash dividend to common shareholders of record as of April 16, 2008 at the rate of ₱0.50 per share payable on May 13, 2008. In connection with this, the management is directed to appropriate ₱1,100 million from the unrestricted retained earnings as of February 29, 2008 for the said cash dividend and such other cash dividend as may be declared by the BOD within the year.

Contingencies of MERALCO

1) Contingent assets

- a. As of December 31, 2007, MERALCO has contingent asset amounting to ₱9,087 million consisting of under-recoveries for Transmission Charge of ₱6,361 million, Lifeline and Inter-class Subsidy of ₱1,921 million and System Loss Charge of ₱805 million. These under-recoveries accumulated in the absence of an adjustment mechanism for these two charges when the unbundled rates were implemented.

Guidelines prescribing a recovery mechanism for the under-recoveries on the system loss charge for prior periods promulgated by the ERC on November 23, 2005 became effective only on January 12, 2005.

Based on these guidelines, MERALCO may already start recovering ₱284 million of unbilled system loss charges. Implementation of the recovery is through a ₱0.0084 per kwh adjustment to the system loss charge for all consumptions starting with the February 2006 billing and will continue until the amount is fully collected. However, following ERC's provisional approval of MERALCO's application to recover the September 2006 generation costs, the collection of the remaining unbilled system loss charges has been suspended.



While the Guidelines on the Adjustment of Transmission Rates by DUs have already been promulgated last September 28, 2005, the said guidelines do not prescribe a recovery mechanism for the under-recoveries in transmission charges for prior periods. Meanwhile, on October 1, 2004, the ERC released an Order that resulted in the revision of the computation of the Transmission Charge component of the minimum charge. Such revision meant a potential liability to customers estimated at ₱1.1 billion as of April 12, 2007. Consequently, on September 26, 2007, MERALCO filed an application to recover ₱5,554 million in transmission charge under-recoveries accumulated over the period June 2003 to July 2007, along with a corresponding carrying cost. The application is currently undergoing hearings at the ERC.

Following the SC's GRAM ruling, to ensure that regulated entities such as MERALCO will be able to comply with jurisdictional and procedural requirements for rate adjustments as enunciated in the said ruling, ERC is drafting the "Rules to Govern the Filing of Consolidated, Monthly/Annual Applications for Adjustments of Rates Under Adjustment True-Up Mechanism" to be approved by the ERC.

- b. MERALCO has a contingent asset for overpaid income taxes for taxable years 1994 to 1998 and 2000 to 2001 estimated at ₱7.1 billion. MERALCO has filed its claim for the recovery of the excess income taxes for the said taxable years. The BIR has issued the letters of authority for the examination of MERALCO's books during the said periods, including submission of the documents. The BIR examination resulted in net income tax refund of ₱6.7 billion subject to a resolution of the issue on prescription, which is being heard by the Court of Tax Appeals (CTA). In 2005, the BIR granted MERALCO an income tax refund for taxable year 2001 of ₱894 million. MERALCO amended its Petition in the CTA to reflect the recoverable amount established by the BIR.

Likewise, MERALCO has a contingent asset for overpaid income taxes for the years 1987 and 1988 amounting to ₱107 million. MERALCO's claim was granted by the CTA in its decision dated August 23, 1995 and the same was affirmed by the Second Division of the SC on October 10, 2007. The Commissioner on Internal Revenue filed a Motion for Reconsideration on November 9, 2007 but was denied by the SC with finality on February 4, 2008.

## 2) Contingent liabilities

### a. Realty tax assessment

MERALCO is being assessed by six local government units (LGUs) for realty taxes on certain properties such as electric poles, wires, insulators, and transformers. One of these cases is now on appeal with the SC because of the CA's decision declaring that the electric poles, wires, insulators and transformers are subject to realty tax under the Local Government Code (LGC). An adverse decision on any of these cases may result in tax assessments by all LGUs within the franchise areas of MERALCO. To date, there are 114 cities and municipalities under MERALCO's franchise.

To address the possible liabilities for realty taxes, MERALCO filed an application for a mechanism to recover all types of tax assessments by LGUs, excluding the local franchise tax with the ERC on December 23, 2004. The first and only hearing related to the application filed was conducted on May 23, 2005. MERALCO is awaiting the guidelines from ERC that would set forth the recovery mechanism for these taxes. MERALCO believes that with a “pass-through” mechanism, the LGUs will exercise prudence with respect to the issuance of an assessment since a retroactive or prospective application will translate to higher amount of bills for its constituents.

In the meantime, in the Final Determination by the ERC of MERALCO’s application for the approval of the annual revenue requirements under ERC Case No 2006-045, the ERC has removed the provision for real property taxes currently being challenged in court by MERALCO, considering that “uncertainty exists around whether expenditure will occur at all.” According to the ERC, “Article XI of the Rules for the setting of the Distribution Wheeling Rates allows for a tax event pass through. However, in terms of the definition of Relevant Tax Events covered under this Article, most of the expenses covered under license fees, levies, duties and other taxes would not qualify. The ERC recognizes that uncertainty exists with regard to the current taxes discussed above and that the new taxes or levies could potentially arise that are not currently foreseen. It is therefore prepared to consider amending Article XI, after following due process, if material unforeseen expenses in this regard arise, including those currently recommended for exclusion

b. Local franchise tax

MERALCO was assessed by certain local governments for local franchise tax during the period when such LGUs were not qualified to issue assessments. In the opinion of management and its legal counsel, MERALCO has strong legal grounds to contest the assessments. Moreover, if management will agree to pay the assessments, any interested party may contest the “pass-through” of such payments in the bills of consumers as not prudent recoverable costs. At any rate, even assuming that the said assessments are upheld by the courts, the principle adopted by the ERC is that franchise tax payments are recoverable from the rates. The unbundled rates approved by the ERC allow MERALCO to recover the current franchise tax payments.

The final outcome of the realty and local franchise tax assessments cannot presently be determined. No other provisions for liabilities, other than those provided for pending cases, that may arise from additional cases in the event of any adverse decision on these cases, have been made in the consolidated financial statements of MERALCO.

c. Income tax assessments

When the SC decision ordering MERALCO to refund ₱0.167 per kWh to affected customers became final in April 2003, it resulted in total overpayment of income taxes of ₱8.9 billion estimated at that time. MERALCO exercised its option to amend its income tax return for taxable year 1999, which was then pending for audit by the BIR, to reflect an overpayment of income tax for that year in the sum of ₱977 million. The overpayment of ₱977 million was carried over and credited to the income tax

liabilities for taxable year 2002, since the books of accounts of MERALCO for the years 2000 and 2001 have already been audited and examined by the BIR and the corresponding returns can no longer be amended.

On March 16, 2007, MERALCO received a Preliminary Assessment Notice dated January 2, 2007 from the BIR Large Taxpayers Division disallowing the carryover and crediting of overpaid income tax of ₱977 million for taxable year 1999 to taxable year 2002. The BIR Preliminary Assessment Notice was for ₱2.2 billion including surcharge and interests.

The BIR maintained that the disallowance of the carryover was on the ground that the crediting of the 1999 overpayment of income tax was done beyond the two-year prescriptive period to ask for tax refund and that such carryover of tax credit can only be applied in the immediately succeeding year.

MERALCO intends to protest this assessment and even go to the extent of contesting this assessment before the CTA. It strongly believes that it had acted properly when it credited the ₱977 million overpayment of income tax in 1999 against its tax liabilities for 2002. The two-year prescriptive period cited by the BIR applies only for tax refund claim and not in the amendment of income tax returns. As regards the contention that the carryover of tax credit can only be applied in the immediately succeeding taxable year, MERALCO believes that this may be true under the 1977 National Internal Revenue Code (NIRC). However, this has been superseded by Section 76 of the 1997 NIRC which states that if the “corporation is entitled to a tax credit or refund of the excess estimated quarterly income taxes paid, the excess amount shown in its final adjustment return may be carried over and credited against the estimated quarterly income tax liabilities for the taxable quarters of the succeeding taxable years.” Furthermore, MERALCO argued that to prevent it from carrying over the amount of its overpaid income tax in 1999 directly to 2002 would be tantamount to unjust enrichment on the part of the Philippine Government.

On March 5, 2008, MERALCO availed of the tax amnesty program of the BIR implementing provisions of RA 9840. Subsequently, MERALCO intends to seek relief invoking Section 6(a) of the said Act which states that “*The taxpayer shall be immune from the payment of taxes, as well as additions thereto, and the opportune civil, criminal or administrative penalties under the National Internal Revenue Code of 1977, as amended, arising from the failure to pay any and all internal revenue taxes for the taxable year 2005 and prior years.*”

d. Other Claims

MERALCO is likewise contingently liable for lawsuits or claims filed by third parties, including labor-related cases, which are pending decision by the courts, the outcome of which are not presently determinable. In the opinion of management and its legal counsel, the eventual total liability from these lawsuits or claims, if any, will not have a material effect on the consolidated financial statements.

Investments in associates include goodwill of ₱7.9 billion and ₱2.9 billion as of December 31, 2007 and 2006, respectively. The goodwill in connection with the purchase of the additional 6.6% investment in MERALCO from the MPF was provisionally determined as the difference between the selling price and the Company's share in the net assets of MERALCO as of December 31, 2008. The provisional goodwill included in the carrying cost of the investment in associate amounted to ₱5.0 billion as of December 31, 2007.

## II. FPPC

FPPC was incorporated on February 3, 1993 by First Gen and MERALCO (each owning 40% equity interest) together with JG Summit Corporation, an unrelated party, which owns the remaining 20%.

FPPC has a BOT Project Agreement with NPC to build and operate a bunker-fired diesel power plant. Separately, BPPC, its subsidiary, was incorporated on February 3, 1993 to assume the rights and obligations of FPPC under the BOT Project Agreement pursuant to an Accession Undertaking. BPPC, then undertook the construction and operation of the 225-MW Bunker-fired Diesel Generator Power Plant in Bo. Payocpoc Sur, Bauang, La Union. BPPC shall operate and maintain the power plant for a Cooperation Period of 15 years up 2010. Upon expiration, it shall transfer to NPC all its rights, titles and interests in the power plant complex, free of liens created by BPPC and without any compensation.

Under the Project Agreement, NPC supplies the fuel for energy conversion and purchases all electricity generated therefrom. BPPC is entitled to payment of fixed capacity and operations and maintenance fees based on the nominated capacity of 225 MW, as well as energy fees from the delivery of electric power to NPC. These revenues are substantially billed and collected in U.S. Dollars and, therefore, guarantee recovery of the BPPC's capital costs. Total revenue from NPC amounted to \$55.28 million in 2007 and \$53.42 million in 2006, of which fixed fees based on nominated capacity amounted to \$51.41 million in 2007 and \$51.94 million in 2006.

Since January 25, 1997, BPPC has maintained 225 MW in nominated capacity, except for a period in 2001 to 2002 when nomination was reduced to 215 MW due to the unavailability of one generating unit. However, in line with the EPIRA-mandated Independent Power Producers (IPP) contracts review, PSALM, NPC and BPPC executed and signed in 2005 a General Framework Agreement (GFA) that embodied the renegotiated terms and conditions of the BOT Agreement. The GFA caps at 215MW the Bauang plant's nominated capacity and obligates BPPC to make the ₱0.01/ per kilowatt hour (kWh) contribution to an environment fund from the effective date of the GFA up to the end of Cooperation Period in July 2010. Conversely, this paves way for allowing the heat run of the Bauang plant at 8.5 MW for one hour daily, except on weekends and holidays, during extended economic shutdown and the carry-over of 50% of the plant's unutilized downtime allowance up to three years. The GFA likewise permits the pursuit of bilateral contracts for ancillary services and the excess 10MW capacity with Trans Co and power purchasers, respectively, under an income sharing arrangement subject to certain limitations and restrictions. The National Economic Development Authority (NEDA) approved the GFA on July 11, 2007.

Under the Project Agreement, BPPC's estimated future gross revenue at 215 MW based on the applicable tariff to NPC as of December 31, 2007 is as follows:

|                                     | U.S. Dollar          |
|-------------------------------------|----------------------|
|                                     | <i>(In Millions)</i> |
| For one year                        | \$53.11              |
| Up to the end of Cooperation Period | 85.13                |
|                                     | <u>\$138.24</u>      |

The Project Agreement also provides that, in the event of any changes in Philippine laws or any government regulations that will materially reduce, prejudice or otherwise adversely affect BPPC's interest in the project and economic return on its investment, the parties shall meet and endeavor to agree on the amendments to the Project Agreement and, if after 90 days, no agreement has been reached, NPC shall purchase all of BPPC's rights, title and interest in the power plant complex at a purchase price equivalent to the net present value of the capacity fees that would have been due for the remainder of the Cooperation Period.

Note 6 presents a detailed discussion of BPPC's adoption of Philippine Interpretation IFRIC 12 while Note 37n includes a discussion on the tax assessment on BPPC.

On September 25, 2007, upon approval by the SEC of the reduction in authorized capital stock of FPPC and ultimate reduction in outstanding capital stock of FPPC from 16 million shares with an aggregate par value of ₱1.5 billion (\$54.9 million) to 11 million shares with an aggregate par value of ₱1,031.2 million (\$37.7 million) for the purpose of returning capital to the stockholders, FPHC received an equivalent ₱175 million (\$4.0 million) from the pro rata return in capital. The ownership of FPHC in FPPC remained at 40% as of December 31, 2007.

Investment in FPPC includes goodwill amounting to ₱82.8 million (\$2.0 million) as of December 31, 2007 and 2006.

### III. ROCKWELL

Rockwell Land Corporation is engaged in real estate development, sale or lease of residential and commercial units and lots and, lease of mall facilities and spaces.

In 2007, land held for future development represents 9,026 square meters of land within the Rockwell Center and 54,279 square meters of land in Pasig City. Rockwell will develop the land in Pasig City into a mid-rise residential condominium community similar to the Rockwell Center. In 2006, land held for future development represents 25,612 square meters of land ready for sale and development within the Rockwell Center.

In March 2008, MERALCO and Rockwell signed a joint venture agreement to construct a three-tower MERALCO BPO building project at the Meralco Compound, Ortigas Center, Pasig City. MERALCO contributed the use of the land while Rockwell will contribute to the development cost of the property. As of December 31, 2007, the project is at the substructure phase and development cost incurred amounted to ₱256 million. The project is expected to be completed in May 2009.

## 12. Property, Plant and Equipment

This account consists of:

|                                                               | 2007                 |                                                       |                             |                                       |                             |         |
|---------------------------------------------------------------|----------------------|-------------------------------------------------------|-----------------------------|---------------------------------------|-----------------------------|---------|
|                                                               | Land                 | Buildings,<br>Other<br>Structures and<br>Improvements | Transportation<br>Equipment | Machinery,<br>Equipment<br>and Others | Construction<br>in Progress | Total   |
|                                                               | <i>(In Millions)</i> |                                                       |                             |                                       |                             |         |
| Cost:                                                         |                      |                                                       |                             |                                       |                             |         |
| Balance at beginning of year                                  | ₱954                 | ₱19,828                                               | ₱344                        | ₱29,062                               | ₱35                         | ₱50,223 |
| Acquisitions through business combination (see Note 5)        | 318                  | 137                                                   | 9                           | 620                                   | –                           | 1,084   |
| Additions                                                     | 151                  | 85                                                    | 109                         | 2,623                                 | 38                          | 3,006   |
| Disposals                                                     | –                    | (13)                                                  | (43)                        | (9)                                   | –                           | (65)    |
| Reclassification                                              | –                    | 75                                                    | (6)                         | (69)                                  | (40)                        | (40)    |
| Foreign currency translation adjustments                      | (134)                | (2,898)                                               | (9)                         | (3,793)                               | –                           | (6,834) |
| Adjustment                                                    | (7)                  | 388                                                   | 2                           | (376)                                 | 1                           | 8       |
| Balance at end of year                                        | 1,282                | 17,602                                                | 406                         | 28,058                                | 34                          | 47,382  |
| Accumulated depreciation, amortization and impairment losses: |                      |                                                       |                             |                                       |                             |         |
| Balance at beginning of year                                  | –                    | 4,536                                                 | 136                         | 9,362                                 | –                           | 14,034  |
| Depreciation and amortization for the year                    | –                    | 544                                                   | 47                          | 2,059                                 | –                           | 2,650   |
| Disposals                                                     | –                    | (9)                                                   | (30)                        | (7)                                   | –                           | (46)    |
| Reclassification                                              | –                    | 76                                                    | (5)                         | (76)                                  | –                           | (5)     |
| Foreign currency translation adjustments                      | –                    | (674)                                                 | (1)                         | (1,304)                               | –                           | (1,979) |
| Adjustment                                                    | –                    | (398)                                                 | –                           | 90                                    | –                           | (308)   |
| Balance at end of year                                        | –                    | 4,075                                                 | 147                         | 10,124                                | –                           | 14,346  |
|                                                               | ₱1,282               | ₱13,527                                               | ₱259                        | ₱17,934                               | ₱34                         | ₱33,036 |

|                                                               | 2006 (As restated - see Note 2) |                                                       |                             |                                       |                             |         |
|---------------------------------------------------------------|---------------------------------|-------------------------------------------------------|-----------------------------|---------------------------------------|-----------------------------|---------|
|                                                               | Land                            | Buildings,<br>Other<br>Structures and<br>Improvements | Transportation<br>Equipment | Machinery,<br>Equipment<br>and Others | Construction<br>in Progress | Total   |
|                                                               | <i>(In Millions)</i>            |                                                       |                             |                                       |                             |         |
| Cost:                                                         |                                 |                                                       |                             |                                       |                             |         |
| Balance at beginning of year                                  | ₱1,033                          | ₱20,111                                               | ₱284                        | ₱28,448                               | ₱43                         | ₱49,919 |
| Acquisitions through business combination (see Note 5)        | –                               | 998                                                   | –                           | 2,682                                 | –                           | 3,680   |
| Additions                                                     | 4                               | 226                                                   | 85                          | 39                                    | (1)                         | 353     |
| Disposals                                                     | (7)                             | –                                                     | (7)                         | (25)                                  | –                           | (39)    |
| Reclassification                                              | –                               | –                                                     | –                           | 13                                    | (7)                         | 6       |
| Foreign currency translation adjustments                      | (76)                            | (1,507)                                               | (14)                        | (2,079)                               | –                           | (3,676) |
| Adjustment                                                    | –                               | –                                                     | (4)                         | (16)                                  | –                           | (20)    |
| Balance at end of year                                        | 954                             | 19,828                                                | 344                         | 29,062                                | 35                          | 50,223  |
| Accumulated depreciation, amortization and impairment losses: |                                 |                                                       |                             |                                       |                             |         |
| Balance at beginning of year                                  | –                               | 3,309                                                 | 93                          | 8,498                                 | –                           | 11,900  |
| Depreciation and amortization for the year                    | –                               | 1,349                                                 | 36                          | 1,772                                 | –                           | 3,157   |
| Disposals                                                     | –                               | –                                                     | (13)                        | (24)                                  | –                           | (37)    |
| Reclassification                                              | –                               | –                                                     | –                           | 2                                     | –                           | 2       |
| Foreign currency translation adjustments                      | –                               | (122)                                                 | 20                          | (886)                                 | –                           | (988)   |
| Balance at end of year                                        | –                               | 4,536                                                 | 136                         | 9,362                                 | –                           | 14,034  |
|                                                               | ₱954                            | ₱15,292                                               | ₱208                        | ₱19,700                               | ₱35                         | ₱36,189 |

No borrowing costs were capitalized in 2007 and 2006.

First Gen Group's property, plant and equipment with net book values of ₱27.0 billion and ₱36.3 billion as of December 31, 2007 and 2006, respectively, have been pledged as security for long-term debt (see Note 21).

MNTC's property and equipment in excess of \$100,000 were pledged as collateral to secure its long-term debt (see Note 21).

### 13. Interest in Joint Venture

FPHC, through FBI entered into several unincorporated construction and engineering joint venture agreements. These include:

| Project Name                                            | Joint Venture Partner               | Interest of FPHC | Nature of Project                                                                         | Project period                 |
|---------------------------------------------------------|-------------------------------------|------------------|-------------------------------------------------------------------------------------------|--------------------------------|
| St. Lukes Medical Center (SLMC)                         | MDC-FB Joint Venture                | 49%              | Construction of SLMC Hospital                                                             | February 2007 to December 2009 |
| SKI-FB Joint Venture (SKI-FB JV)                        | Summa Kumagai, Inc. (SKI)           | 49%              | Construction of "The Manansala" residential condominiums located in Rockwell, Makati City | April 2003 to December 2005    |
| ECCO-Asia Nacap Joint Venture (ECCO-Asia JV)            | Nacap Nederland B. V.               | 60%              | Construction of gas pipeline facility                                                     | January 2000 to October 2001   |
| FB/Chemitreat Joint Venture (FB/Chemitreat JV)          | Chemitreat Pte Limited (Chemitreat) | 100%             | Design and construction of community sanitation projects in Taguig City and Quezon City   | April 2003 to December 2004    |
| e-Engineering Support Services Joint Venture (e-ESS JV) | ESCA, Inc.                          | 70%              | Offers world-class engineering support services to foreign and local customers            | January 2003 to October 2004   |

The share of the asset, liabilities, income and expenses of the joint venture as at December 31, 2007 and 2006 and for each of the three years in the period then ended December 31, 2007, which are included in the consolidated financial statements are as follows:

| Share in:              | 2007       |                    |           |                  |                                   | Total  |
|------------------------|------------|--------------------|-----------|------------------|-----------------------------------|--------|
|                        | MDC-FBI JV | Ecco-Asia Nacap JV | SKI-FB JV | FB/Chemitreat JV | e-Engineering Support Services JV |        |
| Current assets         | ₱956       | ₱11                | ₱96       | ₱17              | ₱-                                | ₱1,080 |
| Noncurrent assets      | 137        | -                  | -         | -                | -                                 | 137    |
| Current liabilities    | 38         | -                  | 114       | 6                | -                                 | 158    |
| Noncurrent liabilities | 1,006      | -                  | -         | -                | 2                                 | 1,008  |

2006

| Share in:              | MDC-FBI JV | Ecco-Asia<br>Nacap JV | SKI-FB JV | Chemitreat JV | FB/<br>e-Engineering<br>Support<br>Services JV | Total |
|------------------------|------------|-----------------------|-----------|---------------|------------------------------------------------|-------|
| Current assets         | ₱–         | ₱11                   | ₱96       | ₱17           | ₱–                                             | ₱124  |
| Noncurrent assets      | –          | –                     | –         | –             | –                                              | –     |
| Current liabilities    | –          | –                     | 114       | 6             | –                                              | 120   |
| Noncurrent liabilities | –          | –                     | –         | –             | 2                                              | 2     |

MDC-FB Joint Venture has revenue and cost of contracts and services amounting to 362 million and 331 million, respectively in 2007.

FPHC group recognizes share in net income in joint ventures only when the percentage of completion of the JV project exceeds 30%.

FPHC group did not recognize share in net income of joint ventures since SLMC project is only 17.4% completed as of December 31, 2007.

#### 14. Investment Properties

Movements of this account are as follows:

|                                             | 2007          |                            |               | 2006   |                            |        |
|---------------------------------------------|---------------|----------------------------|---------------|--------|----------------------------|--------|
|                                             | Land          | Buildings<br>and<br>Others | Total         | Land   | Buildings<br>and<br>Others | Total  |
| <i>(In Millions)</i>                        |               |                            |               |        |                            |        |
| Cost:                                       |               |                            |               |        |                            |        |
| Balance at beginning of year                | ₱1,652        | ₱1,269                     | ₱2,921        | ₱1,878 | ₱1,368                     | ₱3,246 |
| Additions                                   | –             | 39                         | 39            | 80     | 87                         | 167    |
| Disposals                                   | –             | –                          | –             | (301)  | (174)                      | (475)  |
| Foreign currency translation<br>adjustments | (10)          | (22)                       | (32)          | (5)    | (12)                       | (17)   |
| Reclassification                            | –             | 40                         | 40            | –      | –                          | –      |
| Adjustment                                  | 111           | (95)                       | 16            | –      | –                          | –      |
|                                             | <b>1,753</b>  | <b>1,231</b>               | <b>2,984</b>  | 1,652  | 1,269                      | 2,921  |
| Accumulated depreciation:                   |               |                            |               |        |                            |        |
| Balance at beginning of year                | –             | 332                        | 332           | –      | 317                        | 317    |
| Depreciation for the year                   | –             | 77                         | 77            | –      | 77                         | 77     |
| Disposals                                   | –             | –                          | –             | –      | (51)                       | (51)   |
| Foreign currency translation<br>adjustments | –             | (11)                       | (11)          | –      | (11)                       | (11)   |
| Reclassification                            | –             | –                          | –             | –      | –                          | –      |
|                                             | –             | <b>398</b>                 | <b>398</b>    | –      | 332                        | 332    |
| Net book value                              | <b>₱1,753</b> | <b>₱833</b>                | <b>₱2,586</b> | ₱1,652 | ₱937                       | ₱2,589 |

The fair values of investment properties amounted to ₱2,619 million and ₱2,536 million as of December 2007 and 2006, respectively. Fair values have been determined based on valuations performed by Crown Property Appraisal Corporation and Prudential Guarantee and Assurance, Inc., accredited independent valuers. The said valuers are industry specialists in valuing these types of investment properties. The fair value represents the amount at which the assets could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an



arm's length transaction at the date of valuation, in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) in the Philippines.

