SMC GLOBAL POWER

A SUBSIDIARY OF SAN MIGUEL CORPORATION

**SMC Global Power Holdings Corp.**
155 EDSA, Wack-Wack, Mandaluyong City, Philippines

# OFFER SUPPLEMENT

**Offer of up to ₱15,000,000,000.00 Fixed Rate Bonds**
**under its ₱35,000,000,000.00 Shelf Registration**

**consisting of Series G Bonds: 6.75% p.a. Due 2023**

**Offer Price: 100% of Face Value**

**to be listed in the Philippine Dealing & Exchange Corp.**

**Joint Issue Managers, Joint Lead Underwriters and Bookrunners**

BDO Capital and Investment Corporation

BPI Capital Corporation

Chinabank Capital

PNB Capital

**THE SECURITIES AND EXCHANGE COMMISSION HAS NOT APPROVED THESE SECURITIES OR DETERMINED IF THIS OFFER SUPPLEMENT IS ACCURATE OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE AND SHOULD BE REPORTED IMMEDIATELY TO THE SECURITIES AND EXCHANGE COMMISSION.**

The date of this Offer Supplement is 2 August 2018.

**SMC Global Power Holdings Corp.**
155 EDSA, Wack-Wack, Mandaluyong City, Philippines
Telephone Number: (632) 702 4500

SMC Global Power Holdings Corp. (the "**Company**", the "**Issuer**" or "**SMC Global Power**"), prepared the Prospectus dated December 8, 2017 (the "**Prospectus**") relating to the shelf registration and the offer, and sale in the Philippines within the Shelf Period (as defined below) in one or more tranches of Philippine Peso-denominated fixed rate bonds (the "**Bonds**") with an aggregate principal amount of Thirty Five Billion Pesos (₱35,000,000,000). The shelf registration of the Bonds was rendered effective by the Securities and Exchange Commission (the "**SEC**") on 12 December 2017.

The Bonds shall be taken down from the shelf in tranches within a period of 3 years from the effective date of the Registration Statement, subject to applicable regulations (the "**Shelf Period**").

This Offer Supplement dated 2 August 2018 ("**this Offer Supplement**" and as the context may require, the term includes the Prospectus) relates to the takedown of the second tranche of the Bonds (the "**Offer Bonds**") and the public offer for sale, distribution and issuance by the Company of the Offer Bonds (the "**Offer**"). The Offer will have an aggregate principal amount of Fifteen Billion Pesos (₱15,000,000,000). The Offer Bonds will be issued at face-value and listed and traded through the Philippine Dealing & Exchange Corp. ("**PDEx**").

The Offer Bonds will be issued on 17 August 2018 (the "**Issue Date**") and will be comprised of Series G Bonds.

The Series G Bonds shall have a term of 5 years from the Issue Date, with a fixed interest rate equivalent to 6.75% per annum. Interest on the Offer Bonds shall be payable quarterly in arrears on February 17, May 17, August 17 and November 17 of each year with the first Interest Payment Date on 17 November 2018, for as long as the Offer Bonds remain outstanding or the subsequent Business Day without adjustment if such Interest Payment Date is not a Business Day. For a more detailed discussion on the interest payments due on the Offer Bonds, see "*Description of the Offer Bonds" – "Interest*" of this Offer Supplement.

Subject to the consequences of default as may be contained in the Trust Agreement, and unless otherwise redeemed or purchased prior to the relevant Maturity Date, the Offer Bonds will be redeemed at par or 100% of the face value thereof on the relevant Maturity Date. For a more detailed discussion on the redemption of the Offer Bonds, see "*Description of the Offer Bonds" – "Redemption and Purchase*" of this Offer Supplement.

The Company reserves the right to withdraw the offer and sale of the Offer Bonds at any time, and the Joint Lead Underwriters and Bookrunners reserve the right to reject any application to purchase the Offer Bonds in whole or in part and to allot to any prospective purchaser less than the full amount of the Offer Bonds sought by such purchaser. If the Offer is withdrawn or discontinued, the Company shall subsequently notify the SEC and, as applicable, the PDEx. Any of the Joint Lead Underwriters and Selling Agents may acquire for their own account a portion of the Offer Bonds.

It is expected that the Offer Bonds will be delivered in book-entry form against payment thereof to the Philippine Depository & Trust Corp. ("**PDTC**").

This Offer Supplement contains the final terms of the Offer Bonds and must be read in conjunction with the Prospectus. Unless defined in this Offer Supplement, terms used herein shall be deemed to be defined as set forth in the Prospectus. Full information on the Issuer and this Offer is only available on the basis of the combination of this Offer Supplement, the Prospectus, and all other Transaction Documents. All information contained in the Prospectus are deemed incorporated by reference in this Offer Supplement.

Unless otherwise stated, the information contained in the Prospectus and this Offer Supplement has been supplied by the Company. The Company (which has taken all reasonable care to ensure that such is the case) confirms that the information contained in the Prospectus and this Offer Supplement is correct, and that there is no material misstatement or omission of fact which would make any statement in the Prospectus and this Offer Supplement misleading in any material respect. The Joint Lead Underwriters and Bookrunners have exercised reasonable due diligence required by regulations in ascertaining that all material representations contained in the Prospectus and this Offer Supplement are true and correct and that no material information was omitted, which was necessary in order to make the statements contained in said documents not misleading.

Unless otherwise indicated, all information in the Prospectus and this Offer Supplement is as of the date provided. Neither the delivery of the Prospectus and this Offer Supplement nor any sale made pursuant to the Prospectus and this Offer Supplement shall, under any circumstances, create any implication that the information contained herein is correct as of any date after the date hereof or that there has been no change in the affairs of the Company and its subsidiaries since such date. No representation or warranty, express or implied, is made or given by the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners, the Trustee or the Registry and Paying Agent or their respective affiliates or legal advisers as to the accuracy, completeness or sufficiency of the information contained in this Offer Supplement, and nothing contained in this Offer Supplement is, or shall be relied upon as, a promise, representation or warranty by the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners, the Trustee or the Registry and Paying Agent or their respective affiliates or legal advisers. This Offer Supplement is not intended to provide the basis of any credit or other evaluation nor should it be considered as a recommendation by either the Issuer, the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners, the Trustee or the Registry and Paying Agent or their respective affiliates or legal advisers that any recipient of this Offer Supplement should purchase the Offer Bonds.

Market data and certain industry forecasts used throughout the Prospectus and the Offer Supplement were obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information contained therein has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information is not guaranteed. Similarly, internal surveys, industry forecasts and market research, while believed to be reliable, have not been independently verified and the Company does not make any representation, undertaking or other assurance as to the accuracy or completeness of such information, or that any projections will be achieved, or in relation to any other matter, information, opinion or statements in relation to the Offer. Any reliance placed on any projections or forecasts is a matter of commercial judgment. Certain agreements are referred to in the Prospectus and the Offer Supplement in summary form. Any such summary does not purport to be a complete or accurate description of the agreement and prospective investors are expected to independently review such agreements in full.

All disclosures, reports, and filings of the Company made after the date of the Prospectus and this Offer Supplement (the "**Company Disclosures**") and submitted to the SEC and/or PDEX pursuant to the Corporation Code, the Securities Regulation Code, and the disclosure rules of PDEX are incorporated or deemed incorporated by reference in this Offer Supplement. Copies of the Company Disclosures may be viewed at the website of the Company at http://www.smcglobalpower.com.ph. The Company Disclosures contain material and meaningful information relating to the Company and investors should review all information contained in the Prospectus, this Offer Supplement and the Company Disclosures incorporated or deemed incorporation herein by reference.