In conducting the appraisal, the accredited independent valuers used any of the following approaches:

a. Market Data or Comparative Approach

Under this approach, the value of the property is based on sales and listings of comparable property registered within the vicinity. This approach requires the establishment of a comparable property by reducing comparative sales and listings to a common denominator with the subject. This is done by adjusting the differences between the subject property and those actual sales and listings regarded as comparables. The properties used are either situated within the immediate vicinity or at different floor levels of the same building, whichever is most appropriate to the property being valued. Comparison was premised on the factors of location, size and physical attributes, selling terms, facilities offered and time element.

b. Income Capitalization Approach

The premise of such approach is that the value of a property is directly related to the income it generates. This approach converts anticipated future gains to present worth by projecting reasonable income and expense for the subject property.

Rental income from investment property for the years ended December 31, 2007 and 2006 amounted to ₱195 million and ₱227 million, respectively.

Direct operating expenses, such as repairs and maintenance, arising from investment property that generated rental income during the years ended December 31, 2007 and 2006 amounted to ₱23 million and ₱27 million, respectively. On the other hand, direct operating expenses arising from investment property that did not generate rental income during the years ended December 31, 2007 and 2006 amounted to ₱6 million and ₱7 million, respectively.

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## 15. Goodwill

Goodwill consists of the following:

|                                          | 2007           | 2006<br>(As restated -<br>see Note 2) |
|------------------------------------------|----------------|---------------------------------------|
| Cost:                                    |                |                                       |
| Balance at beginning of year             | ₱620           | ₱315                                  |
| Additions (see Note 5a)                  | 43,849         | -                                     |
| Acquisition through business combination | -              | 288                                   |
| Foreign exchange adjustments             | (259)          | 17                                    |
|                                          | <b>₱44,210</b> | <b>₱620</b>                           |

Addition during the year represents the provisional goodwill related to the acquisition of PNOC-EDC on November 29, 2007.

In 2007, the Company completed its determination of the fair value of identifiable assets and liabilities from the acquisition of PAHEP/MAHEP in 2006. The final determination resulted in the reduction of recorded goodwill by ₱1.5 billion recognition of an intangible asset (see Note 16) and adjustment of the recorded fair value of property, plant and equipment.

#### Impairment Testing of Goodwill

The recoverable amount has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. The discount rates applied to cash flow projections are 8.49% and cash flows beyond the remaining term of the existing agreements are extrapolated using growth rate of 2.5%.

Key assumptions used in value in use calculation of the cash-generating units for December 31, 2007 and 2006 on which management has based its cash flow projections to undertake impairment testing of goodwill are as follows:

- Budgeted Gross Margins

The basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year immediately before the budgeted year, increased for expected efficiency improvements.

- Bond Rates

The average yield on a five-year government bond rate at the beginning of the budgeted year is utilized.

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## 16. Intangible Assets

The movements of these accounts are as follows:

|                                          | 2007          |                 |                   | Total          |
|------------------------------------------|---------------|-----------------|-------------------|----------------|
|                                          | Water Rights  | Pipeline Rights | Concession Rights |                |
| <b>Cost:</b>                             |               |                 |                   |                |
| Balance at beginning of year             | ₱2,359        | ₱650            | ₱17,371           | ₱20,380        |
| Adjustment                               | –             | –               | (170)             | (170)          |
| Additions                                | –             | –               | 78                | 78             |
| Acquisition through business combination | –             | –               | 8,705             | 8,705          |
| Foreign exchange adjustments             | 46            | –               | –                 | 46             |
| Balance at end of year                   | 2,405         | 650             | 25,984            | 29,039         |
| <b>Accumulated amortization:</b>         |               |                 |                   |                |
| Balance at beginning of year             | –             | 126             | 1,343             | 1,469          |
| Adjustments                              | –             | 81              | –                 | 81             |
| Amortization during the year             | 96            | 25              | 703               | 824            |
| Foreign exchange adjustments             | 12            | –               | –                 | 12             |
| Balance at end of year                   | 108           | 232             | 2,046             | 2,386          |
|                                          | <b>₱2,297</b> | <b>₱418</b>     | <b>₱23,938</b>    | <b>₱26,653</b> |

|                                                       | 2006 (As Restated - see Note 2) |                 |                   |         |
|-------------------------------------------------------|---------------------------------|-----------------|-------------------|---------|
|                                                       | Water Rights                    | Pipeline Rights | Concession Rights | Total   |
| <b>Cost:</b>                                          |                                 |                 |                   |         |
| Balance at beginning of year                          | ₱–                              | ₱650            | ₱17,136           | ₱17,786 |
| Acquisition through business combination (see Note 5) | 2,359                           | –               | –                 | 2,359   |
| Additions during the year                             | –                               | –               | 235               | 235     |
| Balance at end of year                                | 2,359                           | 650             | 17,371            | 20,380  |
| <b>Accumulated amortization:</b>                      |                                 |                 |                   |         |
| Balance at beginning of year                          | –                               | 96              | 636               | 732     |
| Amortization during the year                          | –                               | 30              | 707               | 737     |
| Balance at end of year                                | –                               | 126             | 1,343             | 1,469   |
|                                                       | ₱2,359                          | ₱524            | ₱16,028           | ₱18,911 |

#### Water Rights

As discussed in Note 5 to the consolidated financial statements, the Company completed the valuation of its water rights as part of its purchase price allocation for the acquisition of PAHEP/MAHEP. Water rights which were identified as intangible assets were recognized retrospectively. Accordingly, 2006 consolidated financial statements were restated to present comparative financial information.

Water rights pertain to FG Hydro's right to use water from the Pantabangan reservoir for the generation of electricity. NPC, through a Certification issued to FG Hydro dated July 27, 2006, has given its consent to the transfer to FG Hydro, as the winning bidder of the PAHEP/MAHEP, of the water permit for Pantabangan river issued by the National Water Resources Council on March 15, 1977. In addition, FG Hydro and the National Irrigation Administration (NIA) entered into an Operation and Maintenance Agreement (the O&M Agreement) as an ancillary to the APA, wherein FG Hydro will derive benefit from the operation and maintenance of the Pantabangan and Masiway dams and other non-power facilities, including the water sourced from the Pantabangan reservoir. The term of the O&M Agreement is for a period of 25 years commencing on the Closing Date. The remaining amortization period of water rights is 23.9 years as of December 31, 2007.

#### Pipeline Rights

Pipeline rights represent the construction cost of the natural gas pipeline facility connecting the natural gas supplier's refinery to FGP's power plant including incidental transfer costs incurred in connection with the transfer of ownership of the pipeline facility to the natural gas supplier. The cost pipeline rights is amortized using the straight-line method over 22 years, which is the term of the Gas Sale and Purchase Agreement (GSPA). The remaining amortization period of pipeline rights is 16.75 years as of December 31, 2007.

### Concession Rights

As discussed in Note 2, the Company opted to early adopt Philippine Interpretation IFRIC 12 effective January 1, 2007. This resulted in, among others, the recording of intangible assets related to the following under the intangible asset model based on the concession grantees' right to charge users of the public services:

- The service concession of PNOC-EDC under its Northern Negros Geothermal Power Plant Project ("NNGPP") given that it has no existing agreement with NPC for the geothermal resources and electrical energy produced from the service contract area. The intangible asset is being amortized over 31.6 years, which represents the term of the related GSC of NNGPP and includes the renewal period on the bases of the constitutional and contractual provisions as well as its historical experience of obtaining such renewals (see Note 36).
- MNTC recognized roads and tollways (see Note 16) as intangible assets in accordance with PAS 38. Such intangible assets are being amortized using the straight-line method over the term of the concession.

The related accumulated depreciation and depreciation expense were also reclassified to accumulated amortization and amortization expenses on a retroactive basis.

The adjustment to the concession rights in 2007 represents the result of the settlement agreement between MNTC and Leighton Contractors (Asia) Limited (see Note 36).

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## 17. Other Noncurrent Assets

This account consists of:

|                                                                                             | 2007          | 2006                 |
|---------------------------------------------------------------------------------------------|---------------|----------------------|
|                                                                                             |               | <i>(In Millions)</i> |
| Prepaid gas (see Notes 2 and 37g)                                                           | ₱2,970        | ₱2,940               |
| AFS investments                                                                             | 36            | 31                   |
| Input VAT                                                                                   | 1,230         | 974                  |
| Prepaid major spare parts (see Note 34)                                                     | 814           | 2,305                |
| Receivable from MERALCO for annual deficiency -<br>net of current portion (Notes 34 and 35) | 777           | 3,124                |
| Share in joint ventures - noncurrent                                                        | 137           | -                    |
| Advances to contractors and others (see Note 32)                                            | 1             | 42                   |
| Debt issuance costs on undrawn facilities (see Note 17)                                     | -             | 43                   |
| Prepaid expenses                                                                            | 764           | -                    |
| Deferred royalty fees                                                                       | 465           | -                    |
| Evaluation and exploration asset                                                            | 1,172         | -                    |
| Others                                                                                      | 1,006         | 218                  |
|                                                                                             | <b>₱9,372</b> | <b>₱9,677</b>        |

### Exploration and evaluation assets

Exploration and evaluation assets represent expenditures that were capitalized based on EDC management's judgment of the degree to which the expenditure may be associated with finding specific geothermal reserves in the project areas. As of December 31, 2007, the exploration and evaluation assets pertain to the following project areas:

| <u>Project Area</u>      | <u>Amount</u>        |
|--------------------------|----------------------|
|                          | <i>(In Millions)</i> |
| Cabalian, Southern Leyte | ₱558                 |
| Northern Negros          | 445                  |
| Mindanao                 | 76                   |
| Ilocos Norte             | 48                   |
| BacMan-Tanawon           | 37                   |
| Other areas              | 8                    |
|                          | <u>₱1,172</u>        |

### AFS Investments

AFS investments consist of government debt securities, proprietary membership shares and unquoted equity investments amounting to ₱1,214 million and ₱31 million as of December 31, 2007 and 2006, respectively. Unrealized fair value gains on AFS investments are recognized as a separate component in the equity section of the consolidated balance sheets. As of December 31, 2007 and 2006, the share in unrealized gain on AFS investments recognized directly in equity amounted to ₱26 million and ₱20 million as of December 31, 2007 and 2006. AFS investments on government debt securities amounting to ₱1,178 million is included in the "Other current asset" account.

The specific identification method is used to determine the cost of securities sold.

### Input VAT

Input VAT recorded under "Other noncurrent assets" pertain to the carved out input taxes from the purchases of goods and services by MNTC in 2004, previously recorded as part of "roads and tollways" account (prior to the adoption of Philippine Interpretation IFRIC 12) plus all input taxes beginning 2005 to date (see Note 3).

On September 26, 2006 and October 9, 2006, the House of Representatives and the Senate, respectively, approved House Bill 5742, which lifted the 70% cap on input VAT, allowing companies to gain charge 100% of input VAT to output VAT per quarter. Following the approval of the Congress, the President of the Republic of the Philippines signed RA No. 9361. The then new law instructed the Secretary of Finance, through the BIR, to draw up IRR.

Upon the effectivity of the RA 9361, the BIR adopted Revenue Memorandum Circular No. 52-2005 issued on September 28, 2005, which, for the first time, expressly referred to toll road operations as being subject to VAT.

The TRB, in its letter dated October 28, 2005, ordered MNTC to defer the imposition of VAT on toll fees, thus, MNTC has deferred, and continues to defer, the imposition and collection of VAT from motorists. MNTC, together with other toll road operators, is currently discussing the issue of VAT with the concerned government agencies.

Owing to the effectivity of the RA 9361 and the possibility that MNTC will eventually be subjected to VAT, MNTC, in 2005, carved out all input taxes from purchases of goods and services (including input taxes related to the construction cost of the North Luzon Expressway) in 2004. The input taxes were then recorded as a separate asset item or included in the then “roads and tollways” account (prior to the adoption of Philippine Interpretation IFRIC 12). Such carved-out input VAT was then reclassified as a separate item under the “Other noncurrent assets” section of the consolidated balance sheets. Similarly, the input taxes from purchases of goods and services beginning 2005 were included in this noncurrent asset account.

In September 2005, MNTC also requested for confirmation from the BIR that MNTC can claim VAT input tax credit for the passed-on VAT from its purchases of goods and services for 2003 and prior years. As of April 14, 2008, confirmation by the BIR is still pending. Consequently, MNTC continues to account for input tax from 2003 and prior years’ purchases as part of concession assets, subject to amortization.

MNTC, in consultation with its legal counsel, believes that, if and when the TRB authorizes the toll road operators to collect VAT from motorists, it will be applied prospectively and at the same time, MNTC will be allowed to claim the input tax against the output tax. Accordingly, no VAT liability was recognized by MNTC.

Input VAT amounted to ₱1,222.8 million and ₱974.1 million as of December 31, 2007 and 2006, respectively. As of December 31, 2007, input VAT pertaining to 2003 and prior years that was capitalized as part of property and equipment and service concession assets amounted to ₱239.0 million, net of accumulated depreciation. The carrying value of service concession assets in the consolidated balance sheets amounted to ₱15,199.6 million and ₱16,028.0 million as of December 31, 2007 and 2006, respectively (see Note 36).

The carrying amounts of the affected assets and liability might change depending on the outcome of the uncertainties discussed above. However, management believes that in any event, the STOA amongst MNTC, ROP, acting by and through the TRB, and PNCC, provides MNTC with legal recourse in order to protect its lawful interests in case there is a change in existing laws, which makes the performance by MNTC of its obligations materially more expensive.

#### Prepaid major spare parts

Prepaid major spare parts consist of capitalizable portion of the O&M fees specifically for the Sta. Rita and San Lorenzo Power Plants scheduled maintenance outages. The cost of the major spare parts will be included as cost of the “property, plant and equipment” account when such items are issued.

#### Advances to Contractors and Others

Advances to contractors and others mainly represent payments in excess of billings for services rendered by the contractors of the North Tollway Project of MNTC.

## 18. Loans Payable

Details of this account as of December 31, 2007 are as follows:

|                                    |                |
|------------------------------------|----------------|
| Bridge loans (see Notes 8 and 33e) | ₱11,920        |
| Short-term loans (see Note 8)      | 6,448          |
|                                    | <u>₱18,368</u> |

On November 22, 2007, First Gen signed the Facility Agreement (the Agreement) between Calyon S.A. Corporate and Investment Bank (COFACE), (the Facility Agent), Standard Chartered Bank (SCB) and The Bank of Tokyo-Mitsubishi UFJ, Ltd. ("BOTM"), collectively, the Lenders, for an aggregate amount not to exceed \$287.5 million. The availed facility shall be used to fund the purchase of certain acquisitions (as enumerated in the Agreement) and pay the related fees and expenses. The availability period shall commence from the date of the Agreement until May 31, 2008 (the Availability Period). The availed facility shall be for a period of twelve (12) months and the interest is payable on a quarterly basis. Interest is computed based on a 3-month LIBOR plus margin. First Gen is required to pay to the Facility Agent (for the account of each lender) a commitment fee computed at the rate of 0.50% per annum based on that Lender's available commitment for the Availability Period. The accrued commitment fee shall be payable on February 29, 2008 and on the last day of the Availability Period.

As set forth in the Agreement, First Gen is obligated to perform certain financial covenants with respect to, among others: maintenance of specified debt-to-equity and interest coverage ratios; disposition of all or substantially all of its assets; maintenance of majority and controlling interests in its subsidiaries; compliance with laws, rules and regulations, orders or writs to which it may be subject; pledging present and future properties under certain circumstances; and material change of corporate structure. In addition, First Gen is restricted to declare or pay dividends during an Event of Default or if such payment would result in an Event of Default.

The details of the Agreement are as follows:

| Name of Lender     | <i>(In Millions)</i> |
|--------------------|----------------------|
| COFACE             | \$100,000            |
| Standard Chartered | 100,000              |
| BOTM               | 87,500               |
|                    | <u>\$287,500</u>     |

As of December 31, 2007, First Gen is in compliance with the foregoing covenants.

Also, on November 21, 2007, First Gen issued a promissory note to the order of Development Bank of the Philippines (DBP) for \$13.5 million (₱561.0 million) payable within 180 days with interest payable monthly.

Finally, on November 28, 2007, First Gen issued promissory note to group of local banks and investors for \$100.0 million (₱4.14 billion) and \$41.9 million (₱1.74 billion) payable within 12 months with interest rates payable quarterly.

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## 19. Trade Payables and Other Current Liabilities

This account consists of:

|                                                              | 2007                 | 2006           |
|--------------------------------------------------------------|----------------------|----------------|
|                                                              | <i>(In Millions)</i> |                |
| Trade payables                                               | <b>₱9,589</b>        | <b>₱7,365</b>  |
| Accruals for:                                                |                      |                |
| Interest                                                     | <b>1,204</b>         | 566            |
| Salaries and bonuses                                         | <b>280</b>           | 334            |
| Construction costs                                           | –                    | 148            |
| Others                                                       | <b>802</b>           | 851            |
|                                                              | <b>2,286</b>         | 1,899          |
| Due to a related party (see Note 32)                         | –                    | 388            |
| Share in current liability of Joint Venture<br>(see Note 13) | <b>158</b>           | 120            |
| Liabilities under trust receipts                             | <b>18</b>            | 227            |
| Due to contractors and consultants                           | <b>53</b>            | 213            |
| Others                                                       | <b>712</b>           | 606            |
|                                                              | <b>941</b>           | 1,554          |
|                                                              | <b>₱12,816</b>       | <b>₱10,818</b> |

Other current liabilities include unearned toll fees amounting to ₱26 million in 2007 and nil in 2006.

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## 20. Bonds Payable

On June 24, 2005, First Gen issued ₱5 billion Peso-denominated Fixed-rate Bonds (Bonds) due on July 30, 2010 with a coupon rate of 11.55%. The effective interest rate of Bonds is 12.03%. Interest is payable semi-annually. The Bonds constitute the direct, unconditional, unsecured and general obligations of First Gen. The proceeds from the Bonds were intended to be used for general corporate purposes, including working capital and investments. The Bonds may be redeemed at the option of First Gen after three years from issue date or if payments under the Bonds become subject to additional or increased taxes as a result of certain changes in law.

As set forth in the Trust Agreement in connection with the issuance of the Bonds, First Gen is obligated to perform certain covenants with respect to, among others: maintenance of specified debt-to-equity and a minimum debt-service-coverage ratios; disposition of all or substantially all of its assets; maintenance of majority and controlling interests in its subsidiaries; pledging present and future properties under certain circumstances; and material change of corporate structure. In addition, First Gen is restricted from declaration or payment dividends (other than stock dividend) during an Event of Default, as defined in the Trust Agreement, or if such payment would result in an Event of Default without the prior written consent of bondholders representing at least 51% of the aggregate outstanding principal amount of the Bonds.

As of December 31, 2007, First Gen is in compliance with all of the foregoing covenants.



As of December 31, 2007 and 2006, the unamortized debt issuance costs incurred in connection with the issuance of bonds amounting to ₱51 million (US\$1.2 million) and ₱74 million (US\$1.5 million), respectively, were deducted against the carrying value of the bonds payable.

The movements of the debt issuance costs are as follows:

|                                                | 2007                 | 2006 |
|------------------------------------------------|----------------------|------|
|                                                | <i>(In Millions)</i> |      |
| Balance at beginning of year                   | ₱74                  | ₱83  |
| Accretion during the year                      | (15)                 | (14) |
| Foreign exchange adjustments                   | (8)                  | 5    |
| Unamortized debt issuance costs at end of year | ₱51                  | ₱74  |

## 21. Long-term Debt

The details of the long-term debt, net of debt issuance costs are as follows:

|                    | 2007                 |                      |         | 2006               |                      |         |
|--------------------|----------------------|----------------------|---------|--------------------|----------------------|---------|
|                    | Current<br>Portion   | Long-term<br>Portion | Total   | Current<br>Portion | Long-term<br>Portion | Total   |
|                    | <i>(In Millions)</i> |                      |         |                    |                      |         |
| Red Vulcan         | ₱–                   | ₱28,834              | ₱28,834 | ₱–                 | ₱–                   | ₱–      |
| PNOC-EDC           | 2,031                | 20,810               | 22,841  | –                  | –                    | –       |
| FPHC               | 37                   | 17,657               | 17,694  | –                  | –                    | –       |
| MNTC               | 477                  | 7,987                | 8,464   | 562                | 9,074                | 9,636   |
| FGPC               | 1,372                | 6,603                | 7,975   | 6,235              | 9,400                | 15,635  |
| FGP                | 1,024                | 6,795                | 7,819   | 1,201              | 9,265                | 10,466  |
| FPH Fund           | –                    | 2,885                | 2,885   | 353                | 4,403                | 4,756   |
| FGHC International | 206                  | 1,239                | 1,445   | –                  | 1,708                | 1,708   |
| Others             | –                    | –                    | –       | –                  | –                    | –       |
|                    | ₱5,147               | ₱92,810              | ₱97,957 | ₱8,351             | ₱33,850              | ₱42,201 |

The details of debt issuance costs deducted from the debt are as follows:

|            | 2007                 |                      |        | 2006               |                      |        |
|------------|----------------------|----------------------|--------|--------------------|----------------------|--------|
|            | Current<br>Portion   | Long-term<br>Portion | Total  | Current<br>Portion | Long-term<br>Portion | Total  |
|            | <i>(In Millions)</i> |                      |        |                    |                      |        |
| Red Vulcan | ₱–                   | ₱365                 | ₱365   | ₱–                 | ₱–                   | ₱–     |
| PNOC-EDC   | 3                    | 31                   | 34     | –                  | –                    | –      |
| FPHC       | 12                   | 335                  | 347    | –                  | –                    | –      |
| MNTC       | 68                   | 304                  | 372    | 80                 | 401                  | 481    |
| FGPC       | 83                   | 43                   | 126    | –                  | 235                  | 235    |
| FGP        | 67                   | 236                  | 303    | –                  | 379                  | 379    |
|            | ₱230                 | ₱918                 | ₱1,148 | ₱80                | ₱1,015               | ₱1,095 |

### FPHC or Parent Company

The long-term debt of the FPHC as of December 31, 2007 consists of the following:

|                                                      | <b>Facility Amount</b> | <b>Amount Drawn</b> | <b>Balance Outstanding of December 31, 2007</b> |
|------------------------------------------------------|------------------------|---------------------|-------------------------------------------------|
| Floating Rate Corporate Notes (FRCNs) consisting of: |                        |                     |                                                 |
| Peso Tranche Note                                    | <b>₱6,400</b>          | <b>₱6,400</b>       | <b>₱6,400</b>                                   |
| Dollar Tranche Note                                  | <b>\$160,000</b>       | <b>\$152,000</b>    | <b>6,294</b>                                    |
| Fixed Rate Corporate Notes (FXCNs)                   | <b>₱5,000</b>          | <b>₱5,000</b>       |                                                 |
| Tranche 1                                            |                        |                     | <b>1,650</b>                                    |
| Tranche 2                                            |                        |                     | <b>2,000</b>                                    |
| Tranche 3                                            |                        |                     | <b>1,350</b>                                    |
|                                                      |                        |                     | <b>₱17,694</b>                                  |

All credit facilities of the Parent Company are unsecured. The Parent Company positions its deals across various currencies, maturities and product types to provide utmost flexibility in its financing transactions.

As of December 31, 2007, the Parent Company has undrawn borrowing facilities from financial institutions amounting to ₱1.9 billion.

### FRCNs

On October 25, 2007, FPHC entered into an FRCN Facility Agreement with a consortium of financial institutions as initial noteholders. The FRCNs consist of U.S. dollar-denominated and peso denominated notes as described in the foregoing. The FRCN Facility Agreement covers the issuance of a 7-year Peso Tranche Notes amounting to ₱6.4 billion and a 5-year Dollar Tranche Notes of up to US\$160.0 million.

On October 30, 2007, the ₱6.4 billion Peso Tranche Notes and US\$130.0 million of the 5-year Dollar Tranche Notes were drawn. On November 23, 2007, FPHC drew another \$22.0 million from the US\$160.0 million 5-year Dollar Tranche Notes and the facility balance of \$8.0 million was cancelled.

Under the terms of the FRCN Facility Agreement, the Parent Company shall issue the Peso Tranche Note and Part A Dollar Tranche Notes in full. Further, the Parent Company shall have the option of issuing, from time to time, part or all of the Part B dollar Tranche Notes, provided that, when issued, the Part B Dollar Tranche Notes shall form part of the Dollar Tranche Notes, without distinction between Part A Dollar Tranche Notes and Part B Dollar Tranche Notes. As of December 31, 2007, the unissued Part B Dollar Tranche Note of \$8 million has been cancelled.

The Peso Tranche Note and Part A Dollar Tranche Note were used to finance (either in whole or in part) the:

- (a) acquisition of 40% of the issued shares of FPUFI shares from Union Fenosa S.A. (see Note 11);
- (b) acquisition of 6.6% of the issued shares of MERALCO from the MPF (see Note 11);
- (c) the \$100 million bridge loan extended by BDO-EPCI, Inc. (BDO) on July 25, 2007 and;
- (d) general corporate fund requirement.

The Part B Dollar Tranche Note was used to buy back \$20.0 million of the FPH Fund's \$100.0 million guaranteed floating rate notes.

The salient provisions of the FCRNs are as follows

|                                                                          |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|--------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Interest rate:                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <ul style="list-style-type: none"> <li>▪ Dollar Tranche Notes</li> </ul> | The sum of:<br>(i) two and one-tenths percent (2.1%) spread ;<br>plus<br>(ii) the 6-month LIBOR based on the outstanding amount of the Dollar Tranche Notes.                                                                                                                                                                                                                                                                         |
| <ul style="list-style-type: none"> <li>▪ Peso Tranche Notes</li> </ul>   | The sum of:<br>a. two and 35/100 percent (2.35%); plus<br>b. The 6-month PDTS-F rate based on the outstanding amount of the Peso Tranche Notes.                                                                                                                                                                                                                                                                                      |
| Interest Payment Date                                                    | Successive periods of six months into which the period between the first issue date and the maturity date is to be divided. Interest payment date is automatically adjusted (together with the amount of interest due) to fall on the immediately succeeding banking day if such date is declared or is allowed to be a non-working holiday or non-banking day in the location of the principal office of the paying agent or Issuer |
| Repayment Date                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <ul style="list-style-type: none"> <li>▪ Dollar Tranche Notes</li> </ul> | On each April 30 or October 30 beginning 2010 through April 30, 2012                                                                                                                                                                                                                                                                                                                                                                 |
| <ul style="list-style-type: none"> <li>▪ Peso Tranche Notes</li> </ul>   | Every six months beginning October 30, 2010 up to October 30, 2014                                                                                                                                                                                                                                                                                                                                                                   |

|                        |                                                                                                                                        |
|------------------------|----------------------------------------------------------------------------------------------------------------------------------------|
| Interest rate:         |                                                                                                                                        |
| Redemption             | FPHC shall redeem the Notes by paying the principal amounts thereof on their respective principal redemption dates and maturity dates: |
| ▪ Dollar Tranche Notes | Six installments starting April 2010                                                                                                   |
| ▪ Peso Tranche Notes   | Nine equal semi-annual installments of ₱711.11 million starting April 2010                                                             |

The FCRNs shall constitute direct, unconditional, unsubordinated and unsecured obligations ranking pari passu with all other present and future direct, unconditional, unsubordinated and unsecured obligations of the Parent Company.

On April 11, 2007, the Parent Company issued ₱5.0 billion FXCNs in three tranches consisting of 5-, 7- and 10-year notes to various financial institutions maturing in 2012, 2014 and 2017, respectively. The FXCNs bear fixed interest rates ranging from 7.15% to 8.37% per annum depending on the terms of the notes.

| Principal Repayment and Redemption Date |                                                                                                                                                                                                                                                        |
|-----------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| ▪ Tranche 1                             | <ul style="list-style-type: none"> <li>▪ ¼% of the face value of the FXCN at each anniversary date and one day in the amount of ₱4,125 million until the 4th anniversary date plus one day</li> <li>▪ ₱1,633.5 million on the maturity date</li> </ul> |
| ▪ Tranche 2                             | <ul style="list-style-type: none"> <li>▪ 1% of the face value of the FXCN at each anniversary date in the amount of ₱20,000 million until the 6th anniversary date</li> <li>▪ ₱1,880 million on the maturity date</li> </ul>                           |
| ▪ Tranche 3                             | <ul style="list-style-type: none"> <li>▪ 1% of the face value of the FXCN at each anniversary date in the amount of ₱13,500 million until the 9<sup>th</sup> anniversary date</li> <li>▪ ₱1,228 million on the maturity date</li> </ul>                |

The terms of the FRCN and FXCN Facility Agreements require FPHC to comply with certain restrictions and covenants, which include among others: (i) maintenance of certain debt service coverage ratio at given periods provided based on core group financial statements; (ii) maintenance of certain ratios at certain levels; (iii) maintenance of its listing on the PSE; (iv) no material changes in the nature of business; (v) incurrence of indebtedness secured by liens, unless evaluated to be necessary; (vi) granting of loans to third parties except to subsidiaries or others in the ordinary course of business; (vii) sale or lease of all assets; (viii) mergers or consolidations; and (ix) declaration or payment of dividends other than stock dividends during an Event of Default (as defined in the Agreement) or if such payment would result in an Event of Default.

### FGPC and FGP

Long-term debt consists of U.S. dollar-denominated borrowings of FGP and FGPC availed from various lenders to partly finance the construction of their power plant complexes.

### FGP

| Nature                                                                                                                              | Repayment Schedule                                                             | Facility Amount | Outstanding Balance |              |        |         |
|-------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|-----------------|---------------------|--------------|--------|---------|
|                                                                                                                                     |                                                                                |                 | 2007                |              | 2006   |         |
| <i>(In Millions)</i>                                                                                                                |                                                                                |                 |                     |              |        |         |
| HERMES Covered Facility Agreement with annual interest at commercial interest reference rate of 7.48%                               | Repayment to be made in 24 equal semi-annual installments from 2003 up to 2014 | US\$133         | <b>₱3,064</b>       | <b>\$74</b>  | ₱4,125 | US\$84  |
| Commercial Loan Credit (ECGD) Facility Agreement with interest at 3-month to 6-month LIBOR plus 2.15%                               | Repayment to be made in 24 equal semi-annual installments from 2003 up to 2014 | US\$115         | <b>2,711</b>        | <b>65</b>    | 3,659  | 75      |
| GKA Covered Facility Agreement with annual interest at 6-month LIBOR plus 1.4% with option to convert into fixed interest rate loan | Repayment to be made in 27 equal semi-annual installments from 2003 up to 2016 | US\$77          | <b>2044</b>         | <b>49</b>    | 2,682  | 55      |
|                                                                                                                                     |                                                                                |                 | <b>7,819</b>        | <b>188</b>   | 10,466 | 214     |
| Less current portion                                                                                                                |                                                                                |                 | <b>1,024</b>        | <b>25</b>    | 1,201  | 25      |
| Long-term portion                                                                                                                   |                                                                                |                 | <b>6,795</b>        | <b>\$163</b> | ₱9,265 | US\$189 |

### FGPC

| Nature                                                                                                                             | Repayment Schedule                                                                                         | Facility Amount | Outstanding Balance |              |        |       |
|------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|-----------------|---------------------|--------------|--------|-------|
|                                                                                                                                    |                                                                                                            |                 | 2007                |              | 2006   |       |
| <i>(In Millions)</i>                                                                                                               |                                                                                                            |                 |                     |              |        |       |
| Foreign currency-denominated loans payable to foreign financing institutions at various interest rates ranging from 2.69% to 8.79% | Back-ended and annuity style repayment to be made in various semi-annual installments from 2001 up to 2012 | US\$360         | <b>₱4,455</b>       | <b>\$108</b> | ₱8,614 | \$176 |
| US Private Placements with annual interest based on the applicable treasury yield plus 2.5%                                        | Repayment to be made in various semi-annual installments from 2005 up to 2012                              | US\$160         | <b>3,520</b>        | <b>85</b>    | 6,266  | 128   |

| Nature                                                                                                      | Repayment Schedule                                                                          | Facility Amount | Outstanding Balance |       |        |       |
|-------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|-----------------|---------------------|-------|--------|-------|
|                                                                                                             |                                                                                             |                 | 2007                |       | 2006   |       |
| Foreign Currency Deposit Unit (FCDU) loans payable to local banks with annual interest at LIBOR plus 2.875% | Back-ended repayment to be made in 15 unequal semi-annual installments from 2001 up to 2007 | US\$110         | ₱–                  | \$–   | ₱755   | \$15  |
|                                                                                                             |                                                                                             |                 | 7,975               | 193   | 15,635 | 319   |
| Less current portion                                                                                        |                                                                                             |                 | 1,372               | 33    | 6,235  | 127   |
| Long-term portion                                                                                           |                                                                                             |                 | ₱6,603              | \$160 | ₱9,400 | \$192 |

As of December 31, 2007 and 2006, the unamortized debt issuance costs incurred in connection with the availment of long-term debt amounting to ₱429 million (\$10.4 million) and ₱728 million (\$14.9 million), respectively, were deducted against the long-term debt.

The movements of the debt issuance costs are as follows:

|                                                       | 2007                 | 2006  |
|-------------------------------------------------------|----------------------|-------|
|                                                       | <i>(In Millions)</i> |       |
| Balance at beginning of year                          | ₱728                 | ₱998  |
| Accretion during the year charged to interest expense | (206)                | (202) |
| Foreign exchange adjustments                          | (93)                 | (68)  |
| Balance at end of year                                | ₱429                 | ₱728  |

FGP has available undrawn committed credit facility amounting to \$50.0 million from its Revolving Credit/Working Capital (RC/WC) Facility, which was available until March 2007. The availability period for FGPC's KfW facility expired on March 17, 2006. Upon the expiration of availability periods of the undrawn facilities, the deferred debt issuance costs amounting to ₱4.2 million (\$0.9 million) for FGP and ₱180 million (\$3.9 million) relating to the undrawn KfW facility of FGPC has been written-off against the 2007 and 2006 earnings, respectively. All conditions precedent to these borrowings had been met.

Under certain project financing facility agreements, FGPC is required to pay to certain foreign lenders a commitment fee ranging from 0.35% to 0.375% based on the undrawn and uncanceled portion of the principal amount of the financing facilities. In addition, a guarantee fee to a certain facility is also required to be paid to the guarantors at the rate of 1.5% a year on the outstanding principal amount. Such fees are payable semi-annually on each interest payment dates.

The common terms of the project financing facility agreements (Common Terms Agreements) contain restrictions with respect to, among others: (i) maintenance of specified debt-to-equity ratio; (ii) acquisition or disposition of major properties; (iii) pledging present and future properties; (iv) change in ownership; any acts that would result in a material adverse effect on the operations of the power plants; and (v) maintenance of good, legal and valid title to the site free from all liens and encumbrances other than permitted liens. As of December 31, 2007, FGP and FGPC are in compliance with the terms of the said agreements.

FGP and FGPC entered into separate agreements in connection with their financing facilities as follows:

- Mortgage, Assignment and Pledge Agreements whereby a first priority lien on most of FGP's and FGPC's real and other properties, including revenues from the operations of the power plants, have been executed in favor of the creditors. In addition, the shares of stock of FGP and FGPC were pledged as part of security to the creditors.
- Inter-Creditor Agreements, which describe the administration of the loans.
- Shareholder Contribution Agreements, which cover additional equity contribution to FGP and FGPC in order to meet the debt-to-equity ratio requirement under the Common Terms Agreements.
- Trust and Retention Agreements (TRA - FGP and FGPC) with the creditors' designated trustees. Pursuant to the terms and conditions of the TRAs, the Security and Co-Security Trustees have established various security accounts where inflows and outflows of proceeds from loans, equity contributions and project revenues are monitored. Disposition of cash deposits on these security accounts requires prior approval of the Inter-Creditor agents acting on the instructions of the creditors.

The balance of FGP's and FGPC's security accounts included as part of "Cash and cash equivalents" account in the consolidated balance sheet as of December 31, 2007 and 2006 amounted to ₱2,729.6 million (\$66.1 million) and ₱7,186.8 million (\$174.1 million), respectively (see Note 7). The restricted security account relating to land titling cases, which are expected to be released within 12 months from the balance sheet date and included as part of the "Other Current Assets" account in the consolidated balance sheet amounted to ₱87 million (\$2.1 million) as of December 31, 2006 (see Note 10). The restricted security account of FGP was released in 2007.

On February 28, 2007, given the resolution of the dispute between FGPC and Siemens AG, Siemens Power Generation and Siemens, Inc. (collectively, "Siemens") (see Note 37f) and as required under the TRA Supplement and the Common Terms Agreements of FGPC, an aggregate amount of ₱3,628 (\$87.6 million) of security accounts was used to prepay the Secured Indebtedness and all indebtedness (inclusive of principal, interest and other fees) under the EIB Finance Contracts of FGPC on a pro-rata basis.

#### Red Vulcan

On November 26, 2007 (the "Drawdown Date"), Red Vulcan availed of a Philippine-peso denominated staple financing amounting to ₱29.2 billion (\$705.1 million), ("the Secured Indebtedness") that was arranged by PNOC-EDC's financial advisors under an Omnibus Loan and Security Agreement (the "Staple Financing Agreement"). The staple financing was made available by a group of local lenders: namely, the Development Bank of the Philippines (DBP), BDO, and the Land Bank of the Philippines (Land Bank), (collectively referred to as the "Red Vulcan Lenders") in relation to the sale of sixty percent (60%) of PNOC-EDC's issued and outstanding capital stock. The interest rate of the Secured Indebtedness is computed semi-annually using the Philippine Dealing System Treasury Fixing ("PDST F") benchmark rate plus the applicable interest margin or the Bangko Sentral ng Pilipinas (BSP) overnight rate, whichever

is higher. The staple financing shall be for a maximum term of 18 months from the Drawdown date.

As set forth in the Staple Financing Agreement, Red Vulcan is obligated to perform certain covenants with respect to, among others: maintenance of a specified debt-to-equity ratio; Red Vulcan shall not make or permit any material change in the character of its or PNOC-EDC's business nor engage or allow PNOC-EDC to engage in any business operation or activity other than those for which it is presently authorized by law; disposition of all or substantially all of its and PNOC-EDC's assets and material changes in the corporate structure or in the composition of its top-level management. In addition, Red Vulcan is restricted from declaring or paying dividends (other than stock dividend) to its stockholders or partners without the consent of all Red Vulcan Lenders. Red Vulcan is also restricted, except for permitted borrowings, to incur any long-term debt, increase its borrowings, or re-avail existing facilities with other banks or financial institutions.

In addition, the shares of stock held by Red Vulcan in the capital stock of PNOC-EDC, representing sixty percent (60%) of PNOC-EDC's issued and outstanding capital stock, consisting of 6.0 billion common shares presently in scripless form and lodged with the Philippine Depository and Trust Corporation, and 7.5 billion preferred shares (collectively referred to as "Pledged Shares"), were pledged as primary security for the due and prompt payment of the Secured Indebtedness.

Aside from the properties pledged and as indicated in the Staple Financing Agreement, the Security Trustee shall make a valuation of the pledged PNOC-EDC common shares on March 28, 2008, the sixth, the ninth, the twelfth and the fifteenth month from Drawdown Date (each a "Valuation Date") based on the weighted average closing prices at the PSE for the thirty trading days immediately prior to the Valuation Date (the "Top-Up provision"). The Pledged Shares shall be equivalent to at least 200% of the total amounts outstanding under the Staple Financing Agreement.

The Secured Indebtedness consists of Philippine peso-denominated borrowings from the Lenders to partly finance the purchase price for Pledged Shares offered for sale by PNOC-EDC, net of the associated fees and expenses in connection with the purchase and the availment of the Secured Indebtedness.

The details of Red Vulcan's long-term debt are as follows:

| Name of Lender: | Gross Loan |                | Net Loan Proceeds | Net Loan Proceeds |
|-----------------|------------|----------------|-------------------|-------------------|
|                 | Amount     | Fees and Taxes |                   |                   |
| BDO             | ₱9,733     | ₱122           | ₱9,611            | \$232             |
| DBP             | 9,733      | 122            | 9,611             | 232               |
| Land Bank       | 9,734      | 122            | 9,612             | 232               |
|                 | ₱29,200    | ₱366           | ₱28,834           | \$696             |

As of December 31, 2007, Red Vulcan is in compliance with the foregoing covenants.



PNOC-EDC

PNOC -EDC's foreign-currency denominated long-term debt was translated into Philippine pesos based on the prevailing foreign exchange rate at December 31, 2007 of US\$1:JP¥113.688 and US\$1:₱41.411) on.

The details of PNOC-EDC's long-term debt are as follows:

| Creditor/Project                                                                                                                         | Maturities   | Interest Rate                                        | Philippine<br>Peso Balances | Equivalent<br>U.S. Dollar<br>Balances |
|------------------------------------------------------------------------------------------------------------------------------------------|--------------|------------------------------------------------------|-----------------------------|---------------------------------------|
| <i>(Amounts in Thousands)</i>                                                                                                            |              |                                                      |                             |                                       |
| <b>International Bank for<br/>Reconstruction and<br/>Development</b>                                                                     |              |                                                      |                             |                                       |
| 2969 PH Bacon-Manito<br>Geothermal Power Plant -<br>\$41 million                                                                         | 1994 to 2008 | ½ of 1% over cost of<br>qualified borrowings         | <b>₱213,918</b>             | <b>\$5,166</b>                        |
| 3164 PH Energy Sector Loan -<br>\$118 million                                                                                            | 1995 to 2010 | ½ of 1% over cost of<br>qualified borrowings         | <b>1,327,866</b>            | <b>32,065</b>                         |
| 3702 PH Geothermal Exploration<br>Project - \$64 million                                                                                 | 1999 to 2013 | ½ of 1% over cost of<br>qualified borrowings         | <b>1,194,375</b>            | <b>28,842</b>                         |
| 3747 PH Geothermal Exploration<br>Project:<br>\$114 million                                                                              | 1999 to 2014 | ½ of 1% over cost of<br>qualified<br>borrowings/3.5% | <b>1,353,630</b>            | <b>32,688</b>                         |
| JP¥12.4 billion                                                                                                                          | 1999 to 2014 |                                                      | <b>971,507</b>              | <b>23,460</b>                         |
| <b>Overseas Economic<br/>Cooperation Fund</b>                                                                                            |              |                                                      |                             |                                       |
| 8th Yen Tongonan I Geothermal<br>Power Plant (share in OECF-<br>NPC loan):<br>JP¥5.8 billion                                             | 1990 to 2010 | 3.0%                                                 | <b>259,487</b>              | <b>6,266</b>                          |
| JP¥1.5 billion (Restructured)                                                                                                            |              | 3.2%                                                 | <b>117,990</b>              | <b>2,849</b>                          |
| 9th Yen Palinpinon I Geothermal<br>Power Plant -<br>JP¥ 10.8 billion                                                                     | 1991 to 2011 | 3.0%                                                 | <b>529,623</b>              | <b>12,789</b>                         |
| 15th Yen Palinpinon I<br>Geothermal Power Plant -<br>JP¥4.0 billion                                                                      | 1999 to 2019 | 5.7%                                                 | <b>650,142</b>              | <b>15,700</b>                         |
| 18th Yen Palinpinon II<br>Geothermal Power Plant -<br>JP¥77.4 million                                                                    | 2003 to 2023 | 3.0%                                                 | <b>₱21,310</b>              | <b>\$515</b>                          |
| 19th Yen Mt. Labo Geothermal<br>Project -<br>JP¥10.8 billion                                                                             | 2004 to 2024 | 4.9%                                                 | <b>96,686</b>               | <b>2,335</b>                          |
| 21 <sup>st</sup> Yen Northern Negros<br>Geothermal Project -<br>JP¥14.5 billion, of which<br>JP¥5.9 billion was drawn<br>during the year | 2007 to 2027 | 2.7%/2.3%                                            | <b>3,612,377</b>            | <b>87,232</b>                         |

| Creditor/Project                                           | Maturities    | Interest Rate                     | Philippine<br>Peso Balances | Equivalent<br>U.S. Dollar<br>Balances |
|------------------------------------------------------------|---------------|-----------------------------------|-----------------------------|---------------------------------------|
| <b>National Government</b>                                 |               |                                   |                             |                                       |
| Principal Collateralized Interest                          | 1992 to 2017  | Year 1 - 4 ¼%                     |                             |                                       |
| Reduction Bonds (PCIR) -<br>\$328 thousand                 |               | 2 - 5 ¼%                          |                             |                                       |
|                                                            |               | 3 - 5 ¾%                          |                             |                                       |
|                                                            |               | 4-5 - 6 ¼%                        |                             |                                       |
|                                                            |               | 6-25 - 6 ½%                       | <b>13,579</b>               | <b>328</b>                            |
| <b>Miyazawa I:</b>                                         |               |                                   |                             |                                       |
| JP¥5.2 billion                                             | June 1, 2009  | Tranche A=3.78%                   | <b>1,889,975</b>            | <b>45,639</b>                         |
| JP¥6.8 billion                                             |               | Tranche B=1.60% +<br>LIBOR        | <b>2,471,931</b>            | <b>59,693</b>                         |
| <b>Miyazawa II -</b>                                       |               |                                   |                             |                                       |
| JP¥22.0 billion                                            | June 26, 2010 | 2.37%                             | <b>7,738,708</b>            | <b>186,876</b>                        |
| <b>ING Bank Syndicated US\$90<br/>Million 5-Year Loan:</b> |               |                                   |                             |                                       |
| \$45.7 million                                             | Feb. 21, 2008 | Tranche 1=3.70% + 6<br>mos. LIBOR | —                           | —                                     |
| \$44.3 million                                             |               | Tranche 2=3.39% + 6<br>mos. LIBOR | —                           | —                                     |
| <b>Land Bank -</b>                                         |               |                                   |                             |                                       |
| ₱1.5 Billion                                               | June 29, 2008 | Ave. 91-day T-Bill +<br>2%        | <b>378,409</b>              | <b>9,138</b>                          |
| <b>Standard Chartered 5-Year<br/>Loan -</b>                |               |                                   |                             |                                       |
| \$75 million                                               | Aug. 4, 2009  | LIBOR + 2.22%                     | —                           | —                                     |
| <b>Total</b>                                               |               |                                   | <b>22,841,513</b>           | <b>551,581</b>                        |
| <b>Current portion</b>                                     |               |                                   | <b>(2,031,566)</b>          | <b>(49,059)</b>                       |
| <b>Long-term portion</b>                                   |               |                                   | <b>₱20,809,947</b>          | <b>\$502,522</b>                      |

The PCIR Bonds represent converted outstanding IBJ Loans equivalent to \$0.33 million to ROP bonds in a MOA dated November 16, 1992. The ROP bonds carry interest rate of 6.5% per annum payable semi-annually with bullet principal payment in 2017.

Embedded prepayment (call) options were bifurcated from the \$90.0 million ING Bank syndicated loan and \$75.0 million Standard Chartered term loans and presented in the balance sheet as Derivative assets. The changes in fair value of the embedded options are presented below.

|                                         |            |
|-----------------------------------------|------------|
| Balance before business combination     | \$9,246    |
| Changes in fair value during the period | 811        |
| Settlement during the year              | (9,656)    |
| Foreign exchange adjustments            | (401)      |
| <b>Balance at end of the year</b>       | <b>\$—</b> |

The changes in fair value during the year are included under Derivative gain (loss) in the consolidated statement of income. All bifurcated embedded prepayment (call) options were exercised in 2007.

The long-term debt is presented net of unamortized transaction costs. A rollforward analysis of unamortized transactions costs follows:

|                                     |            |
|-------------------------------------|------------|
| Balance before business combination | 95         |
| Amortization                        | (57)       |
| Foreign exchange gains              | (4)        |
| <u>Balance at end of year</u>       | <u>₱34</u> |

Amortization during the year is included under “Finance costs” in the consolidated statement of income.

Transaction costs include arrangement/management fee and documentary stamps for Miyazawa I amounting to ₱34 million in 2007.

#### FGHC International

On April 30, 2003, FGHC International entered into a Note Purchase Agreement with AIMCF (Cayman Islands) Limited (AIMCF). Under the Note Purchase Agreement, FGHC International issued a US\$35 million, 8-year note (8-year Note) and drew on the facility provided by AIMCF beginning July 11, 2003. The principal payment shall be in US dollars in an amount equal to one-seventh (1/7) of the aggregate principal amount of ₱1.7 billion (US\$35 million) beginning on July 11, 2008, fifth anniversary from date of issue, and semi-annually thereafter, until full payment. All payments of principal shall be made together with all accrued but unpaid interest on the principal being repaid. The outstanding principal amount of the 8-year Note shall bear interest at a rate of: (a) 9% per annum from the funding date to the fourth anniversary; and (b) 10.5% per annum from the fourth anniversary to the maturity date.

At anytime after the third and fifth anniversaries, FGHC International shall have the option to repay in whole but not in part, at a redemption price equal to 100% of the outstanding aggregate principal amount of the Notes, together with all interest accrued and unpaid up to the date of prepayment subject to certain provisions and the applicable prepayment fee.

The 8-year Note is guaranteed unconditionally and irrevocably by FPHC under a Parent Support Agreement dated April 30, 2003.

Under the Call Option Agreement dated April 30, 2003, AIMCF has the option to acquire certain shares of common stock and preferred stock of First Gen, as well as the right to put the call options and certain other rights to the Parent Company. The Call Option Agreement was amended last January 12, 2006. Among other things, the amendments were made in order: (1) to recognize certain changes in the capital structure of First Gen, particularly the creation of a new class of preferred shares and (2) in connection with First Gen’s initial public offering, to allow a cash settlement in lieu of an actual exercise of the call option. AIMCF did not avail of this cash settlement during the initial public offering, which has been concluded.