**ALL REGISTRATION REQUIREMENTS HAVE BEEN MET AND ALL INFORMATION CONTAINED HEREIN ARE TRUE AND CURRENT.**

**SMC GLOBAL POWER HOLDINGS CORP.**

**By:**

**Ramon S. Ang**
**Chairman & Chief Executive Officer and**
**President & Chief Operating Officer**

SUBSCRIBED AND SWORN to before me this AUG 02 2018 August 2018 in Mandaluyong City, affiant exhibiting to me his Philippine Passport with No. EC3542718 expiring on 26 February 2020 as competent evidence of identity.

Doc. No. : 187;
Page No. : 39;
Book No. : II;
Series of 2018

JULIE ANN B. DOMINO-PABLO
Appointment No. 0470-18
Notary Public for Mandaluyong City
Until December 31, 2019
No. 155 EDSA, Brgy. Wack-Wack, Mandaluyong City
Roll No. 57163
PTR No. 3391561; 1/4/18; Mandaluyong City
IBP Lifetime Member No. 012880; 6/17/14; Quezon City Chapter
MCLE Exemption No. V-001302; 2/22/2016; Pasig City

# Table of Contents

## Definition of Terms

In this Offer Supplement, unless the context otherwise requires, the following terms shall have the meanings set out below:

| | |
|---|---|
| Affiliates ……………………………………………. | With respect to any Person, any other Person directly or indirectly controlling, controlled by, or under direct or indirect common control with, such Person or any Subsidiary of such Person. For purposes of this definition, "control" (including, with correlative meanings, the terms "controlling", "controlled by" and "under common control with"), as applied to any Person, means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise. |
| Allocation Plan …………………………………… | The agreed on procedure for application, acceptance, or rejection of the Applications to Purchase, whether in whole or in part. |
| Applicable Law…………………………………… | Any statute, law, regulation, ordinance, rule, judgment, order, decree, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by, or any interpretation or administration of any of the foregoing by, any Governmental Authority. |
| Applicant ………………………………………….. | Any Person who submits a duly accomplished Application to Purchase, together with all requirements set forth therein. |
| Application to Purchase …………………………. | The application form accomplished and submitted by an Applicant for the purchase of a specified amount of the Series G Bonds, together with all the other requirements set forth in such application form. |
| BDO Capital ……………………………………… | BDO Capital & Investment Corporation. |
| BIR …………………………………………………. | Bureau of Internal Revenue of the Philippines. |
| Board of Directors or Directors …………………. | Board of Directors of SMC Global Power. |
| Bondholder ……………………………………….. | A Person whose name appears, at any time, as the registered owner of the Offer Bonds in the Registry of Bondholders. |
| Bonds ………………………………………………. | Collectively, the Philippine Peso-denominated fixed rate bonds of up to an aggregate principal amount of ₱35,000,000,000.00, inclusive of the Offer Bonds, to be issued in one or more tranches within the Shelf Period. |
| BPI Capital ………………………………………… | BPI Capital Corporation. |
| BSP …………………………………………………. | Bangko Sentral ng Pilipinas. |

| | |
|---|---|
| Business Day ……………………………………… | means a day, other than Saturday, Sunday or legal holiday, on which the facilities of the Philippine banking system are open and available for clearing, and banks are open for business in Metro Manila, Philippines. |
| Capital Stock ………………………………………. | With respect to any Person, any and all shares, interests, rights to purchase, warrants, options, participations or other equivalents (however designated, whether voting or non-voting) in equity of such Person, whether outstanding on the date of the Trust Agreement or issued thereafter, including, without limitation, all Common Stock and preferred stock. |
| Change in Law or Circumstance …………….…... | Each of the events described as such under "*Description of the Offer Bonds – Redemption by Reason of Change in Law or Circumstance*". |
| Change of Control ……………………………….. | San Miguel Corporation (and/or its affiliates) ceasing to, whether directly or indirectly, have an aggregate economic interest of more than 50.0% in the Issuer or ceasing to have control over the Issuer. For purposes of this definition, "affiliate" means, with respect to San Miguel Corporation, any Person that directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with San Miguel Corporation. In this context, "control" (including, with correlative meanings, the terms "controlling", "controlled by" and under common control with) means the possession, directly or indirectly, of the power to direct, or cause the direction of, the management and policies of such Person whether through ownership of voting shares, by contract, or otherwise. |
| China Bank Capital ……………………………….. | China Bank Capital Corporation. |
| Common Stock ……………………………………. | With respect to any Person, any and all shares, interests, rights to purchase, warrants, options or other participations in, and other equivalents (however designated and whether voting or non-voting) of such Person's common stock or ordinary shares, whether or not outstanding at the date of the Trust Agreement, and include, without limitation, all series and classes of such common stock or ordinary shares. |
| Company, Issuer, or SMC Global Power …….. | SMC Global Power Holdings Corp. including, as the context requires, its subsidiaries. |
| Consolidated EBITDA ………………………….. | For any period, the consolidated net income of the Company (excluding items between any or all of the Company and its subsidiaries): (a) before any provision on account of taxation; (b) before any interest, commission, discounts, other fees or foreign exchange gains or losses incurred or payable, received or receivable or realized by the Company or any of its subsidiaries in respect of Indebtedness of the Group; (c) before any item treated as exceptional or extraordinary items; (d) before any amount attributable to the amortization of intangible assets |

| | |
|---|---|
| | and depreciation of tangible assets; and (e) excluding income attributable to or generated by Ring-Fenced Subsidiaries, and so that no amount shall be included or excluded more than once and all as determined on a consolidated basis for the Company and its subsidiaries in conformity with the PFRS. |
| Consolidated Interest Expense ………………….. | Consolidated Interest Expense means the total Interest Expense per consolidated financial statements less interest due on the Project Debt. |
| Consolidated Net Total Debt …………………….. | Consolidated Net Total Debt means at any time, the Consolidated Total Debt less the aggregate amount at that time of all cash and temporary cash investment (on a consolidated basis) to which the Company or any of its subsidiaries is beneficially entitled at that time and which is not subject to any security interest. |
| Consolidated Total Debt ……………………….. | Consolidated Total Debt means at any time, the aggregate amount of all obligations of the Company and its Subsidiaries for or in respect of Indebtedness but excluding; (a) any such obligation to the Company and/or any of its Subsidiaries (and so that no amount shall be included or excluded more than once) and (b) all Project Debt. |
| Consolidated Total Equity ……………………….. | Consolidated Total Equity means the consolidated total assets minus consolidated total liabilities plus deposit for future subscription as reported in the consolidated financial statements. |
| Debt ……………………………………………… | Debt means the sum of interest-bearing debt of the Issuer, as reflected in its financial statements. |
| Declaration of Default …………………………… | Has the meaning defined under "*Events of Default – Consequences of Default*". |
| Default Payment Date …………………………… | Has the meaning defined under "*Events of Default – Consequences of Default".* |
| Disqualified Stock ………………………………. | Any class or series of Capital Stock of any Person that by its terms (or by the terms of any security into which it is convertible or for which it is exchangeable) or otherwise is (a) required to be redeemed prior to the Maturity Date of the Series G Bonds, (b) redeemable at the option of the holder of such class or series of Capital Stock or any other person at any time prior to the Maturity Date of the Series G Bonds or (c) convertible into or exchangeable for Capital Stock referred to in paragraphs (a) or (b) above or Indebtedness having a scheduled maturity prior to the Maturity Date of the Series G Bonds; provided that any class or series of debt securities or preferred stock convertible or exchangeable into Common Stock, the terms of which allow for a cash payment in lieu of Common Stock upon conversion or exchange in the event that the issue or distribution of Common Stock to the holder thereof will cause such Person to violate foreign ownership regulations applicable in the Philippines from time to time, shall not constitute Disqualified Stock provided that any such cash |