So long as the 8-year Note is outstanding, FGHC International and FPHC will be subject to certain undertakings with respect to negative pledge, debt incurrence, asset disposal, dividend payments, maintenance of financial covenants and financial reporting, among others. The violation of the aforementioned may constitute an event of default under the Note Purchase Agreement, the Parent Support Agreement and the Call Option Agreement.

### FPH Fund

On August 1, 2002, FPH Fund issued floating rate notes (Guaranteed Notes) totaling US\$100 million due on October 1, 2009. The payment of such notes is guaranteed unconditionally and irrevocably by the Parent Company. Interest on the Guaranteed Notes is based on six months LIBOR, from August 1, 2002, payable semi-annually commencing on April 1, 2003. The terms of the Guarantee Notes have since been amended to remove the holder's put option on the interest payment date nearest to October 1, 2005 as well as the issue's early redemption option on the interest payment date nearest to October 1, 2007. As of December 31, 2007, the outstanding balance on the original US\$100.0 million FRN was reduced to ₱2,147 million (\$52.0 million) as a result of debt buyback efforts consummated in 2007 and 2006.

On April 22, 2005, FPH Fund drew a US\$25 million loan from Standard Bank Asia Limited, which is fully guaranteed by First Holdings under a Parent Support Agreement. The loan bore interest at the six-month LIBOR plus 5%, but was later swapped for a fixed rate of 9.37%, payable semi-annually commencing October 22, 2005. Semi-annual amortization of US\$3.55 million will commence in April 2007 through April 2010. As of December 31, 2007, the original amount of \$25.0 million was reduced to ₱738.9 million (\$17.9 million) as a result of the payment of maturing amortizations in April and October amounting to US\$7.1 million.

FPH Fund and the Parent Company will be subject to certain undertakings with respect to negative pledge, debt incurrence, asset disposal, dividend payments, maintenance of financial covenants and financial reporting, among others. Any violation of the foregoing covenants may constitute an event of default under the terms of the Guaranteed Notes.

### FPH Ventures

On August 1, 2002, FPH Ventures entered into a Forward Purchase transaction to acquire, by August 1, 2005, all the Guaranteed Notes issued by FPH Fund. FPH Ventures made upfront and periodic cash payments pursuant to the terms of the Forward Purchase Agreement. Upon specified events, FPH Ventures may be required to accelerate its commitment to acquire the Guaranteed Notes and to exercise its purchase rights pursuant to the MERALCO SPORs.

Cash deposit pursuant to the terms of the Forward Purchase Agreement, amounting to \$50 million as of December 31, 2007 and 2006, are included in "Other noncurrent assets" account in the consolidated balance sheets.

The final exchange of the forward purchase transaction has been postponed to April 1, 2008 from August 1, 2005, with the Initial Exchange Amount decreased from US\$60 million to \$50 million, as a result of the return of \$10 million to FPH Ventures. Thereafter, interim payments are to be made on forward purchase transaction for three years, at \$7 million for any interim payment date up to and including April 1, 2006, \$6 million for any interim payment date from but not including April 1, 2006 and including October 1, 2007 and US\$11 million on April 1, 2008.

On March 15, 2006, CSFBI notified FPH Ventures of its intention to exercise its right under the Forward to cancel all of the transaction of FPH Ventures on the periodic payment date falling on April 1, 2006. Since April 1, 2006 was not a business day, the cancellation date was effective on the next business day which was April 3, 2006. The amount cancelled under the notice was the US\$86 million outstanding. On April 3, 2006, CSFBI returned to FPH Ventures its initial payment of US\$50 million.

The loan agreements on long-term debt of the Company and certain subsidiaries provide for certain restrictions and requirements with respect to, among others, maintenance of certain ratios at certain levels, material changes in their ownership, corporate set-up or management incurrence of additional liabilities and restriction to declare or pay dividends during an Event of Default (as defined in the Agreement) or if such payment would result in an Event of Default.

FGHC International, FGPC, FPH Fund are in compliance with the restrictions and covenants of the long-term debt.

These restrictions and requirements were complied with by FPHC and subsidiaries as of December 31, 2007 and 2006.

#### MNTC

Long-term obligation of MNTC consists of:

|                                                                                                                             | 2007          | 2006   |
|-----------------------------------------------------------------------------------------------------------------------------|---------------|--------|
| Fixed Rate Corporate Notes (FXCN)                                                                                           | <b>₱5,472</b> | ₱5,500 |
| Asian Development Bank Loan (ADB)                                                                                           | <b>1,278</b>  | 1,750  |
| USD Bank Facility (USD)                                                                                                     | <b>1,078</b>  | 1,495  |
| Export Finance and Insurance Corporation (EFIC)                                                                             | <b>505</b>    | 691    |
| COFACE                                                                                                                      | <b>503</b>    | 700    |
|                                                                                                                             | <b>8,836</b>  | 10,136 |
| Less unamortized debt issue costs                                                                                           | <b>372</b>    | 500    |
|                                                                                                                             | <b>8,464</b>  | 9,636  |
| Less current portion of long-term debt - net of unamortized debt issue costs of ₱68,055,578 in 2007 and ₱79,532,454 in 2006 | <b>477</b>    | 562    |
|                                                                                                                             | <b>₱7,987</b> | ₱9,074 |

As of December 31, 2007 and 2006, the unamortized debt issue costs incurred in connection with the availing of long-term debt amounting to ₱372.0 million and ₱481.3 million, respectively, were deducted against the long-term debt. The movements in debt issue costs are as follows:

|                                                       | 2007                 | 2006  |
|-------------------------------------------------------|----------------------|-------|
|                                                       | <i>(In Millions)</i> |       |
| Balance at beginning of year                          | <b>₱481</b>          | ₱646  |
| Accretion during the year charged to interest expense | <b>(76)</b>          | (491) |
| Debt issue costs incurred                             | -                    | 371   |
| Foreign exchange adjustments                          | <b>(33)</b>          | (45)  |
| Balance at end of year                                | <b>₱372</b>          | ₱481  |

In 2001, MNTC entered into a Common Terms Agreement with the lenders, the security trustee, the co-security trustee and inter-creditor agent. The Common Terms Agreement specifies the mechanics on the funding under the term facilities, payment and prepayments, as well as the conditions precedent to drawdown set forth by the secured lenders. The Common Terms Agreement also contains covenants concerning restrictions with respect to, among others, waiver, modification, amendment or assignment of the key project agreements, hedge agreements,

restricted payments, and the maximum debt-to-base equity ratio and the level of the debt-service-coverage ratio. Total financing facility availed by MNTC under the original Common Terms Agreement amounted to US\$252.2 million.

The loans were granted under a limited-recourse project finance structure. All existing and future assets of MNTC are mortgaged in favor of the lenders in line with the requirements of the Mortgage, Assignment and Pledge Agreement or the Master Security Agreement (MSA). In addition, FPIDC and Egis provided completion support as agreed under the Sponsor Support Agreement (SSA).

On November 8, 2006, MNTC refinanced its outstanding loans through partial prepayment and restructuring of the Company's US dollar-denominated long-term debt using the proceeds of a ₱5.5 billion FXCN issue. The refinanced debt package consisted of a total of US\$100 million in US dollar denominated term loan facilities participated in by majority of the original project lenders and a ₱5.5 billion FXCN issue participated in by 16 qualified local institutional investors (Issuer).

The US dollar-denominated term loan facilities consist of direct loan facilities from multi-lateral and bi-lateral institutions like ADB and EFIC and syndicated facilities, including a covered loan from COFACE, the French export credit agency, participated in by a mix of four (4) foreign commercial banks. The loans are payable in 16 equal semi-annual installments starting December 15, 2006 up to June 15, 2014, which is the original maturity date.

The FXCNs are payable within seven years from issue date under a bullet-like structure, i.e., 94% of the principal is payable on maturity date (November 17, 2013) while the balance of 6% is payable over the term of the notes in minimal annual installments. The simultaneous prepayment and drawdown on refinancing date (November 17, 2006) was facilitated through a US\$96 million Conversion Bridge Facility (\$96 million-Bridge Loan) provided by Mizuho Corporate Bank, Ltd. (Singapore). This was a cash-secured temporary dollar facility backed by the FXCN proceeds that allowed MNTC to obtain the necessary dollars for the lump sum prepayment on refinancing date. The \$96 million-Bridge Loan was fully paid on December 5, 2006. Under the Notes Purchase Agreement covering the FXCN, the Issuer may at its option, redeem the notes prior to the maturity date in whole but not in part subject to the terms and conditions of the agreement.

Interest rates on direct facilities, consisting of fixed and floating rates, range from 6.13% to 8.59% in 2007 and 8.03% to 8.84% in 2006. Interest rates on syndicated facilities, also consisting of fixed and floating rates, range from 8.70% to 9.75% in 2007 and 5.57% to 7.84% in 2006.

In connection with the refinancing, the Common Terms Agreement, MSA and other loan agreements were amended to reflect the revised covenants and security package covering all the Company's debt on a parri-passu basis. The major amendments are: the removal of pledge of shares and other forms of sponsor support in the security package; the release of trapped cash in the form of maintenance reserves, the principal portion of the debt reserve, and undrawn base equity contributions; the reduction of assigned contracts; the removal of assignment of operator assets and contracts as well as PNCC rights under certain contracts, and the reduced approval rights of lenders and lenders' advisors. Certain agreements like the SSA were terminated and the sponsor guarantees along with other elements of the original security package were released effective November 17, 2006.

The remaining security for the outstanding loans is embodied in the following agreements:

- a. Trust and Retention Agreement (TRA - MNTC) with the secured lenders' designated trustees and the inter-creditor agent. The TRA - MNTC provides for the establishment and regulation of the security accounts and the security account collateral where the inflows and outflows of project revenues may be monitored. The security accounts form part of "Cash and cash equivalents" account in the consolidated balance sheets.
- b. The Master Security Agreement (MSA - MNTC), which grants to the trustees, on behalf of the secured lenders, the security interest in MNTC's various assets. The agreement provides for the establishment of real estate mortgage and chattel mortgage as well as the assignment of key project agreements, insurances, and bank accounts in favor of the co-security trustee for the benefit of the secured lenders.

As of December 31, 2007 and 2006, MNTC is in compliance with the required financial ratios and other loan covenants.

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## 22. Obligation to Power Contractors

In 2007, this account consists of:

|                                                                                 | Minimum<br>Payments | Present Value of<br>Minimum<br>Payments |
|---------------------------------------------------------------------------------|---------------------|-----------------------------------------|
| <u>Amounts payable under BOT Contracts:</u>                                     |                     |                                         |
| Within one year                                                                 | P266                | P247                                    |
| In the second to fifth years (inclusive)                                        | 100                 | 96                                      |
| Future finance charges                                                          | (23)                | -                                       |
| Present value of obligations                                                    | 343                 | 343                                     |
| Amount due for settlement within 12 months<br>(shown under Current liabilities) | (247)               | (247)                                   |
| <u>Amount due for settlement after 12 months</u>                                | <u>P96</u>          | <u>P96</u>                              |

This account pertains to the balance of PNOC-EDC's obligations to its power plant contractors in connection with the construction of the geothermal power plants in some of PNOC-EDC's GSC.

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## 23. Royalty Fee Payable

In 2007, this account consists of:

|                          |               |
|--------------------------|---------------|
| Due to DOE (Note 37c)    | P1,481        |
| Due to LGUs (Note 37c)   | 253           |
|                          | <u>1,734</u>  |
| Current portion          | (456)         |
| <u>Long-term portion</u> | <u>P1,278</u> |

A reconciliation of the Day 1 gain and the accretion on the deferred royalty fee due to the DOE, as recognized by PNOC-EDC, is shown below:

|                                          |             |
|------------------------------------------|-------------|
| Acquisition through business combination | ₱232        |
| Additions                                | 3           |
| Accretion                                | (17)        |
| Foreign exchange adjustments             | 7           |
| <u>Balance at end of year</u>            | <u>₱225</u> |

As discussed in Note 37c by virtue of PD 1442, PNOC-EDC entered into seven service contracts with the DOE granting PNOC-EDC the right to explore, develop, and utilize the country's geothermal resource subject to sharing of net proceeds with the government. In turn, PNOC-EDC will pay royalty fees to the DOE and LGUs under the terms of the arrangement.

The royalty fees are paid to the DOE based on an agreed payment schedule. As the liability is non-interest bearing, a day 1 gain is recognized upon accrual of royalty fee. The day 1 gain pertains to the difference between the maturity value and present value of the royalty fee due. \$0.08 million (₱3.31 million) was recognized as day 1 gains for 2007, and is included under "Other income" in the consolidated statement of income. Subsequent to initial recognition, royalty fee payable is accreted to its maturity value based on its effective interest rate.

The effective interest rate on royalty fee payable ranges from 12.38% to 12.72%, for 2007.

Accretion expense recognized in 2007 amounted to \$0.41 million (₱17.6 million). Such accretion is included under "Interest expense and financing charges" in the consolidated statement of income. As of December 31, 2007, the unamortized discount amounted to \$5.4 million (₱255.59 million).

## 24. Other Noncurrent Liabilities

This account consists of:

|                                                      | 2007                 | 2006          |
|------------------------------------------------------|----------------------|---------------|
|                                                      | <i>(In Millions)</i> |               |
| Unearned revenue (see Notes 36a and 37g)             | <b>₱2,564</b>        | ₱2,459        |
| Share in joint venture - noncurrent liability        | <b>1,008</b>         | 2             |
| Customers' deposits                                  | <b>43</b>            | 65            |
| Asset retirement obligation                          | <b>36</b>            | 38            |
| Deferred output value added tax on annual deficiency | -                    | 337           |
| Derivative liability (see Note 34)                   | <b>54</b>            | 19            |
| Others                                               | <b>553</b>           | 9             |
|                                                      | <b>₱4,258</b>        | <b>₱2,929</b> |



As discussed in Note 2, under their respective ECCs, FGPC and FGP have a legal obligation to dismantle their respective power plant assets at the end of their useful life. FGPC, FGP and FG Bukidnon established their respective provisions to recognize their estimated liability for the dismantlement of the power plant assets. FG Bukidnon, on the other hand, has contractual obligation under the lease agreement with PSALM to dismantle its power plant assets at the end of their useful lives.

As discussed more fully in Note 37(g), under the terms of the PPA and MERALCO, all fuel and fuel-related payments are “pass-through” transactions. Thus, payment obligations of FGP and FGPC under their respective agreements are passed-on to MERALCO. When payment is made, a corresponding prepaid gas is recognized to cover the principal portion paid to the Gas Sellers (shown as part of “Other noncurrent assets”) and a corresponding credit to the unearned revenue is recognized for the principal portion that was already paid by MERALCO.

Movements of asset retirement obligations follow:

|                                                       | 2007                 | 2006       |
|-------------------------------------------------------|----------------------|------------|
|                                                       | <i>(In Millions)</i> |            |
| Balance at beginning of year                          | <b>₱38</b>           | ₱38        |
| Accretion during the year charged to interest expense | <b>2</b>             | 3          |
| Foreign currency translation adjustments              | –                    | (3)        |
| <b>Balance at end of year</b>                         | <b>₱36</b>           | <b>₱38</b> |

In 2007, the “others” account includes accrued vacation and sick leave entitlements of the employees of PNOC-EDC.

## 25. Capital Stock and Retained Earnings

a. Movements of the Parent Company’s common stock follow:

|                                                                                                        | Number of Shares     |               |               |
|--------------------------------------------------------------------------------------------------------|----------------------|---------------|---------------|
|                                                                                                        | 2007                 | 2006          | 2005          |
| Authorized - ₱10 par value per share for common stock and ₱100 par value per share for preferred stock | <b>1,210,000,000</b> | 1,210,000,000 | 1,210,000,000 |
| Issued:                                                                                                |                      |               |               |
| Balance at beginning of year                                                                           | <b>580,021,800</b>   | 569,614,261   | 547,538,819   |
| Issuances                                                                                              | <b>8,890,412</b>     | 10,407,539    | 22,075,442    |
| <b>Balance at end of year</b>                                                                          | <b>588,912,212</b>   | 580,021,800   | 569,614,261   |
| Subscribed:                                                                                            |                      |               |               |
| Balance at beginning of year                                                                           | <b>543,799</b>       | 1,241,456     | 6,682,133     |
| Subscriptions                                                                                          | <b>8,896,505</b>     | 9,709,882     | 16,634,765    |
| Issuances                                                                                              | <b>(8,957,623)</b>   | (10,407,539)  | (22,075,442)  |
| <b>Balance at end of year</b>                                                                          | <b>482,681</b>       | 543,799       | 1,241,456     |

On November 23, 2007, the SEC approved a resolution of the BOD (dated August 2, 2007) and stockholders (dated October 10, 2007) of FPHC, amending the authorized capital stock of the Parent Company from ₱12.1 billion, divided into 1,210,000,000 shares with par value of ₱10 a share to ₱32.1 billion, consisting of (a) 1,210,000,000 common shares with par value of ₱10 a share and (b) 200,000,000 preferred shares with par value of ₱100 a share. The total number of preferred shares is broken down as follows: 50,000,000 each of Series “A” and Series “B” shares and 100,000,000 unclassified preferred shares.

On November 6, 2007, the following subscriptions were made:

| Subscriber         | Number<br>of Shares | Total Par Value |
|--------------------|---------------------|-----------------|
| FGHC International | 20,000,000          | ₱2,000,000,000  |
| First Philec       | 15,000,000          | 1,500,000,000   |
| FPRC               | 15,000,000          | 1,500,000,000   |
|                    |                     | ₱5,000,000,000  |

FGHC International, a wholly-owned Cayman Islands-based subsidiary while First Philec and FPRC are Philippine-based wholly-owned subsidiaries. As of December 31, 2007, the subscription of FGHC International was fully paid while those of First Philec and FPRC are recorded as subscriptions receivable.

Further, the fully paid subscription of FGHC International is presented as a debit to the equity section of the 2007 consolidated balance sheet under the “Parent Company Preferred Stock Held by a Subsidiary” account.

The subscriptions to the Series “A” preferred shares by First Philec and FPRC were redeemed by FPHC on February 20, 2008 and February 21, 2008, respectively.

b. Features of the Preferred Shares

The preferred shares are: (i) non-voting except in those cases expressly provided for by law; (ii) non-convertible into common stock; (iii) non-participating in any other or further dividend payment beyond the specified coupon rate and (iv) redeemable at the option of FPHC at a redemption price equal to the aggregate of the issue value of the share price equal to the issue value of the share plus accrued but unpaid dividends.

Such cumulative preferred shares carry a coupon rate equal to 1% of the par value of the share.

c. The composition of the Parent Company's retained earnings account at equity follows:

|                                                                                   | 2007           | 2006<br>(As Restated) | 2005<br>(As Restated) |
|-----------------------------------------------------------------------------------|----------------|-----------------------|-----------------------|
|                                                                                   |                | <i>(In Millions)</i>  |                       |
| Available for dividend declaration:                                               |                |                       |                       |
| Balance at beginning of year                                                      | <b>₱13,645</b> | ₱13,307               | ₱10,722               |
| Net income (loss) excluding equity in net earnings of subsidiaries and associates | <b>2,785</b>   | (23)                  | 1,830                 |
| Dividends received                                                                | <b>1,928</b>   | 1,460                 | 1,293                 |
| Cash dividends declared - ₱2 a share in 2007 and ₱2 a share in 2006               | <b>(1,176)</b> | (1,154)               | (1,140)               |
| Effect of early adoption of IFRIC 12 - Note 2                                     | -              | 55                    | 602                   |
|                                                                                   | <b>17,182</b>  | 13,645                | 13,307                |
| Not available for dividend declaration -                                          |                |                       |                       |
| Accumulated net earnings of subsidiaries and associates:                          |                |                       |                       |
| Balance at beginning of year                                                      | <b>14,439</b>  | 7,177                 | 5,388                 |
| Earnings of subsidiaries and associates for the year                              | <b>1,690</b>   | 6,679                 | 3,082                 |
| Gain on dilution                                                                  | -              | 2,043                 | -                     |
| Dividends received                                                                | <b>(1,928)</b> | (1,460)               | (1,293)               |
| Balance at end of year                                                            | <b>14,201</b>  | 14,439                | 7,177                 |
|                                                                                   | <b>₱31,383</b> | ₱28,084               | ₱20,484               |

## 26. Executive Stock Option Plan and Employee Stock Purchase Plan

The Parent Company has an Executive Stock Option Plan (ESOP) and Employee Stock Purchase Plan (ESPP) (collectively referred to as the "Plans") that entitle the directors, senior officers (for the ESOP) and employees (for the ESPP) to purchase up to 10% of the Parent Company's authorized capital stock on the offering years at a preset purchase price with payment and other terms to be defined at the time of the offering. The purchase price per share shall not be less than the average of the last dealt price per share of the Parent Company's share of stock. The terms of the Plans include, among others, a two or four-year holding period from the date of purchase for ESPP, a limit as to the number of shares an executive and employee may purchase and the manner of payment based on equal semi-monthly installments over a period of five or ten years through salary deductions.

Movements in the number of stock options outstanding are as follows:

ESOP

|                              | 2007               | 2006        |
|------------------------------|--------------------|-------------|
| Total shares allocated       | <b>40,570,714</b>  | 37,568,407  |
| Options exercisable:         |                    |             |
| Balance at beginning of year | <b>9,342,003</b>   | 15,930,615  |
| Granted                      | –                  | 3,002,307   |
| Exercised                    | <b>(8,829,294)</b> | (9,590,919) |
| Balance at end of year       | <b>512,709</b>     | 9,342,003   |

ESPP

|                                             | 2007             | 2006      |
|---------------------------------------------|------------------|-----------|
| Total shares subscribed                     | <b>9,548,271</b> | 9,548,271 |
| Issuances:                                  |                  |           |
| Balance at beginning of year                | <b>8,786,006</b> | 8,088,349 |
| Issuances during the year                   | <b>61,118</b>    | 697,657   |
| Balance at end of year                      | <b>8,847,124</b> | 8,786,006 |
| Balance of subscribed shares at end of year | <b>701,147</b>   | 762,265   |

Exercise price of the stock option under the ESOP is set at ₱18.80 per share. The weighted average share price at the dates of options exercised during the year was ₱77.50 per share. The weighted average fair value of options granted was ₱8.8 per share.

The weighted average remaining contractual life for the share option outstanding as of December 31, 2007 is 5.5 years.

The fair value of share options granted under the ESOP is estimated at the dates of grant using the Black-Scholes Option Pricing Model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model:

|                                  |      |
|----------------------------------|------|
| Dividend yield (%)               | 5.0  |
| Expected volatility (%)          | 21.7 |
| Risk-free interest rate (%)      | 8.5  |
| Expected life of option (years)  | 5.5  |
| Weighted average share price (₱) | 41.0 |

The share-based payment transaction amounted to ₱29.4 million, ₱50 million and ₱56 million in 2007, 2006 and 2005, respectively.

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which likewise, may not necessarily be the actual outcome.

No other features of options grant were incorporated into the measurement of the fair value of the options.

The options granted under the ESPP are not valued since these cannot qualify as share-based payments.

## 27. Cost and Expenses

This account consists of:

|                                                                   | 2007                 | 2006<br>(As Restated -<br>see Note 2) | 2005<br>(As Restated -<br>see Note 2) |
|-------------------------------------------------------------------|----------------------|---------------------------------------|---------------------------------------|
|                                                                   | <i>(In Millions)</i> |                                       |                                       |
| Power plant operations and maintenance<br>(see Notes 36c and 36e) | <b>₱34,303</b>       | ₱35,633                               | ₱29,256                               |
| Depreciation and amortization<br>(see Note 28)                    | <b>3,585</b>         | 3,983                                 | 4,240                                 |
| Personnel expenses<br>(see Notes 26 and 29)                       | <b>2,041</b>         | 1,757                                 | 2,156                                 |
| Taxes and licenses                                                | <b>1,300</b>         | 788                                   | 1,098                                 |
| Toll operator's fees                                              | <b>1,266</b>         | 1,293                                 | 1,073                                 |
| Professional fees                                                 | <b>853</b>           | 820                                   | 729                                   |
| Raw materials and supplies                                        | <b>734</b>           | 916                                   | 677                                   |
| Insurance                                                         | <b>429</b>           | 506                                   | 506                                   |
| Franchise fees                                                    | <b>292</b>           | 299                                   | 304                                   |
| Land development costs                                            | <b>135</b>           | 96                                    | 176                                   |
| Rent and subcontract costs                                        | <b>84</b>            | 229                                   | 276                                   |
| Others                                                            | <b>315</b>           | 761                                   | 753                                   |
|                                                                   | <b>₱45,337</b>       | ₱47,081                               | ₱41,244                               |

## 28. Finance Costs, Finance Income and Depreciation and Amortization

### Finance Costs

|                                                                                | 2007                 | 2006   | 2005   |
|--------------------------------------------------------------------------------|----------------------|--------|--------|
|                                                                                | <i>(In Millions)</i> |        |        |
| Interest on loans and bonds<br>(see Notes 18, 20 and 21)                       | <b>₱6,114</b>        | ₱5,511 | ₱5,213 |
| Annual deficiency (see Note 36c)                                               | <b>321</b>           | 1,409  | -      |
| Accretion on debt issuance costs                                               | <b>231</b>           | 215    | 239    |
| Write-off of deferred debt issuance costs on undrawn facility<br>(see Note 24) | <b>41</b>            | 200    | -      |
| Accretion on royalty fee payable<br>(see Note 23)                              | <b>19</b>            | -      | -      |
| Accretion on asset retirement obligations (see Note 29)                        | <b>3</b>             | 3      | 3      |
|                                                                                | <b>₱6,729</b>        | ₱7,338 | ₱5,455 |

## Finance Income

|                                  | 2007          | 2006                 | 2005   |
|----------------------------------|---------------|----------------------|--------|
|                                  |               | <i>(In Millions)</i> |        |
| Short-term cash investments      | <b>₱1,587</b> | ₱1,835               | ₱1,066 |
| Annual deficiency (see Note 36c) | <b>321</b>    | 1,410                | –      |
| Others                           | <b>26</b>     | 36                   | 20     |
|                                  | <b>₱1,934</b> | ₱3,281               | ₱1,086 |

## Depreciation and Amortization

|                                                | 2007          | 2006                 | 2005   |
|------------------------------------------------|---------------|----------------------|--------|
|                                                |               | <i>(In Millions)</i> |        |
| Property, plant and equipment<br>(see Note 12) | <b>₱2,650</b> | ₱3,157               | ₱3,564 |
| Concession rights (see Note 12)                | <b>703</b>    | 707                  | 591    |
| Water rights                                   | <b>96</b>     | –                    | –      |
| Investment properties (see Note 14)            | <b>77</b>     | 77                   | 52     |
| Pipeline rights (see Note 16)                  | <b>25</b>     | 30                   | 33     |
| Others                                         | <b>34</b>     | 12                   | –      |
|                                                | <b>₱3,585</b> | ₱3,983               | ₱4,240 |

## 29. Retirement Benefits

The Parent Company and certain subsidiaries maintain qualified, noncontributory, defined benefit retirement plans covering substantially all their regular employees.