| | |
|---|---|
| | payments are made with the proceeds of the sale of equity interests of such Person to an unaffiliated Person. |
| Disruption Event ………………………………… | Either or both of: (a) a material disruption to those payment communications systems or to those financial markets which are, in each case, required to operate in order for payments to be made in connection with the transactions contemplated by the Trust Agreement to be carried out which disruption is not caused by, and is beyond the control of, any of the parties; or (b) the occurrence of any other event which results in a disruption (of a technical or systems-related nature) to the treasury or payments operations of a party preventing that party from: (i) performing its payment obligations under the Trust Agreement and the Registry and Paying Agency Agreement; or (ii) communicating with other relevant parties (including, but not limited to, the Trustee and Paying Agent) in accordance with the terms of the Trust Agreement and the Registry and Paying Agency Agreement. |
| EBITDA …………………………………………….. | Earnings before interest, taxes, depreciation and amortization. |
| Event of Default ………………………………… | Each of the events described as such under "*Events of Default*". |
| Four Quarterly Period …………………………….. | In respect of any date, the then most recent four quarterly periods prior to such date for which consolidated financial statements of the Company (which the Company shall use its best efforts to compile in a timely manner) are available. |
| GDP ………………………………………………… | Gross Domestic Product. |
| Group ……………………………………………… | At any time, the Company and its Subsidiaries at such time. |
| Government ……………………………………… | The Government of the Philippines. |
| Governmental Approval ………………………... | Any authorization, consent, concession, grant, approval, right, franchise, privilege, registration, filing, certificate, license, permit or exemption from, by or with any Governmental Authority, whether given or withheld by express action or deemed given or withheld by failure to act within any specified time period. |
| Governmental Authority …………………………. | The Philippine government or political subdivision thereof, and any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to the Philippine government. |
| Grid Code …………………………………………. | The Philippine Grid Code. |
| Guarantee …………………………………………. | Any obligation, contingent or otherwise, of any Person directly or indirectly guaranteeing any Indebtedness or other obligation of any other Person and, without limiting the generality of the foregoing, any obligation, direct or indirect, contingent or |

| | |
|---|---|
| | otherwise, of such Person (a) to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness or other obligation of such other Person (whether arising by virtue of partnership arrangements, or by agreements to keep-well, to purchase assets, goods, securities or services, to take-or-pay, or to maintain financial statement conditions or otherwise) or (b) entered into for purposes of assuring in any other manner the obligee of such Indebtedness or other obligation of the payment thereof or to protect such obligee against loss in respect thereof (in whole or in part); provided that the term "Guarantee" shall not include endorsement for collection or deposit in the ordinary course of business. The term Guarantee used as a verb has a corresponding meaning. |
| Hedging Obligation ……………………………….. | With respect to any Person, the obligations of such Person pursuant to any currency agreement or interest rate agreement or commodities agreement. |
| Ilijan IPPA Agreement ……………………………. | The IPPA Agreement dated 11 May 2010 between PSALM and South Premiere Power Corp. with the conformity of the NPC relative to the administration of the IPP contract of NPC for the Ilijan Power Plant. |
| Ilijan Power Plant ……………………………….. | The natural gas fired combined cycle power plant with contracted capacity of 1,200 MW located in Ilijan, Batangas. |
| Indebtedness ……………………………………. | With respect to any Person, any indebtedness for or in respect of:<br><br>(a) all obligations of such Person for borrowed money except for non-interest bearing obligations from Affiliates;<br><br>(b) all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments;<br><br>(c) all obligations of such Person to pay the deferred purchase price of property or services, except trade accounts payable arising in the ordinary course of business;<br><br>(d) all obligations of such Person as lessee which are capitalized in accordance with PFRS;<br><br>(e) all Indebtedness of others secured by a Security Interest on any asset of such Person;<br><br>(f) receivables sold or discounted (other than any receivables to the extent they are sold on a non-recourse basis);<br><br>(g) all obligations in respect of any Disqualified Stock, provided that such Disqualified Stock (i) falls within paragraph (a) of the definition of "Disqualified Stock" or (ii) falls within |

| | |
|---|---|
| | paragraph (b) of the definition of "Disqualified Stock" and the Person entitled to exercise the option to require redemption of such Disqualified Stock has exercised or given notice to exercise such option or (iii) falls within paragraph (c) of the definition of "Disqualified Stock" and has been converted into Indebtedness having a scheduled maturity prior to the Maturity Date of the Series G Bonds;<br><br>(h) all Indebtedness of others Guaranteed by such Person;<br><br>(i) all non-contingent obligations of such Person to reimburse any bank or other Person in respect of amounts paid under a letter of credit, Guarantee or similar instrument; and<br><br>(j) any interest rate swap, currency swap, forward foreign exchange transaction, cap, floor, collar or option transaction or any other treasury transaction or any combination thereof or any other transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and the amount of Indebtedness in relation to any such transaction described in this paragraph (j) shall be calculated by reference to the mark-to-market valuation of such transaction at the relevant time),<br><br>and so that where the amount of Indebtedness is to be calculated, no amount shall be taken into account more than once in the same calculation and, where the amount is to be calculated on a consolidated basis in respect of a corporate group, monies borrowed or raised, or other indebtedness, as between members of such group shall be excluded. |
| Incur ……………………………………………... | With respect to any Indebtedness or Capital Stock, to incur, create, issue, assume, guarantee or otherwise become liable for or with respect to, or become responsible for, the payment of, contingently or otherwise, such Indebtedness or Capital Stock; provided that (a) any Indebtedness of a Person existing at the time such Person becomes a Subsidiary of the Issuer will be deemed to be Incurred by such Subsidiary of the Issuer at the time it becomes a Subsidiary of the Issuer and (b) the accretion of original issue discount shall not be considered an Incurrence of Indebtedness. The terms Incurrence, Incurred, and Incurring have meanings correlative with the foregoing. |
| Interest Payment Date …………………………… | Each February 17, May 17, August 17 and November 17 of each year, or on the next Business Day if such date falls on a non-Business Day, during which any of the Offer Bonds are outstanding, without adjustment to the amount of interest to be paid. |

| | |
|---|---|
| IPP ……………………………………………….. | Independent Power Producer. |
| IPPA ……………………………………………… | Independent Power Producer Administrator. |
| IPPA Agreement ………………………………... | Each of the Ilijan IPPA Agreement, the San Roque IPPA Agreement and the Sual IPPA Agreement, collectively referred to as "IPPA Agreements". |
| IPPA Power Plants ……………………………… | The Sual Power Plant, the San Roque Power Plant and the Ilijan Power Plant. |
| Issue Date ……………………………………….. | 17 August 2018 or such other date as the Issuer and the Joint Lead Underwriters and Bookrunners may agree in writing (and with notice to PDTC); provided, that such date shall be a date which is within the validity of the Permit to Sell Securities. |
| Joint Issue Managers …………………………….. | BDO Capital<br>BPI Capital<br>China Bank Capital<br>PNB Capital |
| Joint Lead Underwriters and Bookrunners……… | BDO Capital<br>BPI Capital<br>China Bank Capital<br>PNB Capital |
| Majority Bondholders……………………………… | With respect to matters affecting the Offer Bonds, Bondholders representing more than fifty percent (50%) of the outstanding principal amount of the Offer Bonds. |
| Master Certificate of Indebtedness……………… | The bond certificate issued by the Issuer in the name of the Trustee for the benefit of the Bondholders covering the entire principal amount of the Offer Bonds purchased during the Offer Period and to be issued by the Issuer on the Issue Date. |
| Material Adverse Effect…………………………. | In the reasonable opinion of the Majority Bondholders, acting in good faith and in consultation with the Issuer, a material adverse effect on (a) the ability of the Issuer to observe and comply with the provisions of and perform its financial obligations under the Offer Bonds and the Transaction Documents; or (b) the validity or enforceability of the Offer Bonds or any Transaction Document; or (c) the financial condition, business or operations of the Issuer taken as a whole. |
| Material Agreement…………………………. | Each of the IPPA Agreements, as may be amended or supplemented from time to time. |
| Material Subsidiary ……………………………... | At any time, a Subsidiary of the Company:<br><br>(a) whose net income (consolidated in the case of a Subsidiary which itself has Subsidiaries) or whose Total Assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent in each case (or, in the case of a Subsidiary |

| | |
|---|---|
| | acquired after the end of the financial period to which the then latest audited consolidated accounts of the Company and its Subsidiaries relate, are equal to) not less than 25% of the consolidated net income of the Company and its Subsidiaries taken as a whole, or, as the case may be, 25% of the consolidated Total Assets, of the Company and its Subsidiaries taken as a whole, all as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, unconsolidated) of such Subsidiary and the then latest audited consolidated accounts of the Company and its Subsidiaries, provided that (i) in the case of a Subsidiary of the Company acquired after the end of the financial period to which the then latest audited consolidated accounts of the Company and its Subsidiaries relate, the reference to the then latest audited consolidated accounts of the Company and its Subsidiaries for the purposes of the calculation above shall, until consolidated accounts for the financial period in which the acquisition is made have been prepared and audited as aforesaid, be deemed to be a reference to such first-mentioned accounts as if such Subsidiary had been shown in such accounts by reference to its then latest relevant audited accounts, adjusted as deemed appropriate by the Company and (ii) if the then latest audited consolidated accounts of the Company and its Subsidiaries show a net loss for the relevant financial period then there shall be substituted for the words "net income" the words "gross revenues" for the purpose of this definition;<br><br>(b) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Company which immediately prior to such transfer is a Material Subsidiary of the Company, provided that the transferor Subsidiary shall upon such transfer forthwith cease to be a Material Subsidiary of the Company and the transferee Subsidiary shall cease to be a Material Subsidiary of the Company pursuant to this sub-paragraph on the date on which the consolidated accounts of the Company and its Subsidiaries for the financial period current at the date of such transfer have been prepared and audited as aforesaid but so that such transferor Subsidiary or such transferee Subsidiary may be a Material Subsidiary of the Company on or at any time after the date on which such consolidated accounts have been prepared and |

| | |
|---|---|
| | audited as aforesaid by virtue of the provisions of sub-paragraph (i) above or, prior to or after such date, by virtue of any other applicable provision of this definition; or<br><br>(c) to which is transferred an undertaking or assets which, taken together with the undertaking or assets of the transferee Subsidiary, generated (or, in the case of the transferee Subsidiary being acquired after the end of the financial period to which the then latest audited consolidated accounts of the Company and its Subsidiaries relate, generate net income equal to) not less than 25% of the consolidated net income of the Company and its Subsidiaries taken as a whole, or represent (or, in the case aforesaid, are equal to) not less than 25% of the consolidated Total Assets of the Company and its Subsidiaries taken as a whole, all as calculated as referred to in sub-paragraph (a) above, provided that the transferor Subsidiary (if a Material Subsidiary of the Company) shall upon such transfer forthwith cease to be a Material Subsidiary of the Company unless immediately following such transfer its undertaking and assets generate (or, in the case aforesaid, generate net income equal to) not less than 25% of the consolidated net income of the Company and its Subsidiaries taken as a whole, or its assets represent (or, in the case aforesaid, are equal to) not less than 25% of the consolidated Total Assets of the Company and its Subsidiaries taken as a whole, all as calculated as referred to in sub-paragraph (a) above, and the transferee Subsidiary shall cease to be a Material Subsidiary of the Company pursuant to this sub-paragraph on the date on which the consolidated accounts of the Company and its Subsidiaries for the financial period current at the date of such transfer have been prepared and audited but so that such transferor Subsidiary or such transferee Subsidiary may be a Material Subsidiary of the Company on or at any time after the date on which such consolidated accounts have been prepared and audited as aforesaid by virtue of the provisions of sub-paragraph (a) above or, prior to or after such date, by virtue of any other applicable provision of this definition. |
| Maturity Date …………………………………… | Means the 5th anniversary of the Issue Date or 17 August 2023; provided, that if the relevant Maturity Date falls on a day that is not a Business Day, then the payment of the principal shall be made by the |

| | |
|---|---|
| | Issuer on the next Business Day, without adjustment to the amount of interest and principal to be paid. |
| Offer ……………………………………………… | The public offer for sale, distribution and issuance of the Offer Bonds by the Issuer to eligible investors. |
| Offer Period …………………………………… . | The period when the Offer Bonds are publicly offered for sale, distribution and issuance by the Issuer to eligible investors, commencing at 9:00 a.m., Manila time, on 6 August 2018, and ending at 5:00 p.m., Manila time, on 10 August 2018, or on such other times and dates as may be mutually agreed between the Issue and the Joint Lead Underwriters and Bookrunners. |
| Offer Supplement ……………………………….. | The document so titled and dated 2 August 2018 issued along with and supplementary to the Prospectus and containing the specific terms and conditions of the Offer and the Offer Bonds. |
| Optional Redemption Date……………………… | The third 3rd anniversary of the Issue Date or the 4th anniversary of the Issue Date, provided that if the relevant Optional Redemption Date falls on a day that is not a Business Day, then the payment of the principal shall be made by the Issuer on the next Business Day, without adjustment to the amount of interest and principal to be paid. |
| Paying Agent …………………………………….. | PDTC, whose principal obligation is to handle payments of the principal of, and interest on, the Offer Bonds, to the Bondholders, pursuant to the Registry and Paying Agency Agreement. The term includes, wherever the context permits, all other Person or Persons for the time being acting as paying agent or paying agents under the Registry and Paying Agency Agreement. |
| Payment Date …………………………………… | Each date on which payment for interest, principal, and/or all other payments due on the Bonds become due. |
| PDEx ……………………………………………….. | The Philippine Dealing & Exchange Corp. |
| PDTC ………………………………………. | The Philippine Depository & Trust Corp. |
| PDTC Rules ……………………………………….. | The SEC-approved rules of the PDTC, including the PDTC operating procedures, as may be amended, supplemented, or modified from time to time. |
| Permit to Sell Securities………………………….. | The permit to be issued by the SEC authorizing the Issuer to sell, distribute and issue the Offer Bonds to the public. |
| Permitted Asset Sale …………………………….. | Any sale, transfer or other disposition (including by way of merger, consolidation or sale and leaseback transaction) in one transaction or a series of related transaction by the Company:<br><br>(a) sales, transfers or other dispositions of inventory in the ordinary course of business and the consideration received is at least equal to the fair market value of |