The following tables summarize the components of net benefit expense recognized in the consolidated statements of income and the funded status and amounts recognized in the consolidated balance sheets for the plan.

### Retirement benefit expense

|                                   | 2007         | 2006                 | 2005 |
|-----------------------------------|--------------|----------------------|------|
|                                   |              | <i>(In Millions)</i> |      |
| Current service cost              | <b>₱278</b>  | ₱138                 | ₱87  |
| Interest cost                     | <b>229</b>   | 203                  | 174  |
| Expected return on plan assets    | <b>(79)</b>  | (65)                 | (39) |
| Net actuarial losses recognized   | <b>62</b>    | 6                    | 20   |
| Amortization of past service cost | <b>2</b>     | 2                    | –    |
| Settlement loss                   | <b>4</b>     | –                    | –    |
|                                   | <b>₱496</b>  | ₱284                 | ₱242 |
| <br>                              |              |                      |      |
| Actual return on plan assets      | <b>(₱27)</b> | ₱77                  | ₱105 |

Retirement benefit liability

|                                                                       | 2007                 | 2006    |
|-----------------------------------------------------------------------|----------------------|---------|
|                                                                       | <i>(In Millions)</i> |         |
| Present value of benefit obligation                                   | <b>₱5,236</b>        | ₱2,986  |
| Fair value of plan assets                                             | <b>(3,582)</b>       | (1,779) |
| Present value of unfunded obligation                                  | <b>1,654</b>         | 1,207   |
| Unrecognized actuarial losses                                         | <b>(249)</b>         | (1,118) |
| Unrecognized past service cost                                        | <b>(527)</b>         | (26)    |
| Foreign exchange differences                                          | <b>(38)</b>          | (127)   |
| Excess of contribution over liability                                 | <b>1</b>             | 1       |
| Others                                                                | <b>(12)</b>          | (4)     |
|                                                                       | <b>829</b>           | (67)    |
| Retirement asset recognized by the Parent Company<br>and a subsidiary | <b>418</b>           | 320     |
|                                                                       | <b>₱1,247</b>        | ₱253    |

Movements in the present value of the defined benefit obligation are as follows:

|                                         | 2007                 | 2006   |
|-----------------------------------------|----------------------|--------|
|                                         | <i>(In Millions)</i> |        |
| Balance at beginning of year            | <b>₱2,986</b>        | ₱1,736 |
| Current service cost                    | <b>278</b>           | 138    |
| Interest cost                           | <b>229</b>           | 203    |
| Benefits paid                           | <b>(100)</b>         | (87)   |
| Actuarial losses                        | <b>(599)</b>         | 992    |
| Effect of curtailment                   | <b>(196)</b>         | -      |
| Additions due to PNOC-EDC acquisition   | <b>2,563</b>         | -      |
| Foreign currency translation adjustment | <b>74</b>            | 4      |
| Balance at end of year                  | <b>₱5,235</b>        | ₱2,986 |

Movements in the fair value of plan assets are as follows:

|                                         | 2007                 | 2006   |
|-----------------------------------------|----------------------|--------|
|                                         | <i>(In Millions)</i> |        |
| Balance at beginning of year            | <b>₱1,779</b>        | ₱1,276 |
| Expected return on plan assets          | <b>79</b>            | 65     |
| Contributions                           | <b>485</b>           | 503    |
| Benefits paid                           | <b>(277)</b>         | (86)   |
| Actuarial gains (losses)                | <b>(105)</b>         | 18     |
| Additions due to PNOC-EDC acquisition   | <b>1,571</b>         | -      |
| Foreign currency translation adjustment | <b>50</b>            | 3      |
| Balance at end of year                  | <b>₱3,582</b>        | ₱1,779 |

The First Holdings Group expects to contribute ₱430 million to its defined benefit retirement plan in 2008.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

|                                      | 2007          | 2006          |
|--------------------------------------|---------------|---------------|
| Cash and cash equivalents            | 43.9%         | 84.8%         |
| Investment in shares of stock        | 40.3          | 10.4          |
| Investments in government securities | 15.2          | 3.1           |
| Others                               | 0.6           | 1.7           |
|                                      | <b>100.0%</b> | <b>100.0%</b> |

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled. There has been a significant change in the expected rate of return on assets due to the improved stock market services.

The principal actuarial assumptions at the balance sheet dates used for the Parent Company and subsidiaries' actuarial valuations are as follows:

|                                        | 2007      | 2006        |
|----------------------------------------|-----------|-------------|
| Discount rate                          | 7.0–11.3% | 11.0%–14.5% |
| Expected rate of return on plan assets | 2.5–10.0% | 6.0%–10.0%  |
| Future salary increases                | 5.0–14.0% | 5.0%–14.0%  |

Amounts for the current and previous periods are as follows:

|                            | December 31,<br>2007 | December 31,<br>2006 | December 31,<br>2005 |
|----------------------------|----------------------|----------------------|----------------------|
|                            |                      | <i>(In Millions)</i> |                      |
| Defined benefit obligation | ₱5,236               | ₱2,986               | ₱1,710               |
| Plan assets                | (3,582)              | (1,779)              | (1,279)              |
| Deficit                    | <b>₱1,654</b>        | <b>₱1,207</b>        | <b>₱431</b>          |

### 30. Income Tax

The consolidated deferred tax assets and liabilities as of December 31, 2007 and 2006 consist of the following:

|                                                              | 2007          | 2006 |
|--------------------------------------------------------------|---------------|------|
| <b>Deferred Tax Assets</b>                                   |               |      |
| Capitalized foreign exchange on losses<br>on BOT power plant | <b>₱4,346</b> | ₱–   |
| Allowance for doubtful accounts                              | <b>1,153</b>  | 10   |
| Retirement benefit liability                                 | <b>599</b>    | 17   |
| Financial assets/intangible assets                           | <b>439</b>    | –    |
| Debt issuance costs                                          | <b>155</b>    | 91   |

(Forward)



|                                                                  | 2007          | 2006            |
|------------------------------------------------------------------|---------------|-----------------|
| Accrued expenses                                                 | ₱38           | ₱32             |
| Unused NOLCO and MCIT                                            | 15            | 103             |
| Asset retirement obligation                                      | 90            | 9               |
| Others                                                           | 111           | 586             |
| <b>Total</b>                                                     | <b>6,946</b>  | <b>848</b>      |
| <b>Deferred Tax Liabilities</b>                                  |               |                 |
| Deductible expenses per PD No. 1442                              | 3,662         | –               |
| Prepaid major spare parts                                        | 462           | 584             |
| Unrealized foreign exchange gains                                | 246           | 64              |
| Difference in depreciation method                                | 188           | 395             |
| Capitalized foreign exchange gain, taxes, duties<br>and interest | 162           | 1,428           |
| Prepaid pension assets                                           | 41            | 49              |
| <b>Total</b>                                                     | <b>4,761</b>  | <b>2,520</b>    |
|                                                                  | <b>₱2,185</b> | <b>(₱1,672)</b> |

A reconciliation between the statutory income tax rates and effective income tax rates as shown in the consolidated statements of income follows:

|                                         | 2007         | 2006  | 2005   |
|-----------------------------------------|--------------|-------|--------|
| Statutory income tax rates              | <b>35.0%</b> | 35.0% | 32.5%  |
| Income tax effects of:                  |              |       |        |
| Income tax holiday                      | <b>(5.6)</b> | (5.2) | (18.3) |
| Equity in net earnings<br>of associates | <b>(4.6)</b> | (8.6) | (5.0)  |
| Income subjected to final tax           | <b>(5.2)</b> | (6.9) | (0.2)  |
| Gain on dilution                        | –            | (5.6) | –      |
| Others                                  | <b>(9.4)</b> | (1.0) | (6.8)  |
| <b>Effective income tax rates</b>       | <b>10.2%</b> | 7.7%  | 2.2%   |

Certain deferred income tax assets of the Parent Company and certain other subsidiaries have not been recognized since management believes that it is not probable that sufficient taxable profits will not be available against which they can be utilized. The deductible temporary differences of certain balance sheet items and the carryforward benefits of NOLCO and MCIT for which no deferred tax asset has been recognized in the consolidated balance sheets are as follows:

|                                         | 2007                 | 2006          |
|-----------------------------------------|----------------------|---------------|
|                                         | <i>(In Millions)</i> |               |
| NOLCO                                   | ₱5,083               | ₱1,480        |
| Unrealized foreign exchange (gain) loss | (1,057)              | 569           |
| Allowance for doubtful accounts         | 12                   | 7             |
| MCIT                                    | 17                   | 10            |
| Others                                  | 256                  | 277           |
|                                         | <b>₱4,311</b>        | <b>₱2,343</b> |

The deferred assets has not been recognized as the First Holdings Group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference may not reverse in the foreseeable future.

The consolidated unutilized NOLCO and MCIT as of December 31, 2007 are detailed as follows:

| Year Incurred/Paid   | Carryforward Benefit<br>Up To | Amount        |            |
|----------------------|-------------------------------|---------------|------------|
|                      |                               | NOLCO         | MCIT       |
| <i>(In Millions)</i> |                               |               |            |
| 2005                 | December 31, 2008             | ₱406          | ₱3         |
| 2006                 | December 31, 2009             | 1,189         | 5          |
| 2007                 | December 31, 2010             | 3,531         | 10         |
|                      |                               | <b>₱5,126</b> | <b>₱18</b> |

NOLCO and MCIT amounting to ₱691 million and ₱12 million, respectively, expired in 2007.

There are no income tax consequences attaching to the payment of dividends in either 2007 or 2006 by First Holdings to its shareholders

### 31. EPS Computation

The following table presents information necessary to compute EPS:

|                                                                             | 2007               | 2006        | 2005        |
|-----------------------------------------------------------------------------|--------------------|-------------|-------------|
| <i>(In Millions, Except Number of Shares and Per Share Data)</i>            |                    |             |             |
| (a) Net income attributable to equity holders of the Parent                 | <b>₱4,475</b>      | ₱8,754      | ₱5,514      |
| Number of shares:                                                           |                    |             |             |
| Common shares outstanding at beginning of year                              | <b>580,021,800</b> | 569,614,261 | 547,538,819 |
| Effect of common share issuances during the year                            | <b>5,570,088</b>   | 4,678,866   | 10,754,296  |
| (b) Adjusted weighted average number of common shares outstanding - basic   | <b>585,591,888</b> | 574,293,127 | 558,293,115 |
| Effect of dilutive potential common shares                                  | <b>7,751,528</b>   | 6,250,085   | 9,476,609   |
| (c) Adjusted weighted average number of common shares outstanding - diluted | <b>593,343,416</b> | 580,543,212 | 567,769,724 |
| EPS:                                                                        |                    |             |             |
| Basic (a/b)                                                                 | <b>₱7.642</b>      | ₱15.243     | ₱9.872      |
| Diluted (a/c)                                                               | <b>7.542</b>       | 15.079      | 9.712       |

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## 32. Related Party Transactions

### Related Parties

Enterprises and individuals that directly, or indirectly through one or more intermediaries, control, or are controlled by, or under common control with the Company, including holding companies, and fellow subsidiaries are related entities of the Company. Associates and individuals owning, directly or indirectly, an interest in the voting power of the Company that gives them significant influence over the enterprise, key management personnel, including directors and officers of the Company and close members of the family of these individuals and companies associated with these individuals also constitute related entities. Transactions between related parties are accounted for at arm's-length prices or on terms similar to those offered to non-related entities in an economically comparable market.

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

The significant transactions with associates and other related parties at market prices in the normal course of business, and the related outstanding balances are disclosed below.

- a. FGPC and FGP earn all of their income from sale of electricity to MERALCO under separate PPA (see Note 37a). Billings to MERALCO totaled ₱45.1 billion, ₱51.2 billion and ₱45.5 billion in 2007, 2006 and 2005, respectively. Outstanding receivables from MERALCO from the sale of electricity are included in the "Trade and other receivables" account and amounted to ₱4.9 billion and ₱8.2 billion as of December 31, 2007 and 2006, respectively (see Note 8).
- b. MNTC awarded a Construction Contract in 2001 to Leighton Contractors (Asia) Limited (LCAL) for the construction of Segments 1, 2 and 3 of Phase I of the NLE Tollway Project under a competitive bidding (see Note 36b). The peso component of the Construction Contract was originally set at ₱5.0 billion and its US dollar component was at ₱1,963 million (\$37 million). Billings for peso and dollar contract accomplishments of LCAL totaled ₱80.6 million in 2006.

On March 21, 2007, the Company and LCAL entered into a Settlement Agreement to resolve a number of claims and disputes arising out of or in connection with the Construction Contract and Works, including the pavement defects and outstanding (PD&O) works, and to close out the Construction Contract. LCAL agreed to complete by September 30, 2007 the repair of pavement defects and PD&O Works valued at ₱331.3 million (\$8.0 million). Pursuant to the Settlement Agreement the Company settled all its liabilities net of the amount of cash settlement of ₱132.5 million (\$3.2 million) which LCAL agreed to pay the Company.

On January 25, 2008, the Company issued a Performance Certificate to LCAL being the date upon which the PD&O were completed. In addition, LCAL agreed to pay the Company a Cash Settlement amount of \$3.2 million which equates to ₱155.2 million.

- c. TMC, an associate of FPIDC, provides services as operator to the NLE under the O&M. The O&M agreement contains the terms and conditions for the operation and maintenance by TMC of Phase I of the NLE and subsequently, of Segment 7, and sets forth the scope of its services. TMC is assisted by Transroute Philippines, Inc. as service provider in accordance

with the Technical Assistance Agreement. Under the O&M, MNTC pays TMC a minimum fixed annual amount currently set at ₱637.1 million for the NLE and ₱40.6 million for Segment 7, to be escalated on a quarterly basis plus a variable component, which will take effect upon start of commercial operations. The O&M, which also provides for certain bonuses and penalties as described in the O&M, shall be effective for the entire concession period.

- d. Management services are rendered by First Gen to BPPC under certain terms and conditions of Management Contract (Contract), in consideration of the payment of management fees is fixed at ₱26 million (\$0.5 million) per year effective January 1, 2006. On March 13, 2006, First Gen and BPPC renewed the Contract effective from January 1, 2006 until the end of the 15-year cooperation period of the Project Agreement of BPPC, which will expire in July 2010. Management fees amounted to \$0.5 million in 2007 and 2006 and \$1.67 million in 2005.
- e. Maintenance services rendered by Meralco Industrial Engineering Services Corporation (MIESCOR), a subsidiary of MERALCO, on the 230 kilo-volt transmission line from the Santa Rita plant to the Calaca Substation in Batangas under the Transmission Line Maintenance Agreement. This involves the monthly payment of ₱0.6 million (\$0.02 million) as retainer fee, and ₱2.3 million (\$0.07 million) for every six-month period as service fee, with both fees subject to periodic adjustment as set forth in the agreement. The amount of compensation for additional services requested by the FGPC outside the scope of the agreement is subject to mutual agreement between FGPC and MIESCOR. Total expense amounted to \$0.47 million in 2007 and \$0.38 million in 2006 and \$0.27 million in 2005
- f. In April 2003, the Parent Company acquired a parcel of land at Rockwell Center from ROCKWELL with a total area of 5,220 square meters (including right of way of 2,212 sq.m) for a total consideration of ₱267 million. The property was intended for future joint venture development with ROCKWELL. The said property is subject of a lease agreement for three years with rentals covered by an escalation rate of 10% per annum.

On May 3, 2006, ROCKWELL repurchased the aforementioned lot (inclusive of the right of way) for a total consideration of ₱408 million, resulting in a gain amounting to ₱90 million.

- g. PHILEC and FEDCOR earn portion of their income from selling ballasts and power transformers to MERALCO. Billings to MERALCO totaled ₱901.6 million, ₱582 million and ₱502 million in 2007, 2006 and 2005, respectively. Outstanding receivables from MERALCO for the sale of ballasts and power transformers are included in the "Trade and other receivables" account and amounted to ₱139.2 million and ₱153 million as of December 31, 2007 and 2006, respectively.
- h. The First Holdings Group provides advances to associates and other related parties for working capital and investment requirements. Outstanding balance of the advances amounted to ₱10.2 billion and ₱0.6 billion as of December 31, 2007 and 2006, respectively. Also, the First Holdings Group obtains cash advances from related parties in the normal course of business.

- i. Compensation of key management personnel are as follows:

|                                    | 2007                 | 2006        |
|------------------------------------|----------------------|-------------|
|                                    | <i>(In Millions)</i> |             |
| Short-term employee benefits       | ₱597                 | ₱397        |
| Retirement benefits (see Note 29)  | 72                   | 58          |
| Share-based payments (see Note 26) | 15                   | 24          |
|                                    | <b>₱684</b>          | <b>₱479</b> |

### 33. Registrations with the Board of Investments (BOI) and Philippine Economic Zone Authority (PEZA)

FGRI, PHILEC, FPMTTC, FGPC, FGP, FG Hydro and MNTC are registered with the BOI under the Omnibus Investments Code of 1987, whereas FPIP, FPPSI and FSRI are registered with PEZA pursuant to Presidential Proclamation Nos. 1103 and 1208 and R.A. No. 7916. As registered enterprises, these subsidiaries are entitled to certain tax and nontax incentives which include, among others, income tax holiday (ITH).

Total incentives availed of by these subsidiaries amounted to ₱2.0 billion and ₱ 2.4 billion for the years ended December 31, 2007 and 2006, respectively.

### 34. Financial Risk Management Objectives and Policies

First Holdings Group's principal financial liabilities are comprised of bonds, loans and long-term debt, among others. The main purpose of these financial liabilities is to raise financing for First Holdings Group's growth and operations. First Holdings Group has various financial assets and liabilities such as cash and cash equivalents, short-term cash deposits, trade receivables, AFS investments, trade payables and other liabilities which arise directly from its operations.

As a matter of policy, First Holdings Group does not trade its financial instruments. However, First Holdings Group enters into derivative transactions, primarily interest rate swaps, as needed, for the sole purpose of managing the risks that are associated with First Holdings Group's borrowing activities. First Holdings Group has an Enterprise Wide Risk Management Program which is aimed to identify risks based on the likelihood of occurrence and impact to the business, formulate risk management strategies, assess risk management capabilities and continuously monitor the risk management efforts.

The main risks arising from First Holdings Group's financial instruments are interest rate risk, foreign currency risk, credit risk, credit concentration risk and liquidity risk. The BOD reviews and approves policies for managing each of these risks as summarized below. First Holdings Group's accounting policies in relation to derivatives are set out in Note 2.

### Interest Rate Risk

The First Holdings Group's exposure to the risk for changes in market interest rates relates primarily to the First Holdings Group's long-term debt obligations with floating interest rates. First Holdings Group believes that prudent management of its interest cost will entail a balanced mix of fixed and variable rate debt. On a regular basis, the Finance team of First Holdings Group monitors the interest rate exposure and presents it to management by way of a compliance report. To manage the exposure to floating interest rates in a cost-efficient manner, prepayment, refinancing or entering into derivative instruments such as interest rate swaps are undertaken as deemed necessary and feasible. As of December 31, 2007, approximately 56% and First Holdings Group's borrowings are subject to fixed interest rate.

The following table demonstrates the sensitivity of the Group's profit before tax and equity to a reasonably possible change in interest rates on December 31, 2007, with all variables held constant. There is no other impact on First Holdings Group's equity other than those already affecting the consolidated statements of income.

|                                           | Increase/<br>Decrease<br>in Basis Points | Effect<br>on Income<br>Before<br>Income Tax |
|-------------------------------------------|------------------------------------------|---------------------------------------------|
| Parent Company - floating rate borrowings | +100                                     | (P148)                                      |
|                                           | -100                                     | 148                                         |
| Subsidiaries - floating rate borrowings   | +100                                     | (187)                                       |
|                                           | -100                                     | 187                                         |

The terms and maturity profile of the interest-bearing financial instruments, together with its carrying values, are shown in the following tables:

| Interest Rates            | Within<br>1 Year                         | 1-5 Years    | > 5 Years    | Total  |       |
|---------------------------|------------------------------------------|--------------|--------------|--------|-------|
| <i>(In millions)</i>      |                                          |              |              |        |       |
| <b>Parent</b>             |                                          |              |              |        |       |
| Long-term debt:           | Various rates from 6.95% to 8.37%        |              |              |        |       |
| Floating                  | 37                                       | 11,664       | <b>5,993</b> | 17,694 |       |
| <b>Fixed</b>              |                                          |              |              |        |       |
| 6 months PDST-F + 2.35%   |                                          | 3,556        | <b>2,844</b> | 6,400  |       |
| 6 months LIBOR + 2.1%     | –                                        | 6,294        | –            | 6,294  |       |
| 7.15%                     | 4                                        | 1,646        |              | 1,650  |       |
| 7.9%                      | 20                                       | 100          | 1,880        | 2,000  |       |
| 8.37%                     | 13                                       | 68           | 1,269        | 1,350  |       |
| <b>Subsidiaries</b>       |                                          |              |              |        |       |
| First Gen - loans Payable | Various rates from 6.12% to 7.00%        |              |              |        |       |
| Foreign bridge            | 18,343                                   | –            | –            | 18,343 |       |
| Local bridge USD          | 11,906                                   | –            | –            | 11,906 |       |
| Local bridge PHP          | 4,141                                    | –            | –            | 4,141  |       |
| DBP loan                  | 1,735                                    | –            | –            | 1,735  |       |
| First Gen - Bonds Payable | 561                                      | –            | –            | 561    |       |
| FGPC                      | –                                        | <b>5,000</b> |              | 5,000  |       |
|                           | various rates ranging from 2.69% - 8.79% |              |              |        |       |
| KfW Facility              | 1,455                                    | 6,646        |              | 8,101  |       |
| EIB Facility              | 405                                      | 1,620        |              | 2,025  |       |
| Mexim Facility            | 216                                      | 1,050        |              | 1,266  |       |
| US Private Placements     | 466                                      | 818          |              | 1,284  |       |
|                           | plus 2.5%                                | <b>368</b>   | 3,158        | –      | 3,526 |

|                              | Interest Rates                                                      | Within |           |           | Total  |
|------------------------------|---------------------------------------------------------------------|--------|-----------|-----------|--------|
|                              |                                                                     | 1 Year | 1-5 Years | > 5 Years |        |
| <i>(In millions)</i>         |                                                                     |        |           |           |        |
| Red Vulcan                   | "PDST F" rate or BSP rate, whichever higher                         | –      | 28,834    | –         | 28,834 |
| PNOC-EDC                     |                                                                     |        |           |           |        |
| IBRD loans                   | 1/2 of 1% over cost of qualified borrowings                         | 530    | 1,328     | 3,203     | 5,061  |
| Land Bank of the Philippines | ave. 91- day T-Bill + 2%                                            | 378    | –         | –         | 378    |
| OECD                         | 3.0%- 5.7%%                                                         | 1,123  | 907       | 3,257     | 5,287  |
| PCIR Bonds                   | 4.25% - 6.50%                                                       | –      | –         | 14        | 14     |
| Miyazawa I & II              | 2.63%                                                               | –      | 12,101    | –         | 12,101 |
| FPH fund                     | Various rates ranging from 9.37% to 12.08%                          | 293    | 2,593     | –         | 2,886  |
|                              | Swapped to fixed at 9.37%                                           | 293    | 446       | –         | 739    |
|                              | 6 months LIBOR + 6.94%                                              |        | 2,147     | –         | 2,147  |
| FGP                          | various rates ranging from 3 to 6 month LIBOR + 1.4% to 2.15%/7.48% | 1,091  | –         | 7,031     | 8,122  |
| ECGD Facility*               | LIBOR plus 2.15%                                                    | 396    | –         | 2,381     | 2,777  |
| Hermes-Covered Facility      | 7.48%                                                               | 460    | –         | 2,760     | 3,220  |
| GKA Covered Facility         | LIBOR plus 1.4%                                                     | 235    | –         | 1,890     | 2,125  |
| FGHC                         | 10.5%                                                               | 206    | 1,239     |           | 1,445  |
| MNTC                         | various rates ranging from 6.13% to 9.75%                           | 546    | 2,292     | 5,998     | 8,836  |
| FXCN                         | 9.75%                                                               | 28     | 220       | 5,225     | 5,473  |
| Asian Development Bank       |                                                                     |        |           |           |        |
| Loan (ADB)                   | 8.25%                                                               | 93     | 373       | 137       | 603    |
| USD Bank Facility (USD)      | LIBOR + 3.00% Margin                                                | 166    | 663       | 249       | 1,078  |
| ADB-CFS                      | LIBOR + 2.75% Margin                                                | 104    | 416       | 155       | 675    |
| EFIC                         | 8.03%                                                               | 78     | 311       | 116       | 505    |
| COFACE                       | 6.13%                                                               | 77     | 309       | 116       | 502    |

Floating interest rates on financial instruments are repriced semi-annually on each interest payment date. Financial instruments of the First Holdings Group that are not included in the above table are non interest-bearing financial instruments thus not subject to interest rate risk.

| 2007                                                         | Interest Income | Interest Expense | Net Interest Income |
|--------------------------------------------------------------|-----------------|------------------|---------------------|
| Financial instruments:                                       |                 |                  |                     |
| Cash in banks and short-term placements                      | ₱1,612          | ₱–               | ₱1,612              |
| Interest on loans and bonds                                  | 1               | 6,073            | (6,072)             |
| Annual deficiency                                            | 321             | 321              | –                   |
| Accretion on debt issuance cost                              | –               | 272              | (272)               |
| Write-off of deferred debt issuance cost on undrawn facility | –               | 41               | (41)                |
| Accretion on deferred royalty fee                            | –               | 19               | (19)                |
| Accretion on asset retirement                                | –               | 3                | (3)                 |
| <b>Total</b>                                                 | <b>₱1,934</b>   | <b>₱6,729</b>    | <b>(₱4,795)</b>     |

### Foreign Currency Risk

First Holdings Group's, except First Gen, exposure to foreign currency risk arises mainly from cash, short-term investments and long-term liabilities denominated in U.S. dollar. Any depreciation of the U.S. dollar against the Philippine peso posts material foreign exchange losses relating to cash and short-term investments, trade and other receivables, deposit and due to related parties while any appreciation of the U.S. dollar and other currencies posts material foreign exchange losses relating to long-term deposits. To better manage the foreign exchange risk, stabilize cash flows, and further improve the investment and cash flow planning, First Holdings Group may consider entering into derivative contracts and other hedging products as necessary. However, these hedges do not cover all the exposure to foreign exchange risk.