| | |
|---|---|
| | the assets sold or disposed of;<br><br>(b) sales, transfers or other dispositions of assets with a fair market value which, when aggregated with the fair market value of all other assets which are the subject of any sale, transfer or other disposition, does not exceed ₱1,500,000,000 in any transaction or series of related transactions;<br><br>(c) any sale, transfer, assignment or other disposition of any inventory or property with a fair market value not in excess of ₱50,000,000 to an employee of the Company in any transaction or series of related transactions under an employee benefit plan approved by the Board of Directors of the Company and in effect from time to time;<br><br>(d) any sale, transfer, assignment or other disposition of any property or equipment that has become damaged, worn out, obsolete or otherwise unsuitable for use in connection with the business of the Company or any of the Material Subsidiaries;<br><br>(e) any sale, transfer or disposition of assets, including rights under the IPPA Agreements, if applicable, to the Company or a Subsidiary;<br><br>(f) any transfer, assignment or other disposition deemed to occur in connection with creating or granting any Permitted Security Interest;<br><br>(g) any sale transfer or other disposition of any Capital Stock of Strategic Power Devt. Corp. or any of its assets (including its rights under an IPPA Agreement);<br><br>(h) any transfer of the proceeds from the sale or issuance of Capital Stock of the Company through an initial public offering or any other public offering or private placement, provided that San Miguel Corporation (and/or its Subsidiaries) retains whether directly or indirectly an aggregate economic interest of more than 50.0% in the Company or control over the Company. For purposes of this definition, “control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise. For the avoidance of doubt, the Company shall not permit any person, other than San Miguel Corporation, to hold directly or indirectly, an aggregate economic |

| | |
|---|---|
| | interest of more than 50% in the Company or control over the Company for as long as any of the Offer Bonds remain outstanding;<br><br>(i) Any transfer of the proceeds for the sale or issuance of Capital Stock of the Subsidiary of the Company through an initial public offering or any other public offering or private placement, provided that the Company (and/or its Subsidiaries) retains whether directly or indirectly an aggregate economic interest of more than 50.0% in its Subsidiary or control over its Subsidiary. For the avoidance of doubt, the Company shall retain, directly or indirectly an aggregate economic interest of more than 50% in its Subsidiaries or control over its Subsidiaries for as long as any of the Offer Bonds remain outstanding; and<br><br>(j) Any sale of electricity (i) under power purchase agreements and other offtake agreements entered into under arms' length terms; or (ii) to the WESM. |
| Permitted Security Interest…………………… | Means:<br><br>(a) any Security Interest existing as of the date of the Trust Agreement;<br><br>(b) any preference or priority granted over the payments under the IPPA Agreements pursuant to Article 2244(14) of the Civil Code of the Philippines;<br><br>(c) any Security Interest over or affecting any asset of any company which becomes a member of the Group after the date of the Trust Agreement, where the Security Interest is created prior to the date on which that company becomes a member of the Group;<br><br>(d) to the extent notified to the Lenders in writing, any Security Interest created by a Ring-Fenced Subsidiary securing Project Debt incurred by that Ring-Fenced Subsidiary;<br><br>(e) to the extent notified to the Lenders in writing, Security Interest created over shares in any Ring-Fenced Subsidiary securing Project Debt incurred by that Ring-Fenced Subsidiary;<br><br>(f) any Security Interest upon, or with respect to, any of the present or future business, undertaking, assets or revenues (including uncalled capital) of any of the Material Subsidiaries to secure:<br><br>(i) any Indebtedness which (subject to (ii) of |

| | |
|---|---|
| | this definition below) is not Public Debt; or<br><br>(ii) any Public Debt (1) which (x) by its terms does not provide that the Company or any Material Subsidiary is an obligor, (y) by its terms does not provide that a Guarantee or credit support of any kind is given by the Company or any of the Material Subsidiaries and (z) does not have the legal effect of providing recourse against any of the assets of the Company or any of the Material Subsidiaries and (2) no default with respect to which would permit upon notice, lapse of time or both any holders of any other Indebtedness of the Company or any of the Material Subsidiaries to declare a default on such other Indebtedness or cause the payment of such other Indebtedness to be accelerated or payable prior to its stated maturity, which, in either case (either alone or when aggregated with all other present or future business, undertaking, assets or revenues (including uncalled capital) of any of the Material Subsidiaries upon, or with respect to, which Security Interests are subsisting), does not exceed 15% of the consolidated Total Assets of the Company and its Subsidiaries taken as a whole;<br><br>(g) any extension, renewal, supplement, or replacement (or successive extensions, renewals, supplements, or replacements) in whole or in part of any Security Interest referred to in paragraphs (a), (b), (d), (e), and (f), or any Indebtedness secured thereby; provided that such extension, renewal, supplements, or replacement is limited to all or any part of the same property that secured the Security Interest extended, renewed, supplemented, or replaced (plus any construction, repair, or improvement on such property) and shall secure no larger amount of financial Indebtedness than that existing at the time of such extension, renewal, supplement, or replacement;<br><br>(h) Security Interest created with the prior written consent of the Majority Bondholders;<br><br>(i) Liens for taxes, assessments, or governmental charges or levies; provided, that the Indebtedness which is secured thereby is paid when due or contested in good faith in appropriate proceedings and properly provisions; and<br><br>(j) Any Lien arising by operation of law and in the ordinary course of trading of any property or asset of the Company or its Subsidiaries; provided, that the debt or |

| | |
|---|---|
| | other obligations which is secured thereby is paid when due or contested in good faith in appropriate proceedings and properly provisions. |
| Person …………………………………………….. | Any individual, firm, corporation, partnership, association, joint venture, tribunal, limited liability company, trust, government or political subdivision or agency or instrumentality thereof, or any other entity or organization. |
| PFRS …………………………………………….. | The Philippine Financial Reporting Standards. |
| Philippine peso or PhP or Pesos or ₱ ………….. | The legal currency of the Republic of the Philippines. |
| Philippines …………………………………………. | The Republic of the Philippines. |
| PhilRatings ...……………………………………… | The Philippine Rating Services Corporation. |
| PNB Capital ……………………………………….. | PNB Capital and Investment Corporation. |
| Project Debt ……………………………………….. | Indebtedness incurred by a Ring-Fenced Subsidiary in relation to project finance in respect of which there is no recourse to the Company or any other member of the Group, and in respect of which neither the Company nor any other member of the Group has any actual or contingent liability of any nature, whether as principal, guarantor, surety or otherwise, except in respect of any Security Interest granted by the Company or any member of the Group over its shares in a Ring-Fenced Subsidiary. |
| Prospectus ………………………………………. | The prospectus dated 8 December 2017 and any amendments, supplements and addenda thereto for the offer and sale to the public of the Bonds (inclusive of Offer Bonds) within the Shelf Period. For purposes of these Terms and Conditions, the term "Prospectus" is deemed to include this Offer Supplement. |
| PSALM ……………………………………………. | Power Sector Assets and Liabilities Management Corporation. |
| Public Debt ………………………………………… | Any present or future indebtedness (whether being principal, interest or other amounts) for or in respect of any notes, bonds, debentures, debenture stock, loan stock or other securities which are for the time being, or capable of being, quoted, listed or ordinarily dealt in on any stock exchange, over-the-counter or other securities market, and any Guarantee or indemnity of any such indebtedness. |
| Record Date ……………………………………….. | As used with respect to any Payment Date, (a) 2 Business Days immediately preceding the relevant Payment Date, which shall be the cut-off date in determining the Bondholders entitled to receive interest, principal or any amount due under the Offer Bonds or (b) such other date as the Issuer may duly notify PDTC. |

| | |
|---|---|
| Redemption Date ……………………………….. | The date when the Offer Bonds (or any series thereof) are redeemed earlier than the relevant Maturity Date in accordance with the terms and conditions of the Offer Bonds; provided that if the relevant Redemption Date falls on a day that is not a Business Day, then the payment of the principal shall be made by the Issuer on the next Business Day, without adjustment to the amount of interest and principal to be paid. For the avoidance of doubt, the term "Redemption Date" includes the Optional Redemption Date. |
| Registrar …………………………………………… | PDTC, a corporation duly organized and existing under and by virtue of the laws of the Republic of the Philippines, with principal office at the 37th Floor, Tower 1, The Enterprise Center, 6766 Ayala Avenue, Makati City, whose principal obligation is to maintain the Registry of Bondholders and record the initial issuance and subsequent transfers of the Offer Bonds, pursuant to the Registry and Paying Agency Agreement. |
| Registration Statement …………………………… | The registration statement filed by the Issuer with the SEC in relation to the shelf registration and the offer and sale to the public of the Bonds, as the same may be amended or supplemented. The Registration Statement was rendered effective by the SEC on 12 December 2017 pursuant to SEC MSRD Order No. 37 series of 2017.<br><br>On 6 July 2018, the Issuer filed an amended Registration Statement in relation to the offer and sale to the public of the Offer Bonds. |
| Registry of Bondholders . . . . . . . . . . . . . . . . . . . | The electronic registry book of the Registrar containing the official information on the Bondholders, including, but not limited to, the names and addresses of the Bondholders and the amount of Offer Bonds they respectively hold, including all transfers and assignments thereof, and any lien or encumbrance thereon, to be maintained by the Registrar pursuant to and under the terms of the Registry and Paying Agency Agreement. |
| Registry and Paying Agency Agreement (RPAA) | The Registry and Paying Agency Agreement dated 2 August 2018, and its annexes and attachments, as may be modified, supplemented or amended from time to time, and entered into between the Issuer and the Registrar and Paying Agent in relation to the Offer Bonds. |
| R.G. Manabat & Co. ……………………………… | R.G. Manabat & Co., a member firm of KPMG. |
| Ring-Fenced Subsidiary …………………………. | Any entity that satisfies the following conditions:<br><br>(a) such entity is a Subsidiary of the Company but not a Material Subsidiary;<br><br>(b) such entity, to the extent directly owned by the Company or a member of the Group (other than another Ring-Fenced Subsidiary), is a limited liability company or corporation organized and existing |

| | |
|---|---|
| | under the laws of the Philippines;<br><br>(c) the Company has delivered a written notification to the Trustee designating such entity as a Ring-Fenced Subsidiary;<br><br>(d) no member of the Group (other than that Ring-Fenced Subsidiary) shall be contingently liable for any Indebtedness of such entity or its Subsidiaries, except in respect of the granting by a member of the Group of Security Interest over its shares in such entity or such entity's Subsidiaries; and<br><br>(e) all transactions conducted between any member of the Group and such entity or its Subsidiaries must be on an arm's length basis and on normal commercial terms,<br><br>and each Subsidiary of any such entity shall also be a Ring-Fenced Subsidiary. |
| RTGS ………………………………………………. | The Philippine Payment Settlement System via Real Time Gross Settlement. |
| San Roque IPPA Agreement ……………………. | The IPPA Agreement dated 29 December 2009 between PSALM and Strategic Power Devt. Corp. with the conformity of NPC relative to the administration of the IPP contract of NPC for the San Roque Power Plant. |
| San Roque Power Plant …………………………. | Hydroelectric multipurpose power plant with contracted capacity of 345 MW located in San Manuel, Pangasinan. |
| San Roque PPA …………………………………... | The PPA made between SPDC and NPC dated 11 October 1997 in relation to the San Roque Power Plant. |
| SEC ………………………………………………… | The Securities and Exchange Commission of the Philippines. |
| Security Interest …………………………………... | Any (a) mortgage, charge, pledge, lien or other security interest or encumbrance or other preferential arrangement of any kind, including, without limitation, any preference or priority under Article 2244 (14) of the Civil Code of the Philippines, as the same may be amended from time to time, in each case, to the extent securing payment or performance of an Indebtedness prior to any general creditor of such person; and (b) right of a vendor, lessor, or similar party under any conditional sales agreement, capital lease or other title retention agreement, any other right of or arrangement with any creditor to have its claims satisfied out of any property or assets, or the proceeds therefrom, prior to any general creditor of the owner thereof. |

| | |
|---|---|
| Selling Agents…..………………………………… | Collectively, the Joint Lead Underwriters and Bookrunners and Bank of Commerce, RCBC Capital Corporation, SB Capital and Investment Corporation, and United Coconut Planters Bank. |
| Series G Bonds ………………………………… | Bonds to be issued by the Issuer, with an aggregate principal amount of ₱15,000,000,000.00, having a term beginning on the Issue Date and ending five (5) years from the Issue Date or 17 August 2018, with a fixed interest rate equivalent to 6.75% per annum. |
| Shelf Period ……………………………………... | Subject to applicable regulations, a period of three years from the effective date of the Registration Statement within which the Bonds under shelf registration may be offered and sold in tranches. |
| SRC ………………………………………………… | Securities Regulation Code of the Philippines (Republic Act No. 8799) and its implementing rules, as amended. |
| Sual IPPA Agreement ……………………………. | The IPPA Agreement dated 2 September 2009 between PSALM and SMEC with the conformity of NPC relative to the administration of the IPP contract of NPC for the Sual Power Plant. |
| Sual Power Plant …………………………………. | Coal-fired power plant with a contracted capacity of 1,000 MW located in Sual, Pangasinan. |
| Subsidiary ………………………………………….. | With respect to any Person, more than 50% of the voting power of the outstanding voting stock of which is owned or controlled, directly or indirectly, by such Person and one or more other Subsidiaries of such Person. To be controlled by another means that (a) the controlling entity (whether, directly or indirectly, and whether by the ownership of share capital, the possession of voting power, contract or otherwise) has the power to appoint and/or remove all or the majority of the members of the board of directors or other governing body of that controlled company or otherwise controls or has a power to control the affairs and policies of that controlled company and control shall be construed accordingly, and (b) the controlling entity identifies said controlled company as a subsidiary in its latest available consolidated financial statements. |
| Tax Code ………………………………………… | The National Internal Revenue Code of 1997. |
| Taxes …………………………………………….. | Any present or future taxes, including, but not limited to, documentary stamp tax, levies, imposts, filing and other fees or charges imposed by the Republic of the Philippines or any political subdivision or taxing authority thereof, including surcharges, penalties and interests on said taxes, but excluding final withholding tax, gross receipts tax, taxes on the overall income of the underwriter or of the Bondholders, value added tax, and taxes on any gains realized from the sale of the Offer Bonds. |