The foreign-currency denominated assets and liabilities, which pertain to the U.S. dollar, are then translated to Philippine peso being the functional and presentation currency for statutory reporting purposes. In translating these foreign currency-denominated monetary assets and liabilities into Philippine peso, the exchange rates used were ₱41.41 to US\$1.00 Philippine peso U.S. dollar exchange rates as of December 31, 2007.

The table below summarizes the First Holdings Group's exposure to foreign exchange risk as of December 31 2007.

| Assets                                       | U.S. Dollar-<br>Denominated<br>Balances | Equivalent<br>Philippine Peso-<br>Denominated<br>Balances |
|----------------------------------------------|-----------------------------------------|-----------------------------------------------------------|
| Financial assets:                            |                                         |                                                           |
| Cash and cash equivalents                    | \$39                                    | ₱1,610                                                    |
| Trade and other receivables                  | 4                                       | 182                                                       |
| Deposit                                      | 220                                     | 9,974                                                     |
| Due from related parties                     | 5                                       | 206                                                       |
| Total financial assets                       | 268                                     | 11,972                                                    |
| Financial liabilities:                       |                                         |                                                           |
| Trade payable and other payables             | 9                                       | 367                                                       |
| Long-term debt, including current portion    | 285                                     | 18,050                                                    |
| Total financial liabilities                  | 294                                     | 18,417                                                    |
| Net foreign currency denominated liabilities | (\$26)                                  | (₱6,445)                                                  |

The following table sets out the impact of the range of reasonably possible movement in the U.S. Dollar and Philippine peso exchange rates with all other variables held constant, First Holdings Group's income before income tax (due to changes in the fair value of monetary assets and liabilities) for the year ended December 31, 2007. There is no other impact on the FPHC equity other than those already affecting the consolidated statements of income.

| Change in Exchange Rate<br>in U.S. Dollar against Philippine Peso | Effect on Income before Income Tax |
|-------------------------------------------------------------------|------------------------------------|
|                                                                   | <i>(In Millions)</i>               |
| 5%                                                                | (₱53)                              |
| (5%)                                                              | 53                                 |



First Gen's exposure to foreign currency risk arises as the functional currency of First Gen and certain subsidiaries, the U.S. Dollar, is not the local currency in its country of operations. Certain financial assets and liabilities, as well as some costs and operating expenses, are denominated in Philippine Peso or in Japanese Yen in the case of PNOC-EDC. To manage the foreign currency risk, First Gen considers entering into derivative transactions as necessary. As of December 31, 2007, First Gen has not entered into any derivative transactions to cover the foreign exchange fluctuations. Moreover, First Gen has a natural hedge with regard to its Philippine Peso bonds since it receives cash dividends from FG Hydro in Philippine Peso.

In the case of PNOC-EDC, its foreign currency risk primarily arises from future payments of foreign loans, BOT lease obligations, other commercial transactions and its investment in ROP bonds. Its exposure to foreign currency risk, to some degree, is mitigated by some provisions indicated in PNOC-EDC's GSCs, SSAs and PPAs. The GSC allows full cost recovery while the SSA include billing adjustments covering the movements in Philippine Peso and the U.S. Dollar rates, U.S. Price and Consumer indices, and other inflation factors.

The following table sets out First Gen's Philippine Peso-denominated financial assets and liabilities as of December 31, 2007 that may affect the consolidated financial statements of First Holdings Group.

|                                             | 2007                                  |                                                          |                                       |
|---------------------------------------------|---------------------------------------|----------------------------------------------------------|---------------------------------------|
|                                             | Original Currency                     |                                                          |                                       |
|                                             | Japanese Yen<br>Balances <sup>1</sup> | Philippine Peso-<br>denominated<br>Balances <sup>2</sup> | Equivalent<br>U.S. Dollar<br>Balances |
| <i>(In Millions)</i>                        |                                       |                                                          |                                       |
| Financial assets:                           |                                       |                                                          |                                       |
| Cash and cash equivalents                   | ¥6.5                                  | ₱5,026.9                                                 | \$121.4                               |
| Trade and other receivables                 | –                                     | 4,876.4                                                  | 117.8                                 |
| AFS investments                             | –                                     | 16.4                                                     | 0.4                                   |
|                                             | 6.5                                   | 9,919.7                                                  | 239.6                                 |
| Financial liabilities:                      |                                       |                                                          |                                       |
| Loans payable                               | –                                     | 2,296.0                                                  | 55.4                                  |
| Accounts payable and accrued<br>expenses    | –                                     | 4,985.6                                                  | 120.4                                 |
| Due to stockholders<br>and affiliates       | –                                     | 220.8                                                    | 5.3                                   |
| Long-term debt including<br>current portion | 17,929.9                              | 33,303.4                                                 | 804.2                                 |
| Bonds payable                               | –                                     | 5,000.0                                                  | 120.7                                 |
|                                             | 17,929.9                              | 45,805.8                                                 | 1,106.1                               |
| <b>Net financial liabilities</b>            | <b>¥17,923.4</b>                      | <b>₱35,886.1</b>                                         | <b>\$866.5</b>                        |

<sup>1</sup> \$1=JPY 113.688 and \$1=₱41.411

<sup>2</sup> \$1=₱49.045

The following table sets out, the impact of the range of reasonably possible movement in the U.S. Dollar, Japanese Yen and Philippine peso exchange rates with all other variables held constant, First Gen's income before income tax and equity (due to changes in the fair value of

monetary assets and liabilities) for the year ended December 31, 2007. There is no other impact on the FPHC equity other than those already affecting the consolidated statements of income.

|                                       | 2007                                                                |       |                                                                        |        |
|---------------------------------------|---------------------------------------------------------------------|-------|------------------------------------------------------------------------|--------|
|                                       | Change in Exchange Rate<br>(in Japanese Yen Against<br>U.S. Dollar) |       | Change in Exchange Rate<br>(in Philippine Peso Against<br>U.S. Dollar) |        |
|                                       | (5%)                                                                | 5%    | (5%)                                                                   | 5%     |
| Effect on income before<br>income tax | (\$8.3)                                                             | \$7.5 | (\$45.6)                                                               | \$41.3 |

### Credit Risk

The First Holdings Group trades only with recognized, creditworthy third parties and/or transacts only with institutions and/or banks which have demonstrated financial soundness. It is the First Holdings Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances and the level of allowance are monitored and reviewed on a continuous basis. The result of such review revealed that the First Holdings Group's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the First Holdings Group, which comprise mostly of cash and cash equivalents, and AFS investments, the First Holdings Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

The table below shows the gross maximum exposure to credit risk of First Holdings Group as of December 31, 2007, without considering the effects of collaterals and other credit risk mitigation techniques.

|                              |                |
|------------------------------|----------------|
| Cash and cash equivalents    | ₱14,823        |
| Trade receivables            | 10,807         |
| Concession receivables       | 34,695         |
| Receivable from MERALCO      | 3,077          |
| AFS investments              | 1,178          |
| <b>Total credit exposure</b> | <b>₱64,580</b> |

The table below shows the First Holdings Groups credit quality and aging of trade and other receivables as of December 31, 2007:

|                            | Neither<br>Past Due<br>Nor<br>Impaired | Past Due but not Impaired |                 |                 |                  |               | Impaired    | Total       |                |
|----------------------------|----------------------------------------|---------------------------|-----------------|-----------------|------------------|---------------|-------------|-------------|----------------|
|                            |                                        | < 30 Days                 | 30 -<br>60 Days | 60 -<br>90 days | 90 -<br>120 Days | > 120<br>Days |             |             |                |
| <i>(In Millions)</i>       |                                        |                           |                 |                 |                  |               |             |             |                |
| Trade                      | ₱9,782                                 | ₱271                      | ₱46             | ₱35             | ₱6               | ₱252          | ₱610        | ₱415        | ₱10,807        |
| Concession<br>receivables  | 36,895                                 | -                         | -               | -               | -                | -             | -           | -           | 36,895         |
| Receivable from<br>MERALCO | 3,076                                  |                           |                 |                 |                  |               |             |             | 3,076          |
| <b>TOTAL</b>               | <b>₱49,753</b>                         | <b>₱271</b>               | <b>₱46</b>      | <b>₱35</b>      | <b>₱6</b>        | <b>₱25</b>    | <b>₱610</b> | <b>₱415</b> | <b>₱50,778</b> |

As of December 31, 2007, the financial assets categorized as neither past due nor impaired are viewed by management as high grade, considering the collectibility of the receivables and the credit history of the counterparties.

Past due but not impaired receivables are viewed by management as standard grade, as delays in collection are within tolerable limits. Accordingly, no impairment losses have been recognized for the foregoing categories.

Past due or impaired receivables are viewed by management as substandard grade, after performing a review of the status of these accounts relative to the counterparties ability to pay.

#### Credit Concentration Risk

The First Holdings Group, through First Gen's operating subsidiaries FGP and FGPC, earns a substantial portion of its revenues from MERALCO, their largest customer. MERALCO is committed to pay for the capacity and energy generated by the San Lorenzo and the Santa Rita power plants under the existing long-term PPAs which are due to expire in September 2027 and August 2025, respectively. While the PPAs provide for the mechanisms by which certain costs and obligations including fuel costs, among others, are treated as "pass-through" to MERALCO or are otherwise recoverable from MERALCO, it is the intention of the Parent Company, FGP and FGPC to ensure that the pass-through mechanisms, as provided for in their respective PPA, are followed.

Under the current regulatory regime, generation rate charged by FGP and FGPC to MERALCO are not subject to regulations and are complete pass-through charges to MERALCO'S customers.

PNOC-EDC's geothermal and power generation business trades with only one major customer which is NPC, a government-owned-and-controlled corporation. Any failure on the part of NPC to pay its obligations to PNOC-EDC would significantly affect PNOC-EDC's business operations. As a manner of practice, PNOC-EDC monitors closely its collections with NPC.

First Holdings Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amounts of the receivables from MERALCO, in the case of FGP and FGPC, and receivables from NPC in the case of PNOC-EDC.

#### Liquidity Risk

First Holdings Group's exposure to liquidity risk refers to the lack of funding needed to finance its growth and capital expenditures, service its maturing loan obligations in a timely fashion, and meet its working capital requirements. To manage this exposure, First Holdings Group maintains internally generated funds and prudently manages the proceeds obtained from fund raising in the debt and equity markets. On a regular basis, First Holdings Group's treasury department monitors the available cash balances. First Holdings Group maintains a level of cash and cash equivalents deemed sufficient to finance the operations.

In addition, First Holdings Group has short-term cash investments and had available credit lines with certain banking institutions. As part of its liquidity risk management, First Holdings Group regularly evaluates its projected and actual cash flows. It also continuously assesses the financial market conditions for opportunities to pursue fund raising activities. As of December 31, 2007, 61% of First Holdings Group's debt will mature in less than one year based on the carrying value of borrowings reflected in the consolidated financial statements.

The table summarizes the maturity profile of the Group's financial liabilities as of December 31, 2007 based on contractual undiscounted payments.

|                                                                           | On Demand      | Less than 3 Months | 3 to 12 Months | 1 to 5 Years   | More than 5 Years | Total          |
|---------------------------------------------------------------------------|----------------|--------------------|----------------|----------------|-------------------|----------------|
| <i>(In Millions)</i>                                                      |                |                    |                |                |                   |                |
| Trade payables                                                            | ₱7,818         | ₱1,792             | ₱5             | ₱-             | ₱-                | ₱9,615         |
| Accrued expenses                                                          | 2,155          | 68                 | 54             | 7              | 2                 | 2,286          |
| Due to contractors and consultants                                        | 53             |                    |                |                |                   | 53             |
| Royalty fee payable                                                       | -              | 306                | 150            | 1,278          | -                 | 1,734          |
| Other Current Liabilities                                                 | -              | -                  | 821            | -              | -                 | 821            |
| Bonds payable                                                             | -              | -                  | -              | 4,984          | -                 | 4,984          |
| Long-term debt, including current portion                                 | -              | -                  | -              | -              | -                 | -              |
| Obligation to Gas Sellers, including current portion                      | -              | 290                | 858            | 2,735          | -                 | 3,883          |
| Deferred payment facility with PSALM, including current portion (Note 5c) | -              | -                  | 313            | 2,252          | 630               | 3,195          |
| Obligation to power contractors, including current portion                | -              | 66                 | 199            | 100            | -                 | 365            |
|                                                                           | <b>₱10,026</b> | <b>₱2,522</b>      | <b>₱2,400</b>  | <b>₱11,356</b> | <b>₱632</b>       | <b>₱26,936</b> |

### 35. Financial Instruments

#### Fair Values

Set out below is a comparison by category of carrying amounts and fair values of all of First Holdings Group's financial instruments that are carried in the consolidated financial statements as of December 31, 2007 and 2006.

|                                                                           | 2007            |                | 2006            |                |
|---------------------------------------------------------------------------|-----------------|----------------|-----------------|----------------|
|                                                                           | Carrying Amount | Fair Value     | Carrying Amount | Fair Value     |
| Financial assets:                                                         |                 |                |                 |                |
| Loans and receivables:                                                    |                 |                |                 |                |
| Cash and cash equivalents                                                 | <b>₱14,823</b>  | <b>₱14,823</b> | ₱32,249         | ₱32,249        |
| Trade and other receivables:                                              |                 |                |                 |                |
| Trade receivables                                                         | <b>10,807</b>   | <b>10,807</b>  | 9,778           | 9,778          |
| Concession receivables                                                    | <b>36,895</b>   | <b>36,895</b>  | -               | -              |
| Receivable from MERALCO                                                   | <b>3,076</b>    | <b>3,076</b>   | 5,166           | 5,166          |
| Restricted cash deposits (presented under "other current assets" account) | -               | -              | 103             | 103            |
|                                                                           | <b>65,601</b>   | <b>65,601</b>  | 47,296          | 47,296         |
| FVPL investments                                                          | <b>83</b>       | <b>83</b>      | 275             | 275            |
| AFS investments                                                           | <b>1,214</b>    | <b>1,214</b>   | 31              | 31             |
| <b>Total financial assets</b>                                             | <b>₱66,898</b>  | <b>₱66,898</b> | <b>₱47,602</b>  | <b>₱47,602</b> |

|                                                                 | 2007            |                 | 2006            |                |
|-----------------------------------------------------------------|-----------------|-----------------|-----------------|----------------|
|                                                                 | Carrying Amount | Fair Value      | Carrying Amount | Fair Value     |
| Financial liabilities:                                          |                 |                 |                 |                |
| Financial liability at FVPL designated as cash flow hedge       |                 |                 |                 |                |
| Derivative liability                                            | ₱1,315          | ₱1,315          | ₱387            | ₱387           |
| Financial liabilities carried at amortized cost:                |                 |                 |                 |                |
| Financial liabilities carried at amortized cost:                |                 |                 |                 |                |
| Loans payable                                                   | 18,368          | 18,368          | 10              | 10             |
| Trade payables and other current liabilities                    |                 |                 |                 |                |
| Trade payables                                                  | 9,615           | 9,615           | 7,365           | 7,365          |
| Accrued expenses                                                | 2,286           | 2,286           | 1,899           | 1,899          |
| Due to a related party                                          | —               | —               | 388             | 388            |
| Due to contractors and consultants                              | 53              | 53              | 213             | 213            |
| Bonds payable                                                   | 4,974           | 5,802           | 4,931           | 5,588          |
| Obligation to Gas Sellers, including current portion            | 2,747           | 2,774           | 4,612           | 4,644          |
| Deferred payment facility with PSALM, including current portion | 2,891           | 3,736           | 3,796           | 4,211          |
| Royalty fee payable                                             | 1,734           | 2,083           | —               | —              |
| Obligation to power contractors, including noncurrent portion   | 343             | 343             | —               | —              |
| Long-term debt, including current portion                       | 97,932          | 99,070          | 42,201          | 45,672         |
|                                                                 | <b>₱142,258</b> | <b>₱145,445</b> | <b>₱65,802</b>  | <b>₱70,377</b> |

The fair value of cash and cash equivalents (including cash deposit, sinking fund, refundable deposits and restricted cash deposits), short-term cash investments, receivables, other current assets, loans payable, accounts payable and other current liabilities approximates the carrying amounts at balance sheet date due to the short-term nature of the accounts.

The fair value of long-term debt and obligation to gas sellers was computed by discounting the instruments' expected future cash flows using the prevailing credit adjusted LIBOR interest rates, ranging from 4.56% to 5.40%.

The fair value of bonds payable and deferred payment facility with PSALM (see Note 5c) was computed by discounting the bonds' expected future cash flows using the prevailing credit adjusted MART1 interest rates.

The fair value of derivative liability pertaining to the interest rate swap represents the present value of expected future cash flows of the instrument as confirmed by third counterparty.

## Hedging Activities

*Cash Flow Hedge.* As of December 31, 2007 and 2006, FGP has an interest rate swap agreement with ABN AMRO Bank NV to hedge half of its floating rate exposure on its ECGD Facility Agreement. Under the interest rate swap agreement, FGP pays a fixed rate of 7.475% and receives a floating rate of U.S. LIBOR plus spread on a semi-annual basis simultaneous with interest payments on the loan, which is every June and December. The original term loan was priced against the benchmark three to six month LIBOR plus 215 basis points. The interest rate swap agreement will mature in December 2014.

FGP designated the interest rate swap as a hedging instrument to hedge the variability in the cash flows involving half of the floating rate loan from the ECGD Facility Agreement, which is attributable to the movements of interest rates. The hedge is accounted for as cash flow hedge. Under a cash flow hedge, changes in the fair value of the hedging instrument are recognized as cumulative translation adjustments in equity until the hedged item affects earnings. As of December 31, 2007 and 2006, the change in fair value of the interest rate swap that was deferred to cumulative translation adjustments amounted to \$1.3 million and \$0.4 million, respectively.

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## 36. Service Concession Arrangements

### a. Service Concession and Related Arrangements of PNOC-EDC

The service concession and related agreements of PNOC-EDC are discussed in Note 6.

### b. NLE Tollway Project Agreement

#### Joint Venture Agreement (JVA)/Supplemental Toll Operation Agreement (STOA)

FPIDC has a JVA with the Philippine National Construction Corporation (PNCC) for the establishment of a Joint Venture Company (JVC) with the sole purpose of implementing the NLE Tollway Project. MNTC was established to be the JVC. The JVA is for a period of 30 years from the construction and delivery of the last segment of the NLE Tollway Project.

PNCC is the franchise holder for the construction, operation and maintenance of toll facilities in the North and South Luzon Tollways and the Metro Manila Expressway by virtue of PD No. 1113, "Granting the Construction and Development Corporation of the Philippines a Franchise to Operate, Construct and Maintain Toll Facilities in the North and South Luzon Toll Expressways and for Other Purposes," issued on March 31, 1977, as amended by PD No. 1894 issued on December 22, 1983. The Philippine National Construction Corporation (PNCC) has an existing Toll Operations Agreement (TOA) with the Government, by and through the TRB.

Pursuant to the JVA entered into by PNCC and FPIDC on August 29, 1995, PNCC assigned its rights, interests and privileges under its franchise to construct, operate and maintain toll facilities in the NLE in favor of MNTC, including the design, funding and rehabilitation of the NLE, and installation of the appropriate collection system therein is concerned. FPIDC in turn assigned all its rights, interests and privileges to the Binictican-Bo. Tipo road project, as defined in the MOU dated March 6, 1995, to MNTC, which assumed all the rights and obligations as a necessary and integral part of the NLE project. The assignment of PNCC's

usufructuary rights, interests and privileges under its franchise, to the extent of the portion pertaining to the NLE, was approved by the then President of the Republic of the Philippines. On October 10, 1995, the Department of Justice issued Opinion No. 102, Series of 1995, affirming the authority of the TRB to grant authority to operate a toll facility and to issue the necessary Toll Operation Certificate in favor of PNCC and its joint venture partner, as reiterated and affirmed by the Secretary of Justice in his letter to the Secretary of Public Works and Highways dated November 24, 1995, for the proper and orderly construction, operation and maintenance of the NLE as a toll road during the concession period.

In April 1998, the Government, acting as “Grantor” by and through the TRB, PNCC (Franchisee) and MNTC (Concessionaire) executed the STOA for the Manila North Expressway, whereby the Government granted MNTC the rights, obligations and privileges including the authority to finance, design, construct, operate and maintain the project roads as toll roads (Concession) commencing upon the date the STOA comes into effect until December 31, 2030 or 30 years after the issuance of the Toll Operations Permit (TOP) for the last completed phase, whichever is earlier, unless further extended pursuant to the STOA. Unless the PNCC franchise is further extended beyond its expiry on May 1, 2007, the ROP undertook to issue the necessary Toll Operation Certificate for the NLE, in order to allow the continuation of the Concession. The Company pays a certain amount to PNCC in consideration for the assignment of its franchise in favor of MNTC.

Also, under the STOA, MNTC shall pay for Grantor’s project overhead expenses based on certain percentages of total construction costs or of periodic maintenance works on the project roads. Fees billed by TRB amounted to ₱15.7 million and ₱13.5 million in 2007 and 2006, respectively.

Upon expiry of the concession period, MNTC shall hand over the project roads to the Grantor without cost, free from any and all liens and encumbrances and fully operational and in good working condition, including any and all existing land required, works, toll road facilities and equipment found therein directly related to and in connection with the operation of the toll road facilities.

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### 37. Commitments and Contingencies

The First Holdings Group has the following significant contracts and commitments:

a. Power Purchase Agreement (PPA)

FGP and FGPC

FGP and FGPC each have an existing PPA with Meralco, the largest power distribution company operating in the island of Luzon and in the Philippines and the sole customer of both projects. Under the PPA, Meralco will purchase in each contract year from the start of commercial operations, a minimum number of kilowatt-hours of the net electrical output of FGP and FGPC for a period of 25 years. Billings to Meralco under the PPA are substantially in U.S. Dollars and a small portion is billed in Philippine Pesos.

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

Under the respective PPAs of FGP and FGPC, the fixed capacity fees and fixed operating and maintenance fees are recognized monthly based on the actual Net Dependable Capacity (NDC) tested and proven, which is usually conducted on a semi-annual basis. Total fixed capacity fees and fixed operating and maintenance fees amounted to \$276.6 million in 2007, \$268.2 million in 2006 and \$267.5 million in 2005.

#### FG Bukidnon

On January 9, 2008, FG Bukidnon and Cagayan Electric Power and Light Co., Inc. (CEPALCO), an electric distribution utility operating in the City of Cagayan de Oro, signed a Power Supply Agreement (PSA) for the FG Bukidnon plant. Under the PSA, FG Bukidnon shall generate and deliver to CEPALCO and CEPALCO shall take, or pay for if not taken, the Available Energy for a period commencing on the commercial operations date until March 28, 2025. The terms and conditions of the PSA are still subject to the review by the ERC and the effectivity and commercial operations date of the PSA will coincide with the date of ERC approval of the agreement. The sale to CEPALCO of the plant's output since March 29, 2005 has been governed by a MOA signed by both parties in 2005.

#### FG Hydro

FG Hydro has existing contracts, which were transferred by NPC to FG Hydro as part of the acquisition of PAHEP/MAHEP for the supply of electric energy with several customers within the vicinity of Nueva Ecija. FG Hydro shall generate and deliver to these customers the contracted energy on a monthly basis. FG Hydro is bound to service these customers of the remainder of the stipulated terms, the range of which falls between June 2007 and 2010. These contracts may be renewable upon renegotiation with the customers and due process as stipulated by the ERC. With the expiration on December 25, 2007 of the existing contract with the Nueva Ecija 1 Electric Cooperative, Inc. (NEECO1), a new contract was signed by FG Hydro and NEECO1 in December 2007 for the supply of power for the next five years. The contract with Cabanatuan Electric Corporation, which expired on June 25, 2007, was not renewed.

#### PNOC-EDC

The electricity produced by the operating plants of PNOC-EDC is sold to NPC, pursuant to the following PPAs:

- Leyte-Cebu, Leyte-Luzon

The PPA provides, among others, that NPC shall pay PNOC-EDC a base price per kWh of electricity delivered subject to inflation adjustments. The PPA stipulates a contracted annual energy of 1,370 GWH for Leyte-Cebu and 3,000 GWH for Leyte-Luzon



throughout the cooperation period. It also stipulates a nominated energy of not lower than 90% of the contracted annual energy.

On November 12, 1999, NPC agreed to accept from PNOC-EDC a combined average annual nominated energy of 4,455 GWH for the period July 25, 1999 to July 25, 2000 for both Leyte-Cebu and Leyte-Luzon PPA. However, the combined annual nominated energy starting July 25, 2000 is currently under negotiation with NPC. The contracts are for a period of 25 years commencing in July 1996 for Leyte-Cebu and July 1997 for Leyte-Luzon.

- 47 MW Mindanao I

The PPA provides, among others, that NPC shall pay PNOC-EDC a base price per kWh of electricity delivered subject to inflation adjustments. The PPA stipulates a minimum offtake energy of 330 GWH for the first year and 390 GWH per year for the succeeding years. The contract is for a period of 25 years which commenced in March 1997.

- 48.25 MW Mindanao II

The PPA provides, among others, that NPC shall pay PNOC-EDC a base price per kWh of electricity delivered subject to inflation adjustments. The PPA stipulates a minimum offtake energy of 398 GWH per year. The contract is for a period of 25 years which commenced in June 1999.

b. Stored Energy Commitment of PNOC-EDC

On various dates, PNOC-EDC entered into Addendum Agreements to the PPA for the Unified Leyte and BacMan 2 projects where it agreed to credit such payments made by NPC under the minimum take-or pay arrangements for periods with undelivered electricity against stored energy, reporting the contracted energy that NPC was not able to take. Deliveries of the stored energy are to be taken from delivery above the nominated energy for the agreed lifting period. As of December 31, 2007, the commitment for stored energy follows (in gigawatt-hours):

|                    |         |
|--------------------|---------|
| Unified Leyte      | 4,326.6 |
| BacMan 2 – Cawayan | 306.1   |

c. Geothermal Service Contracts of PNOC-EDC

As discussed in Note 36, still by virtue of PD 1442, PNOC-EDC entered into seven service contracts with the DOE granting PNOC-EDC the right to explore, develop, and utilize the country's geothermal resource subject to sharing of net proceeds with the government. The net proceeds is what remains after deducting from the gross proceeds the allowable recoverable costs, which include development, production and operating costs, the residual amount.

The allowable recoverable costs shall not exceed 90% of the gross proceeds. PNOC-EDC pays 60% of the net proceeds as government share and retains the remaining 40%.

The 60% government share is comprised of royalty fees and income taxes. The royalty fees are shared by the government through DOE (60%) and the LGU (40%).

PNOC-EDC secured an approval from the DOE to defer remittance of the royalty portion of the government share at ₱180 million per year. A portion of said payment was applied to the amortization of the deferred royalty fees as of December 31, 1998, and the balance to 1999 and future obligations. On March 23, 2004, PNOC-EDC and DOE agreed to increase the royalty payment plan to ₱200 million per year starting 2004. A portion of the revised payment shall be applied to the amortization of the deferred royalty fees as of December 31, 2003 and the balance to 2004 and future obligations for existing PNOC-EDC operating projects. However, remittances to the LGU of their share in royalty fees are made as they fall due pursuant to the LGC.

Total royalty fees due to DOE and to LGUs are shown in Note 23.

The DOE approved the application of PNOC-EDC for the 20-year extension of the Tongonan, Palinpinon and Bacon-Manito (BacMan) Geothermal Service Contracts (GSCs). The extension is embodied in the fourth amendment to the GSCs dated October 30, 2003. The amendment extended the Tongonan GSC from May 15, 2011 to May 16, 2031, while the Palinpinon and Bacon-Manito GSCs are extended from October 16, 2011 to October 17, 2031.

d. Geothermal Resources Sales Contracts of PNOC-EDC

The geothermal energy currently produced by PNOC-EDC's geothermal projects is supplied to its BOT contractors and the power plants owned and operated by NPC pursuant to the following steam sales contracts:

▪ Tongonan I

Under the steam sales contract entered in June 1984 for Tongonan I, NPC agrees to pay PNOC-EDC a base price per kWh of net generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate at 75% plant factor for a period of 25 years.

▪ Palinpinon I

The steam sales contract for Palinpinon I provides, among others, that NPC shall pay PNOC-EDC a base price per kWh of gross generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate at 75% plant factor. The contract is for a period of 20 which commenced on December 25, 1988.

▪ Palinpinon II

In June 1996, PNOC-EDC and NPC signed a steam sales contract for Palinpinon II's four modular plants - Nasuji, Okoy, Sogongon I and Sogongon II. Under the terms and conditions, NPC agrees to pay PNOC-EDC a base price per kWh of gross generation, subject to inflation adjustments and based on a guaranteed TOP rate commencing from the established commercial operation period, using the following plant factors: 50% for the 1<sup>st</sup> year, 65% for the 2<sup>nd</sup> year and 75% for the 3<sup>rd</sup> and subsequent years. The contract is for a period of 25 years for each module commencing on December 13, 1993 for Nasuji;

November 28, 1994 for Okoy; January 28, 1995 for Sogongon I and March 23, 1995 for Sogongon II.

- BacMan I

The steam sales contract for the BacMan geothermal resources entered in November 1988 provides, among others, that NPC shall pay PNOC-EDC a base price per kWh of gross generation, subject to inflation adjustments and based on a guaranteed TOP rate at 75% plant factor. The contract is for a period of 25 years commencing in May 1993.

- BacMan II

BacMan II's steam sales contract with NPC was signed in June 1996 for its two 20-MW capacity modular plants - Cawayan and Botong. The terms and conditions under the contract contain, among others, NPC's commitment to pay PNOC-EDC a base price per kWh of gross generation, subject to inflation adjustments and based on a guaranteed TOP rate, commencing from the established commercial operation period, using the following plant factors: 50% for the 1<sup>st</sup> year, 65% for the 2<sup>nd</sup> year and 75% for the 3<sup>rd</sup> and subsequent years. The contract is also for a period of 25 years commencing in March 1994 for Cawayan and December 1997 for Botong.

e. Build-Operate-Transfer (BOT) Agreements

BPPC

BPPC has an existing Fast Track Build, Operate and Transfer Project Agreement (Project Agreement) with NPC. Under the Project Agreement, NPC supplies all the fuel required to generate electricity, with all electricity generated purchased by NPC. BPPC is entitled to payment of fixed capacity and operations and maintenance fees based on the nominated capacity as well as energy fees from the delivery of electric power to NPC. The Project Agreement is for a period of 15 years which runs up to July 2010 (Compensation period). Upon expiration of the 15-year period, BPPC shall transfer to NPC all of its rights, titles and interests in the power plant complex, free from liens created by BPPC and without any compensation.

In line with the EPIRA-mandated IPP contracts review, PSALM, NPC and BPPC executed and signed in 2005 a General Framework Agreement (GFA) that embodied the renegotiated terms and conditions of the BOT Agreement. The GFA caps at 215MW the Bauang plant's nominated capacity and obligates BPPC to make the ₱0.01/kwh contribution to an environment fund from the effective date of the GFA up to the end of Cooperation Period. Conversely, this paves way for allowing the heat run of the Bauang plant at 8.5 MW for 1 hour daily, except on weekends and holidays, during extended economic shutdown and the carry-over of 50% of the plant's unutilized downtime allowance up to 3 years. The GFA likewise permits the pursuit of bilateral contracts for ancillary services and the excess 10MW capacity with National Transmission Corporation (TransCo) and power purchasers, respectively, under an income sharing arrangement subject to certain limitations and restrictions. The National Economic Development Authority (NEDA) approved the GFA on July 11, 2007.

### PNOC-EDC

Pursuant to RA 7718 dated May 5, 1994 (Amended BOT Law), PNOC-EDC entered into Energy Conversion Agreements (ECA) with various international geothermal power producers for the construction and operation of power plants in Leyte and Mindanao to convert the geothermal steam to be supplied by PNOC-EDC to electricity. Under these contracts, the BOT Contractor shall deliver electricity to NPC on behalf of PNOC-EDC.

### Leyte

Under the ECA with the BOT Contractors, namely: California Energy for a) 125 MW Power Plant - Upper Mahiao Agreement; b) 231 MW Power Plant - Malitbog Agreement; and c) 180 MW Power Plant - Mahanagdong Agreement and with Ormat Inc. for the Leyte Optimization Project BOT Agreement, PNOC-EDC shall pay the BOT Contractors monthly energy fees to be computed based on actual energy delivered and capacity fees, which include capital and fixed operating cost recovery fees and service fees, to be computed on a per kilowatt nominated capacity basis.

Except for the capital cost recovery portions, the fees are subject to inflation adjustments. The contracts are for a period of ten years commencing July 1996 for the Upper Mahiao Agreement, July 1997 for the Malitbog and Mahanagdong Agreements and September 1997 for the Optimization Agreement. The ownership of the Upper Mahiao Power Plant was transferred to PNOC-EDC on June 25, 2006; Malitbog and Mahanagdong Power Plants were transferred on July 25, 2007; and the Optimization Power Plant on September 25, 2007.

### Mindanao

Under the terms and conditions of the ECA with Oxbow Power Corporation and Marubeni Corporation, PNOC-EDC shall pay the BOT Contractor monthly energy efficiency fees and capacity fees, which include capital and fixed operating cost recovery fees and service fees, to be computed on a per kW nominated capacity basis and excess energy fees which are payment for the share of BOT Contractor for the revenues from surplus energy generation on top of the nominated energy. Except for energy efficiency payments and capital cost recovery portion of capacity fees, the fees are subject to inflation adjustments. The contract is for a period of ten (10) years commencing in March 1997 for Mindanao I (47 MW) and June 1999 for Mindanao II (48.25 MW). An amendment to the Mindanao I ECA was signed on November 17, 2006 extending the contract period to June 2009 with the corresponding restructuring of BOT fees.

The fair value of these BOT contracts are included as part of the fair value of the construction services accounted for under Philippine Interpretation IFRIC 12 as discussed in Notes 16 and 36.

#### f. Engineering, Procurement and Construction (EPC) Contract

FGPC entered into a Turnkey EPC Contract (EPC Contract) with Siemens AG, Siemens Power Generation and Siemens, Inc. (collectively, "Siemens") for the construction of the 1,000 MW Combined Cycle Power Plant (the "Santa Rita Power Plant" or "Project").

A dispute has arisen between FGPC and Siemens in connection with its construction of FGPC's power plant in accordance with the EPC Contract with Siemens for the construction of the Santa Rita power plant. The dispute stemmed from the delays incurred by Siemens and its subcontractors in the timely completion of the Project.

In December 2002, Siemens submitted a request for arbitration to the ICC in London against FGPC. After several hearings, the Arbitral Tribunal ruled in November 2005 that FGPC was entitled to \$94.2 million that it had previously withheld from Siemens in connection with delays to the completion of the Santa Rita power plant. The withheld amount, net of applicable taxes was recorded as a reduction in the cost of the power plant in 2005. With respect to Siemens' monetary claims against FGPC and FGPC's counterclaims against Siemens, the Arbitral Tribunal ruled in April 2006 the following: (i) FGPC was entitled to an \$11.2 million award (inclusive of the \$5.1 million already recognized as other income in 2005) for its remaining counterclaims against Siemens and (ii) Siemens was entitled to approximately \$8.5 million for its remaining claims against FGPC.

Following the ruling of the Arbitral Tribunal in April 2006, FGPC and Siemens entered into a Settlement Agreement on October 2, 2006 to conclude the arbitration and to settle all outstanding matters between them. Pursuant to the Settlement Agreement, Siemens agreed to make an additional net payment to FGPC of \$10.5 million (inclusive of the \$5.1 million that was initially recognized as other income in 2005 and the \$1.5 million outstanding receivables of FGPC from Siemens).

On October 16, 2006, FGPC received the net payment from Siemens of \$10.5 million. The net balance of \$3.9 million was recognized as part of "Other income (charges)" account in the consolidated statement of income in 2006.

On December 12, 2006, the Arbitral Tribunal issued its Final Award, which is final and binding, incorporating all previous awards and the agreement of the parties to settle all outstanding matters between them. The issuance of the Final Award finally resolved all outstanding matters in the arbitration, and formally concluded the dispute between FGPC and Siemens.

g. Obligations to Gas Sellers on Annual Deficiencies

The details of obligations to Gas Sellers on Annual Deficiencies recognized pursuant to the SAs and the PDAs, including accrued interest, are as follows:

|                                               | 2007                  |                   | 2006                  |                   |
|-----------------------------------------------|-----------------------|-------------------|-----------------------|-------------------|
|                                               | In Philippine<br>Peso | In U.S.<br>Dollar | In Philippine<br>Peso | In U.S.<br>Dollar |
| FGP:                                          |                       |                   |                       |                   |
| Balance at beginning of year                  | ₱1,128                | \$23              | ₱1,911                | \$36              |
| Principal payments                            | (369)                 | (8)               | (513)                 | (10)              |
| Interest payments                             | (46)                  | (1)               | (308)                 | (6)               |
| Alleged annual deficiency<br>for the year     | –                     | –                 | 205                   | 4                 |
| Interest                                      | 46                    | 1                 | 103                   | 2                 |
| Application of excess gas<br>consumed in 2005 | –                     | –                 | (154)                 | (3)               |
| Foreign exchange                              | (138)                 | –                 | (116)                 | –                 |
| (Total Carried Forward)                       | 621                   | 15                | 1,128                 | 23                |

|                                               | 2007                  |                   | 2006                  |                   |
|-----------------------------------------------|-----------------------|-------------------|-----------------------|-------------------|
|                                               | In Philippine<br>Peso | In U.S.<br>Dollar | In Philippine<br>Peso | In U.S.<br>Dollar |
| (Total Brought Forward)                       | <b>₱621</b>           | <b>₱15</b>        | <b>₱1,128</b>         | <b>₱23</b>        |
| FGPC:                                         |                       |                   |                       |                   |
| Balance at beginning of year                  | <b>3,484</b>          | <b>71</b>         | 6,849                 | 129               |
| Principal payments                            | <b>(924)</b>          | <b>(20)</b>       | (2,053)               | (40)              |
| Interest payments                             | <b>(231)</b>          | <b>(5)</b>        | (1,078)               | (21)              |
| Alleged annual deficiency<br>for the year     | –                     | –                 | 205                   | 4                 |
| Interest                                      | <b>231</b>            | <b>5</b>          | 411                   | 8                 |
| Application of excess gas<br>consumed in 2005 | –                     | –                 | (462)                 | –                 |
| Foreign exchange                              | <b>(434)</b>          | –                 | (388)                 | (9)               |
|                                               | <b>2,126</b>          | <b>51</b>         | 3,484                 | 71                |
| Total                                         | <b>2,747</b>          | <b>66</b>         | 4,612                 | 94                |
| Less current portion                          | <b>2,053</b>          | <b>40</b>         | 1,823                 | 28                |
|                                               | <b>₱694</b>           | <b>\$26</b>       | <b>₱2,789</b>         | <b>\$66</b>       |

FGP and FGPC each executed on March 22, 2006 their respective Settlement Agreements (SA) and Payment Deferral Agreements (PDA) with the Gas Sellers to amicably settle their long-standing disputes under the GSPA for Contract Years 2002 to 2004. The disputes related to the Gas Sellers' claim for Annual Deficiency payments totaling ₱2,816 million (\$68.0 million) and ₱6,767 million (\$163.4 million) from FGP and FGPC, respectively, covering the unconsumed gas volumes during these Contract Years.

Under the terms of their respective SAs and the PDAs, the Gas Sellers' claims from FGP and FGPC have been reduced to ₱1,354 million (\$32.7 million) and ₱4,775 million (\$115.3 million), respectively. Mandatory prepayments of ₱85 million (\$2.05 million) and ₱330 million (\$7.98 million) and pre-settlement interest of ₱118 million (\$2.86 million) and ₱453 million (\$10.95 million) for FGP and FGPC, respectively, were paid on June 7, 2006. Additional reductions of Annual Deficiency amounting to ₱157 million (\$3.8 million) for FGP and ₱393 million (\$9.5 million) for FGPC were recognized in 2006 to credit FGP and FGPC for gas consumption in excess of their respective TOPQ's for 2005.

The remaining liabilities will be paid through quarterly principal payments until December 26, 2009 with interest at LIBOR plus margin. The respective SAs and PDAs allow FGP and FGPC to prepay all or part of the outstanding balances and to "make up" the volume of gas up to the extent of the principal repayments made under the PDA for a longer period of time instead of the ten-Contract Year recovery period allowed under their respective GSPAs. On May 31, 2006, all the conditions precedent set out in the respective SAs and PDAs of FGP and FGPC were completely satisfied. Such conditions precedent included an acknowledgment and consent by Meralco.

Under the terms of the PPA with Meralco, all fuel and fuel related payments are pass-through. The payment obligations of FGP and FGPC under their respective SAs, the PDAs and the GSPAs are passed on to Meralco on a "back-to-back" and full pass-through basis. The corresponding receivables from Meralco, including accrued interest and output value added taxes, are presented as part of "Other current assets" and "Other noncurrent assets" accounts in the consolidated balance sheet.

Upon payment of the principal amount, a corresponding prepaid gas is recognized to cover the principal portion paid to the Gas Sellers (shown as part of “Other noncurrent assets” account in the consolidated balance sheet) and a corresponding credit to the unearned revenue is recognized for the principal portion that was already paid by Meralco. As of December 31, 2007 and 2006, the remaining prepaid gas arising from the SAs and PDAs and the corresponding unearned revenue amounted to ₱2,563 million (\$61.9 million) and ₱2,075 million (\$50.1 million), respectively. The December 31, 2007 prepaid gas balance is net of the recoveries of Annual Deficiencies recognized by the Gas Sellers for gas consumed above the TOPQ, as calculated by the Gas Sellers, for the current contract year which totaled to ₱658 million (\$15.9 million).

For Contract Year 2006, the Gas Sellers issued the Annual Reconciliation Statements (ARS) of FGP and FGPC on December 29, 2006. The Gas Sellers are claiming Annual Deficiency payments for Contract Year 2006 amounting to ₱162 million (\$3.9 million) for FGP and ₱224 million (\$5.4 million) for FGPC. Both FGP and FGPC disagree that such Annual Deficiency payments are due and each claimed relief for, among others, force majeure events arising from governmental actions beyond its control as well as circumstances which affected the Transmission Facilities or the Transmission Company’s ability to accept or transmit electric energy generated by the power plant. FGP’s and FGPC’s position is that the power plants actually consumed more than their respective TOPQs and are entitled to make-up its Outstanding Balance of Annual Deficiencies. The matter is now in arbitration under the International Chamber of Commerce (ICC) Rules of Arbitration pursuant to the terms of the GSPA.

#### h. Gas Sale and Purchase Agreements (GSPA)

FGP and FGPC each have an existing GSPA with the consortium of Shell Philippine Exploration B.V., Shell Philippines LLC, Chevron Malampaya, LLC and PNOG Exploration Corporation (collectively referred to as Gas Sellers), for the supply of natural gas in connection with the operations of the power plants. The GSPA, now on its sixth Contract Year, is for a total period of approximately 22 years.

Total cost of natural gas purchased amounted to ₱7,297 million (\$176.2 million) in 2007, ₱8,146 (\$196.7 million) in 2006 and ₱7,007 million (\$169.2 million) in 2005 for FGP and ₱18,411 million (\$444.6 million) in 2007, ₱16,448 million (\$397.2 million) in 2006 and ₱13,773 (\$332.6 million) in 2005 for FGPC.

Under the GSPA, FGP and FGPC are obligated to consume (or pay for, if not consumed) a minimum quantity of gas for each Contract Year (which runs from December 26 of a particular year up to December 25 of the immediately succeeding year), called the Take-Or-Pay Quantity (TOPQ). Thus, if the TOPQ is not consumed within a particular Contract Year, FGP incurs an “Annual Deficiency” for that Contract Year equivalent to the total volume of unused gas (i.e., the TOPQ less the actual quantity of gas consumed). FGP and FGPC are required to make payments to the Gas Sellers for such Annual Deficiency after the end of the Contract Year. After paying for Annual Deficiency gas, FGP and FGPC can, subject to the terms of the GSPA, “make-up” such Annual Deficiencies by consuming the unused-but-paid-for gas (without further charge) within ten-Contract Year after the Contract Year for which the Annual Deficiency was incurred, in the order that it arose.

FGP paid certain fees to the Gas Sellers, in lieu of incurring certain Annual Deficiency payment obligations for the first Contract Year (2002) as a result of the failure to commence commercial operations of the power plant at the Start Date (July 2, 2002) in accordance with the GSPA. These fees amounted to ₱406 million (\$9.8 million) and have been booked as prepaid gas, net of adjustment, in the same manner as if the fees were paid for Annual Deficiency incurred in Contract Year 2002.

i. Lubricating Oil Supply Agreement

BPPC entered into a supply contract with Pilipinas Shell Petroleum Corporation, whereby the latter will supply lubricating oil for a period of 15 years until 2010 at the agreed price indicated in the contract. The price is subject to adjustments twice a year based on various conditions, such as changes in the cost or rates of the product, among others.

j. Operating and Maintenance (O&M) Agreements

FGP and FGPC have separate O&M Agreements with Siemens Power Operations, Inc. (SPO) mainly for the operation, maintenance, management and repair services of their respective power plants. As stated in the respective O&M Agreements of FGP and FGPC, SPO is responsible for maintaining adequate inventory of spare parts, accessories and consumables. SPO is also responsible for replacing and repairing the necessary parts and equipment of the power plants to ensure the proper operation and maintenance of the power plants to meet the contractual commitments of FGP and FGPC under their respective PPAs and in accordance with the Good Utility Practice. Total operations and maintenance costs charged to the consolidated statement of income amounted to ₱1,412 million (\$34.1 million) in 2007, ₱1,213 million (\$29.3 million) in 2006 and ₱1,155 million (\$27.9 million) in 2005. In 2007, prepaid major spare parts amounting to ₱2,108 million (\$50.9 million) were reclassified to "Power, plant and equipment" account as a result of the scheduled maintenance outage of Santa Rita and San Lorenzo power plants. As of December 31, 2007 and 2006, certain O&M fees amounting to ₱817 million (\$19.6 million) and ₱1,946 million (\$47.0 million), respectively, which relates to major spare parts that will be replaced during the scheduled maintenance outage, were presented as part of "Other noncurrent assets" account in the consolidated balance sheet (see Note 17).

Based on the current operating regime of both plants, it is estimated that the Santa Rita and San Lorenzo O&M Agreements will expire in 2010. FGP and FGPC are currently considering the options for the Plants' operation and maintenance after 2010.

k. Substation Interconnection Agreement

FGPC has an agreement with Meralco and NPC for: (a) the construction of substation upgrades at the NPC substation in Calaca and the donation of such substation upgrades to NPC; (b) the construction of a 35-kilometer transmission line from the power plant to the NPC substation in Calaca and subsequent donation of such transmission line to NPC; (c) the interconnection of the power plant to the NPC Grid System; and (d) the receipt and delivery of energy and capacity from the power plant to Meralco's point of receipt.