| | |
|---|---|
| Total Assets ……………………………………… | Total Assets means with respect to any specified Person for any period, the aggregate total current assets and total non-current assets for such period, on a consolidated basis, determined in conformity with PFRS; provided that any foreign currency denominated deposits secured for the purposes of Hedging Obligations shall be excluded in computing Total Assets (without duplication). |
| Total Equity ……………………………………… | Total Equity means with respect to any period, the sum of the total paid up capital, deposit for future subscription and all accumulated profits of the Company and its Subsidiaries, as reflected in the consolidated financial statements. |
| Transaction Documents ………………………….. | As the context may require the Trust Agreement, the Underwriting Agreement and/or the Registry and Paying Agency Agreement. |
| Trust Agreement ………………………………..…. | The Trust Agreement dated as of 2 August 2018, and its annexes and attachments, as may be modified, supplemented or amended from time to time, executed by and between the Issuer and the Trustee in connection with the distribution and sale by the Issuer of the Offer Bonds. |
| Trustee ……………………………………..…… | Philippine National Bank – Trust Banking Group |
| Underwriting Agreement ……………………..….. | The Issue Management and Underwriting Agreement dated as of 2 August 2018, and its annexes and attachments, as may be modified, supplemented or amended from time to time, executed by and among the Issuer, the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners for the issuance, placement, distribution and sale of the Offer Bonds in the Philippines. |

# Executive Summary

*The following summary is qualified in its entirety by, and is subject to, the more detailed information and audited financial statements, including notes thereto, found in the appendices of this Offer Supplement.*

*Prospective investors should read this entire Offer Supplement fully and carefully, including the section on "Risk Factors and Other Considerations" in the Prospectus. In case of any inconsistency between this summary and the more detailed information in this Offer Supplement, then the more detailed portions, as the case may be, shall at all times prevail.*

**Business**

SMC Global Power is a holding company which owns subsidiaries that are primarily engaged in the generation, supply and sale of electric power in the Philippines. SMC Global Power, together with its subsidiaries, associates, and joint ventures (collectively referred to as the "**Group**") is one of the largest power companies in the Philippines, controlling 4,153 megawatts ("**MW**") of combined capacity as of March 31, 2018 and which benefits from diversified fuel sources, including natural gas, coal and hydroelectric. Based on the installed generating capacities under Energy Regulatory Commission of the Philippines ("**ERC**") Resolution No. 04, Series of 2018, the Group has a 19% market share of the power supply of the National Grid, a 25% market share of the Luzon Grid and a 9% market share of the Mindanao Grid, in each case as of March 31, 2018[1].

San Miguel Corporation entered the power industry in 2009 following the acquisition of rights to administer the output produced by Independent Power Producers ("**IPPs**") in privatization auctions conducted by the government through the Power Sector Asset and Liabilities Management Corporation ("**PSALM**"). Through its subsidiaries, San Miguel Corporation became the Independent Power Producer Administrator ("**IPPA**") of the following plants: (1) San Miguel Energy Corporation ("**SMEC**") became the IPPA for the Sual Power Plant, a coal-fired thermal power plant located in Sual, Pangasinan, in November 2009; (2) Strategic Power Devt. Corp. ("**SPDC**") became the IPPA for the San Roque Power Plant, a hydroelectric power plant located in San Manuel, Pangasinan in January 2010; (3) South Premiere Power Corp. ("**SPPC**") became the IPPA for the Ilijan Power Plant, a natural gas-fired combined cycle power plant located in Ilijan, Batangas in June 2010. The Sual Power Plant, San Roque Power Plant and the Ilijan Power Plant are collectively referred to herein as the "**IPPA Power Plants**".

An IPPA under the IPP Administration Agreement (the "**IPPA Agreement**") has the right to sell electricity generated by the power plants owned and operated by the IPPs without having to bear any of the large upfront capital expenditures for power plant construction or maintenance. As an IPPA, SMEC, SPDC and SPPC also have the ability to manage both market and price risks by entering into bilateral contracts with offtakers while capturing potential upside from the sale of excess capacity through the Philippine Wholesale Electricity Spot Market ("**WESM**").

In order to consolidate its power generation business, San Miguel Corporation eventually transferred its equity interest in SMEC, SPDC and SPPC to SMC Global Power. In September 2010, SMC Global Power became a wholly-owned subsidiary of San Miguel Corporation. Since then, SMC Global Power controls the 2,545 MW combined contracted capacity of the IPPA Power Plants through the IPPA Agreements executed by SMEC, SPDC and SPPC, respectively.

In August 2011, as part of the reorganization of the power-related assets of San Miguel Corporation, SMC Global Power acquired from San Miguel Corporation a 100% equity interest in San Miguel Electric Corp. ("**SMELC**"), which is a grantee of a Retail Electricity Supplier ("**RES**") license issued by the ERC.

---

[1] Market share is computed by dividing the total capacity of the Company (4,153,000 KW) with the installed generating capacity of Luzon Grid, Mindanao Grid or National Grid (15,325,967 KW, 3,496,262 KW and 22,107,117 KW, respectively) based on data provided under ERC Resolution No. 04 Series of 2018.

In April 2013, SMC Global Power, through SMC Power Generation Corp. ("**SPGC**"), acquired a 35% equity stake in Olongapo Electricity Distribution Company, Inc. ("**OEDC**"). In October 2013, SMC Global Power entered into a 25-year concession agreement with Albay Electric Cooperative, Inc. ("**ALECO**") which became effective upon the confirmation of the National Electrification Administration ("**NEA**") in November 2013. SMC Global Power organized and established a wholly-owned and controlled subsidiary, Albay Power and Energy Corp. ("**APEC**"), which assumed, as the concessionaire, all the rights and interests and performs the obligations of SMC Global Power under the concession agreement with ALECO.

In July 2013, SMC Global Power through San Miguel Consolidated Power Corporation ("**SMCPC**"), a wholly-owned subsidiary, commenced construction works for its 2 x 150 MW coal-fired power plant in Malita, Davao (the "**Davao Greenfield Power Plant**"). Units 1 and 2, with a combined rated capacity of 300 MW, of the Davao Greenfield Power Plant attained commercial operations on July 26, 2017 and February 26, 2018, respectively.

In September 2013, SMC Global Power, through SMC Powergen Inc. ("**SPI**"), acquired 100% of the 140 MW Co-Generation Solid Fuel-Fired Power Plant located at the Petron Bataan Refinery, Barangay Alangan, Limay Bataan ("**Limay Co-Gen Power Plant**") from Petron Corporation. On December 23, 2016, the Limay Co-Gen Power Plant was sold back by SPI to Petron Corporation.