As of December 31, 2007, FGPC is still in the process of transferring the substation upgrades in Calaca, as well as the 230 KV Santa Rita to Calaca transmission line, to NPC.



l. Interim Interconnection Agreement

FGP has an agreement with NPC and Meralco whereby NPC will be responsible for the delivery and transmission of all energy and capacity from FGP's power plant to Meralco's point of receipt.

m. Franchise

The Parent Company, through FGHC, has a franchise granted by the 11th Congress of the Philippines through Republic Act (RA) No. 8997 to construct, install, own, operate and maintain a natural gas pipeline system for the transportation and distribution of the natural gas throughout the island of Luzon (the "Franchise"). The Franchise is for a term of 25 years until February 25, 2026. FGHC must commence the exercise of any privileges granted under the Franchise within five years (until February 25, 2006) from its effectivity, otherwise, the Franchise shall be deemed revoked. As of January 31, 2008, FGHC, among others, has secured an ECC on May 16, 2005 and has undertaken substantial pre-engineering works and design and commenced preparatory works for the right-of-way acquisition activities.

n. Contingencies

FGPC

FGPC was assessed by the Bureau of Internal Revenue (BIR) on July 19, 2004 for deficiency income tax for taxable years 2001 and 2000. FGPC filed its Protest Letter to the BIR on October 5, 2004. On account of the BIR's failure to act on FGPC's Protest within the prescribe period, FGPC filed with the Court of Tax Appeals (CTA) on June 30, 2005 a Petition against the Final Assessment Notices and Formal letters of Demand issued by the BIR. On February 20, 2008, the CTA granted FGPC's Motion for Suspension of Collection of Tax until the case is resolved with finality. Management believes that the resolution of this assessment will not materially affect First Gen Group's audited consolidated financial statements.

On June 25, 2003, FGPC received various Notices of Assessment and Tax Bills dated April 15 and 21, 2003 from the Provincial Government of Batangas, through the Office of the Provincial Assessor, imposing an annual real property tax (RPT) on steel towers, cable/transmission lines and accessories (the T-Line) amounting to ₱12 million (\$0.22 million) per year. FGPC, claiming exemption from said RPT, appealed the assessment to the Provincial Local Board of Assessment Appeals (LBAA) and filed a Petition on August 13, 2003, praying for the following: (1) that the Notices of Assessment and Tax Bills issued by the Provincial Assessor be recalled and revoked; and (2) that the Provincial Assessor drop from the Assessment Roll the 230 KV transmission lines from Sta. Rita to Calaca in accordance with Section 206 of the LGC. FGPC argued that the T-Line does not constitute real property for RPT purposes, and even assuming that the T-Line is regarded as real property, FGPC is still not liable for RPT as it is NPC/TRANSCO, a government-owned and -controlled corporation (GOCC) engaged in the generation and/or transmission of electric power, which has actual, direct and exclusive use of the T-Line.

Pursuant to Section 234(c) of the LGC, a GOCC engaged in the generation and/or transmission of electric power and which has actual, direct and exclusive use thereof, is exempt from RPT. FGPC sought for, and was granted, a preliminary injunction by the Regional Trial Court (Branch 7) of Batangas City to enjoin the Provincial Treasurer of

Batangas City from collecting the RPT pending the decision of the LBAA. Despite the injunction, the LBAA issued an Order dated September 22, 2005 requiring FGPC to pay the RPT within 15 days from receipt of the Order. On October 22, 2005, FGPC filed an appeal before the Central Board of Assessment Appeals (CBAA) assailing the validity of the LBAA order. In a Resolution rendered on December 12, 2006, the CBAA set aside the LBAA Order and remanded the case to the LBAA. The LBAA was directed to proceed with the case on the merits without requiring FGPC to first pay the RPT on the questioned assessment.

In a decision dated January 30, 2006, the Regional Trial Court (Branch 7) of Batangas City denied a 2nd motion to lift the injunction previously issued by the court to stop the Province from collecting the tax pending decision of the LBAA. Hence, the preliminary injunction stays. The court is scheduled to conduct a pre-trial of the main case for prohibition.

### BPPC

There are ongoing cases involving the assessment of RPT and franchise tax by the local government. BPPC believes that under the Project Agreement, any RPT and franchise tax that may be found due is for the sole account of NPC.

- i. The first case was filed by NPC with the LBAA of Province of La Union in connection with the assessment of RPT by the Provincial Treasurer on BPPC's machinery and equipment from 1995 to 1998. Following the denial of NPC's petition for exemption by the LBAA and NPC's appeal with the CBAA, BPPC formally intervened in the CBAA case to further protect its interest. The CBAA affirmed the decision of the LBAA. Both NPC and BPPC filed their respective appeals with the CTA. On February 13, 2006, the CTA promulgated a decision denying the appeal's filed by BPPC and NPC. While NPC elevated the matter directly to the Supreme Court (SC), BPPC filed a Motion for Reconsideration (MR) with the CTA, which denied said motion on July 10, 2006. BPPC then filed a Petition for Review on Certiorari with the SC on September 11, 2006, reiterating NPC's exemption from RPT. In a minute resolution dated October 4, 2006, the SC's First Division denied BPPC's petition on the ground that it failed to show that the CTA committed any reversible error as to warrant the exercise by the SC of its appellate jurisdiction. An MR was filed by BPPC on December 12, 2006. The MR was denied with finality by the 3<sup>rd</sup> Division of the SC in another minute resolution dated February 26, 2007. BPPC filed a second MR on April 16, 2007 requesting for the consolidation of all related RPT cases and the elevation to the Supreme Court En Banc for decision. The petition seeks a definitive ruling on the issue of exemption from RPT of the machinery and equipment of all NPC-independent power producers (NPC-IPPs). The second MR was consequently denied with finality in July 2007. In the light of these developments on August 22, 2007, the Province of La Union filed with the SC a Motion to Dismiss the NPC case. The said Motion has not yet been decided upon as of the date of April 3, 2008.

To protect the plant assets from any untoward action by the local government of La Union, BPPC and NPC obtained a Writ of Preliminary Injunction against the collection of RPT by the Province of La Union until the SC rules on the NPC petition.

In total disregard of the valid Writ of Preliminary Injunction, on December 10, 2007, the Province of La Union issued a Final Notice of Delinquency on the RPT of the equipment plus the building and improvements for assessments unpaid by NPC since 2003. Subsequently, on December 27, 2007, the Province issued a Warrant of Levy on all the

tax-delinquent properties of the Bauang Plant, which were to be auctioned on February 1, 2008 at the Provincial Capitol in La Union, if unsettled.

On January 16, 2008, the counsels filed with the Regional Trial Court of Bauang, La Union a Petition for Indirect Contempt (PIC) by the Province of the Injunction, although the filing was not adequate to avert the auction on February 1, 2008. Because of the absence of a bidder at auction proper, the province forfeited the property. The law accords the taxpayer the right to redeem the property within one year from date of forfeiture, or until February 1, 2009, within which period the owner shall remain possession of the asset(s) and entitlement to its income.

In view of the supervening events and further acts of contempt by the Respondent Province, BPPC filed anew on February 15, 2008 a Supplemental Petition in the same regional court with the purpose of declaring null and void the February 1, 2008 auction. Respondent Province was ordered by the court to submit its Comment to the Supplemental Petition within 15 days from receipt of Order, or until March 6, 2008. BPPC is expected to respond to the Comment of the Province within 15 days from submission or until March 21, 2008. Subsequently, the matter would be admitted for resolution by the Court.

In the meantime, BPPC continues to operate the plant.

- ii. The second case was filed by NPC, for itself and on behalf of BPPC, following issuance of a revised assessment of RPT on BPPC's machinery and equipment on July 15, 2003 by the Municipal Assessor of the Municipality of Bauang, La Union. Under the said revised Assessment, the maximum tax liability for the period 1995 to 2003 is about ₱775.1 million (\$18.72 million), based on the maximum 80% assessment level imposable on privately-owned entities and a tax rate of 2%. In addition, interest on the unpaid amounts (2% per month not exceeding 36 months) has reached a total amount of ₱489.0 million (\$11.81 million). The case remains pending with the LBAA of the Province of La Union.

In addition to the case filed by BPPC, there are two other cases involving the very same issues which are still pending with the Third Division of the SC. Notwithstanding the denial of its MR, BPPC believes it will benefit if the SC conducts a thorough review of these two pending cases and subsequently rules in favor of NPC on the substantive and novel issue on the validity of the imposition of RPT on the machinery and equipment being operated under the BOT scheme, which was not squarely addressed in the BPPC case.

There is also an outstanding preliminary injunction against the collection of RPT by the Province of La Union, which is for the benefit of both BPPC and NPC, and the Province cannot collect the tax until the NPC petition (involving the same facts and issues and the very same machinery and equipment, which has been given due course and is pending with the Third Division of the SC) is also finally resolved.

In any event, BPPC believes that NPC shall be directly responsible for the payment of all RPT that may be assessed on machinery and equipment at Bauang Plant, pursuant to the terms of the Project Agreement which specifically provides that NPC shall pay all real estate taxes and assessments in respect of the site, machinery and equipment and improvements of the power plant complex.

To date, the potential maximum tax liability on BPPC's machinery and equipment for the period from 1995 to 2007 is about ₱1.1 billion (\$26.6 million), based on the maximum 80% assessment level imposable on privately-owned entities and a tax rate of 2%. In addition, maximum interest on the tax liability (2% per month not exceeding 36 months) amounts to ₱735.42 million (\$17.76 million).

While BPPC maintains its position that, pursuant to the terms of the Project Agreement, it is NPC that is ultimately responsible for the payment of all real property taxes related to the power plant, and that BPPC has the right of recourse against NPC for whatever amount of real property taxes it may be required to pay, BPPC recognized as of December 31, 2007 a "Provision for real property taxes" amounting to \$44.36 million (including interest) in accordance with PAS 37, "Provisions, Contingent Liabilities and Contingent Assets." Correspondingly, the BPPC also recognized a "Receivable from NPC" for the same amount representing its claim for reimbursement for real property taxes. The combined effect of the provision and the claim for reimbursement is presented on a net basis in BPPC's statement of income.

- iii. The third case was filed on October 19, 2005 by NPC, for itself and on behalf of BPPC, following receipt of Statement of Account from the Municipal Treasurer dated August 5, 2005 for RPT on BPPC's buildings and improvements from 2003 to August 2005 amounting to ₱4.2 million (\$0.10 million). The case is pending with the LBAA of the Province of La Union. NPC paid all RPT on Buildings and Improvements directly to the local government from 1995 until 2003, when it stopped payment of the tax and claimed an exemption under the LGC.

Despite the pending case at the LBAA, these properties were included in the Final Notice of Delinquency and Warrant of Levy issued by the Province of La Union.

To date, the potential maximum tax liability on BPPC's buildings and improvements for the year ended December 31, 2007 is about \$1.1 million (₱48.45 million), pursuant to Statement of Account from the Municipal Treasurer dated November 14, 2007, including alleged back-taxes and interest dating back from 1995.

- iv. BPPC also filed a Petition for Certiorari and Prohibition in September 2004 to contest an assessment for franchise tax for the period 2000 to 2003 amounting to ₱33.0 million (\$0.82 million), including surcharges and penalties, on the ground that BPPC is not a public utility which is required by law to obtain a legislative franchise before operating, thus is not subject to franchise taxes. The case is pending before the RTC of Bauang, La Union.

Both NPC and BPPC believe that they are not subject to pay franchise tax to the local government. In any case, BPPC believes that the Project Agreement with NPC allows BPPC to claim indemnity from NPC for any new imposition, including franchise tax, incurred by BPPC that was not originally contemplated when it entered into said Project Agreement.

o. Lease Commitments

FGPC has a non-cancelable annual offshore lease agreement with the DENR for the lease of a parcel of land in Sta. Rita, Batangas where the power plant complex is located. The term of the lease is for a period of 25 years starting May 26, 1999 for a yearly rental of ₱3 million (\$0.05 million) and renewable for another 25 years at the end of the term. The land will be appraised every ten years and the annual rental after every appraisal shall not be less than 3% of the appraised value of the land plus 1% of the value of the improvements, provided that such annual rental cannot be less than ₱3 million (\$0.05 million).

FG Bukidnon has a non-cancelable lease agreement with PSALM on the land occupied by its power plant. The term of the lease is for a period of 20 years commencing on March 29, 2005, renewable for another period of 10 years or the remaining corporate life of PSALM, whichever is shorter. The rental paid in advance by the Company for the entire term is ₱1.12 million (\$0.02 million).

Future minimum rental payments under the non-cancelable operating leases with INAEC and the DENR are as follows:

|                                             | Amount  |
|---------------------------------------------|---------|
| Within one year                             | \$298   |
| After one year but not more than five years | 266     |
| After five years                            | 734     |
|                                             | \$1,298 |

p. NLE Tollway Project Agreements

Cooperation Agreement

FPIDC has a Cooperation Agreement with Egis in relation to the NLE Tollway Project.

Provisional Operating and Maintenance Agreement (POMA)

On April 5, 1997, a POMA was signed by the Subic Base Management Authority (SBMA) to initiate the collection process of Segment 7. On May 24, 2002, the TRB issued a resolution authorizing a set of toll rates starting February 1, 2003.

Construction Contract

MNTC has awarded a Construction Contract to LCAL for the construction of Segments 1, 2 and 3 of Phase I of the NLE Tollway Project. The Contract is a firm fixed price contract and is not subject to indexation or exchange rate fluctuations except where expressly stated in the Contract or otherwise agreed with LCAL the Philippine Peso component of the Contract price was originally set at ₱5.8 billion and the US dollar component is US\$37 million. In addition to the fixed Contract price, LCAL shall be entitled to an early completion bonus to be computed based on the terms of the contract.

q. FBI-MDC Joint Venture

Makati Development Corporation (MDC) is the joint venture partner of FBI in the construction of St. Luke's Hospital in Fort Bonifacio, Taguig City. The project was started last February 2007 and is expected to be substantially completed by March 2009. The sharing

arrangement of the venturers is 51:49 in favor of MDC. As of 2007, the progress of work was 17.4%.

r. **Guarantee on Performance and Surety Bonds**

First Balfour is contingently liable for guarantees arising in the ordinary course of business, including letters of guarantee for performance and surety bonds for various construction projects amounting to about ₱1,728 million and ₱72 million as of December 31, 2007 and 2006, respectively.

Certain associates have contingent liabilities with respect to claims, lawsuits and tax assessments. The respective management of the associates, after consultations with outside counsels, believes that the final resolution of these issues will not materially affect their respective financial position and results of operations.

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### 38. **Other Matters**

#### EPIRA

RA 9136, otherwise known as the EPIRA, and the covering IRR provides for significant changes in the power sector, which includes among others: the unbundling of the generation, transmission, distribution and supply and other disposable assets of a company, including its contracts with IPP and electricity rates; creation of a Wholesale Electricity Spot Market (WESM); and open and nondiscriminatory access to transmission and distribution systems.

The law also requires public listing of not less than 15% of common shares of generation and distribution companies within five years from the effectivity date of the EPIRA. It provides cross ownership restrictions between transmission and generation companies and between transmission and distribution companies and a cap of 50% of its demand that a distribution utility is allowed to source from an associated company engaged in generation except for contracts entered into prior to the effectivity of the EPIRA.

There are also certain sections of the EPIRA, specifically relating to generation companies, which provide for a cap on the concentration of ownership to only 30% of the installed capacity of the grid and/or 25% of the national installed generating capacity; and VAT zero-rating of sale of generated power.

On June 26, 2006, the commercial operation of the WESM in the Luzon Grid commenced. During the first year of operation, total registered peak demand reached 6,552 MW with total registered capacity at 11,396 MW. The monthly transaction volumes for both the spot and bilateral contract quantities recorded a high of more than 3,500 GWh. The WESM has now at least 13 direct participants, 14 indirect participants, 10 applicants and four intending participants. Trial operations in the Visayas Grid are on-going.

Retail competition and open access have yet to be implemented since the preconditions of privatizing at least 70% of NPC's generating assets and at least 70% of NPC IPP contracts have not been met so far.

The ERC has continued to issue regulations implementing the EPIRA, among which are the Rules for Setting Distribution Wheeling Rates for Privately-Owned Distribution Utilities Entering Performance-Based Regulation, Competition Rules, Rules for Registration of Wholesale Aggregators, Guidelines for the Issuance of Licenses to Retail Electricity Suppliers and Distribution Service and Open Access Rules.

Following are the proposed amendments to the EPIRA that, if enacted, may have material adverse effect on First Gen Group business, financial condition and results of operations.

In the Philippine Senate, proposed amendments are pending consideration by the Committee on Energy, which include:

- Cross-ownership among distribution utilities and generation companies will no longer be allowed. If this proposal becomes law, FPHC would be required to divest its interests in either Meralco or the Parent Company.
- Further restriction on the amount of electric power that a distribution utility can source from a single generation company or from generation companies wholly owned or controlled by the same interests. If this restriction was enacted into law, generation facilities acquired or developed by the First Gen Group in the Luzon Grid may be unable to enter into offtake agreements with Meralco, the largest distribution utility operating in Luzon island and the Philippines.

In the House of Representatives, the Committee on Energy has submitted for plenary approval a substitute bill proposing the following amendment to the EPIRA, among others:

Acceleration of the implementation of retail competition and open access by lowering the pre-requisite level of privatization of NPC's generating assets and IPP contracts from 70% to 50%. This could adversely affect the Company's competitiveness vis-à-vis NPC, which would control sizeable generating capacity sufficient to dominate the market at the time of implementation. Such control is expected to wane over time as the privatization program progresses.

Pursuant to the EPIRA's mandate and that of its IRRs, FGP, FGPC, FG Bukidnon and BPPC have filed its application for the issuance of a Certificate of Compliance (COC) for the operations of their respective power plants. On September 14, 2005, November 5, 2003, June 4, 2003 and February 16, 2005, ERC issued the COCs of FGP, FGPC, BPPC and FG Bukidnon, respectively, which are required for all generation companies under the EPIRA.

FG Hydro has likewise obtained, which came in as part of the APA, the respective COCs dated December 3, 2005 for the Pantabangan plant and on December 7, 2005 for the Masiway plant. The COCs will be effective for a period of five years subject to further renewal.

Pursuant to the provisions of Section 36 of the EPIRA, all Electric Power Industry Participants shall prepare and submit for approval of the ERC their respective Business Separation and Unbundling Plan (BSUP) which requires all industry participants to maintain separate accounts for, or otherwise "structurally and functionally unbundled" their business activities.

Since each of FGP, FGPC, FG Bukidnon, FG Hydro and BPPC is engaged solely in the business of power generation, to the exclusion of the other business segments of transmission, distribution, supply and other related business activities, compliance with the BSUP requirement on maintaining separate accounts is not reasonably practicable.

Based on FGP, FGPC, FG Bukidnon, FG Hydro and BPPC's assessments, they are in the process of complying with the provisions of the EPIRA and its IRR.

#### Clean Air Act

On November 25, 2000, the IRR of the Philippine Clean Air Act (PCAA) took effect. The IRR contain provisions that have an impact on the industry as a whole, and on FGP, FGPC and BPPC in particular, that need to be complied with within 44 months (or July 2004) from the effectivity date, subject to approval by the DENR. The power plants of FGP and FGPC use natural gas as fuel and have emissions that are way below the limits set in the National Emission Standards for Sources Specific Air Pollution and Ambient Air Quality Standards. Based on FGP and FGPC's initial assessments of the power plants' existing facilities, the companies believe that both are in full compliance with the applicable provisions of the IRR of the PCAA.

On the other hand, BPPC believes that the Project Agreement specifically provides that it is not contractually obligated to bear the financial cost of complying with the PCAA. In this connection, the DENR has issued a Memorandum on September 19, 2006 directing all regional directors to hold in abeyance the implementation of the Continuous Emission Monitoring System (CEMS) which is required under the PCAA, until such time that a set of guidelines has been approved. BPPC has been conducting Ambient Air Emission Monitoring every quarter and Source Emission Monitoring once a year in lieu of the installation of the CEMS. Results are submitted to the Environmental Monitoring Bureau (EMB) and the DENR-Region 1 Office.

BPPC has also engaged a private consultant to study alternative means of compliance with PCAA requirements. On November 20, 2006, Apercu Consultants presented to representatives from the DENR-EMB and NPC the Bauang Plant's Modified Compliance Plan to the PCAA. The plan reiterated earlier position on the use of (a) Predictive Emissions Monitoring System as an alternative to CEMS, (b) low sulfur fuel (2% or lower) to reduce SO<sub>2</sub> emissions and (c) combustion to reduce NO<sub>x</sub> emission.

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### **39. Events After the Balance Sheet Date**

#### **a. Acquisition of FPUFI Shares -**

On January 23, 2008, the Parent Company acquired the 40% interest of Union Fenosa Internacional. S.A. in FPUFI. The Parent Company is now the sole owner of FPUFI. FPUFI owns 253,093,270 shares or 28.82% interest in MERALCO. With this acquisition, the First Holdings Group now owns, directly and indirectly, through FPUFI, 33.4% interest in MERALCO.

The decision to increase its stake in MERALCO stems from the Company's optimistic view of MERALCO's more predictable financial performance under a new rate setting mechanism. The Performance Based Rate (PBR) setting mechanism embodies a new rate-fixing scheme, which sets power distribution tariffs according to forecasts of operational performance and



capital and operating expenditures. PBR addresses the regulatory lag between cost incurrence and the corresponding recovery. PBR also employs a penalty-reward mechanism depending on the utility's actual performance.

b. Loans Payable of First Gen

On February 1, 2008, a Waiver and Amendment Agreement (the "Waiver Agreement") was entered into between the Parent Company, the Facility Agent, Calyon, Standard Chartered and BOTM (collectively referred to as the "Mandated Lead Arrangers") to make certain amendments to the Facility Agreement and to permit it to complete the Convertible Bond (CB) Offering which was successfully issued on February 11, 2008 (see below). As part of the Waiver Agreement, the Parent Company undertakes that the net proceeds of the CB Offering shall be used for no other purpose than (i) prepayment of the \$287.5 million facility, (ii) prepayment of the ₱29.2 billion (\$705.1 million) Staple Financing availed by Red Vulcan, and /or (iii) funding of any costs or expenses incurred in connection with the CB Offering. The Mandated Lead Arrangers grant their consent to the CB Offering and waive any breaches of or defaults under paragraph 5.1 (Clear Market) of the Mandate Letter that may arise due to the execution and completion of the CB Offering.

The net proceeds from the CB Offering were used by the Parent Company to prepay the principal amount of \$125.0 million, of which \$100.0 million was paid on March 3, 2008 and \$25.0 million was paid on April 1, 2008 on a pro-rata basis among the Lenders and in accordance with their respective participation in the Facility Agreement. On March 10, 2008, the Staple Financing availed by Red Vulcan was prepaid by ₱5.9 billion.

c. Issuance of Bonds by First Gen

On February 11, 2008, First Gen issued \$225 million, U.S. Dollar denominated Convertible Bonds (CBs) due on February 11, 2013 with a coupon rate of 2.50% due February 11, 2013. The CBs are traded at the Singapore Stock Exchange Securities Trading Limited in a minimum board lot size of ₱20.7 million (\$0.50 million). Interest is payable semi-annually. The CBs constitute the direct, unsubordinated and unsecured obligations of the Parent Company ranking *pari passu* in right of payment with all other unsecured and unsubordinated obligations of the Parent Company.

The proceeds from the CBs are intended to be used to prepay the existing debt of the First Gen and its subsidiaries. The CBs will be convertible, at the option of the holder, into fully-paid shares at an initial conversion price of ₱63.72 per share, subject to adjustments. The conversion right attached to the CBs may be exercised, at the option of the holder, at any time on and after March 22, 2008. J.P. Morgan Securities Limited (JP Morgan), Bookrunner and Lead Manager for the CBs, has an option to purchase up to ₱3,105.8 million (\$75.0 million) additional aggregate principal amount of the CBs (the Optional Bonds). On January 15, 2008, JP Morgan partially exercised such option with the purchase of ₱1,449.4 million (\$35.0 million) aggregate principal amount of the Optional Bonds. The CBs and the shares to be issued upon conversion of the CBs have not been and will not be registered under the U.S. Securities Act of 1933, as amended, and subject to certain exceptions, may not be offered or sold within U.S.

d. Planned Issuance of Series “B” Preferred Shares by FPHC

On March 6, 2008, the Philippine SEC favorably considered FPHC’s Registration Statement to offer 50,000,000 Series “B” Perpetual Preferred Shares at an Offer price of ₱100 a share, subject to customary conditions in connection with the approval of the Registration Statements.

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**40. Supplemental Information - Consolidated Statements of Cash Flows**

In 2007, prepaid major spare parts included in the “other noncurrent asset” account amounting to ₱2,105 was reclassified to property, plant and equipment in relation to O&M Agreements (see Note 36).

In 2006, the non-cash investing activity includes the ₱3.8 billion (US\$77.4 million) deferred payment facility availed from PSALM in relation to the PAHEP/MAHEP acquisition (see Note 5).

In 2005, the non-cash investing activity includes the reduction in the cost of the property, plant and equipment of ₱5.0 billion (\$93.9 million) representing claims of the First Holdings Group for the delays incurred by Siemens (see Note 37f).

AGENCY

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