In October 2013, SMC Global Power through SMC Consolidated Power Corporation ("**SCPC**"), a wholly-owned subsidiary, commenced construction works for its 4 x 150 MW coal-fired power plant in Limay, Bataan (the "**Limay Greenfield Power Plant**"). The second 2 x 150 MW of the Limay Greenfield Power Plant was used to be owned by another subsidiary, the Limay Premiere Power Corp., but this was later transferred to SCPC in June 2017. Units 1, 2 and 3 with a rated capacity of 450 MW of the Limay Greenfield Power Plant attained commercial operations on 26 May 2017, 26 September 2017, and 26 March 2018, respectively, while Unit 4 is expected to commence commercial operations early next year. SCPC was granted a retail electricity supplier ("**RES**") license by the ERC on 24 August 2016, which gave it the ability to directly contract with industrial customers.

In November 2014, SMC Global Power through its subsidiary, PowerOne Ventures Energy Inc. ("**PVEI**") acquired a 60% stake in Angat Hydropower Corporation ("**AHC**"), the owner and operator of the 218 MW Angat Hydroelectric Power Plant ("**AHEPP**").

On 16 June 2016, Meralco Powergen Corporation ("**MGen**"), a subsidiary of Meralco, and Zygnet Prime Holdings, Inc. ("**Zygnet**") subscribed to 2,500 and 102 common shares of Mariveles Power Generation Corporation ("**MPGC**"), then a wholly-owned subsidiary of SMC Global Power, respectively. As a result, SMC Global Power's ownership was reduced to 49% of the outstanding capital stock of MPGC while MGen and Zygnet each owns 49% and 2% equity interest in MPGC, respectively. MPGC shall develop, construct, finance, own, operate and maintain a 4 x 150 MW circulating fluidized bed coal-fired power plant and associated facilities in Mariveles, Bataan.

On 20 March 2018, SMC Global Power acquired 51% and 49% equity interests in SMCGP Masin Pte. Ltd. (formerly, Masin-AES Pte. Ltd. and hereinafter referred to as "**SMCGP Masin**") from AES Phil Investment Pte. Ltd. ("**AES Phil**") and Gen Plus B.V., respectively. SMCGP Masin indirectly owns, through its subsidiaries, Masinloc Power Partners Co. Ltd. ("**MPPCL**")) and SMCGP Philippines Energy Storage Co. Ltd. (formerly, AES Philippines Energy Storage Co. Ltd. and hereinafter referred to as "**SMCGP Philippines Energy**"). MPPCL owns, operates and maintains the 2 x 315 MW coal-fired power plant (Units 1 and 2), the under-construction project expansion of the 335 MW unit known as Unit 3 (the "**Masinloc Greenfield Power Plant**"), and the 10 MW battery energy storage project (the "**Masinloc BES**"), all located in Masinloc, Zambales, Philippines (collectively, the "**MPPCL Assets**"),while SMCGP Philippines Energy plans to construct the 2 x 20 MW battery energy storage facility ("**Kabankalan BES**") in Kabankalan, Negros Occidental.

As part of the sale, SMC Global Power also acquired SMCGP Transpower Pte. Ltd. (formerly, AES Transpower Private Ltd. and hereinafter referred to as "**SMCGP Transpower**"), and SMCGP Philippines Inc. (formerly, AES Philippines Inc. and hereinafter referred to as ("**SPI**"). SMCGP Transpower was a subsidiary of The AES Corporation which provides corporate support services to MPPCL through its Philippine Regional Office and Headquarters, while API was a wholly-owned subsidiary of AES Phil and provides energy marketing services to MPPCL.

SMC Global Power, through SMEC, SPDC, SPPC, AHC, SCPC, SMCPC and MPPCL sells power through offtake agreements directly to customers, including Manila Electric Company ("**Meralco**") and other distribution utilities, electric cooperatives and industrial customers, or through the WESM. The majority of the consolidated sales of SMC Global Power are through long-term take-or-pay offtake contracts which have provisions for passing on fuel costs and certain other fixed costs.

During the years ended 31 December 2015, 2016 and 2017 and the three months ended 31 March 2017 and 2018, respectively, SMC Global Power, through its subsidiaries, sold 14,714 gigawatt hours ("**GWh**"), 15,758 GWh, 15,707 GWh, 3,551 GWh, and 4,330 GWh of power pursuant to offtake agreements and 1,844 GWh, 1,588 GWh, 1,520 GWh, 410 GWH, and 460 GWh of power through the WESM, respectively. During the years ended 31 December 2015, 2016 and 2017, and the three months ended 31 March 2017 and 2018, SMC Global Power, through its subsidiaries, purchased 690 GWh, 767 GWh, 684 GWh, 125 GWh, and 213 GWh of power from the WESM, respectively.

For the year ended 31 December 2017, the total consolidated revenue, net income and EBITDA of SMC Global Power were ₱82,791 million, ₱8,217 million and ₱7,654 million, respectively, and for the three months ended 31 March 2018, the total consolidated revenue, net income and EBITDA of SMC Global Power were ₱24,661 million, ₱1,347 million, and ₱3,093 million, respectively, while as of 31 December 2017 and 31 March 2018, SMC Global Power had total consolidated assets of ₱350,173 million and ₱499,922 million, respectively.

The experience of SMC Global Power, through its subsidiaries, in acting as an IPPA and its ownership of the Limay Cogeneration Plant and the AHEPP and construction of Limay and Malita Greenfield Power Plants have enabled SMC Global Power to gain expertise in the Philippine power generation industry. With this experience, SMC Global Power believes it has a strong platform to participate in the expected future growth of the Philippine power market, through both the development of greenfield power plants and the acquisition of existing power generation capacity.

SMC Global Power is considering further expansion of its power portfolio of additional capacity nationwide through greenfield power projects over the next few years, depending on market demand. With the increased development of greenfield power plants, an increasing portion of the portfolio of SMC Global Power is expected from Company-owned and Company-operated IPPs. SMC Global Power would also continue to identify strategic acquisitions of existing power generation capacity by participating in the bidding of selected National Power Corporation of the Philippines ("**NPC**")-owned power generation plants that are scheduled for privatization as asset sales or under the IPPA framework, and privately-owned plants with commercial and technical profile that fit its existing portfolio of power assets.

Furthermore, to the extent viable and allowed under prevailing industry regulations, SMC Global Power is open to opportunities for vertical integration by expanding into businesses along the power sector value chain that complement its current power generation operations. In particular, SMC Global Power intends to pursue downstream integration by capitalizing on changes in the Philippine regulatory structure which allow the expansion into the sale of power to a broader range of customers, including retail customers. With open access and retail competition already implemented, SMC Global Power, through SMELC, SCPC and MPPCL, to enter into retail supply contracts ("**RSCs**") with end-users who have a choice on their supplier of electricity as may be certified by the ERC ("**Contestable Customers**").

SMC Global Power, through SMEC and its subsidiaries, Bonanza Energy Resources, Inc. ("**Bonanza Energy**"), Daguma Agro-Minerals, Inc. ("**Daguma Agro**") and Sultan Energy Phils. Corp. ("**Sultan Energy**"), also owns coal exploration, production and development rights over approximately 17,000 hectares of land in Mindanao which, depending on prevailing global coal prices and the related logistical costs, may be tapped to eventually serve as an additional source of coal fuel for its planned and existing greenfield power plants.

SMC Global Power is a wholly-owned subsidiary of San Miguel Corporation, a diversified conglomerate in the Philippines founded in 1890 that is listed in the Philippine Stock Exchange, Inc. (the "**PSE**") -with market-leading businesses in the food, beverage, packaging, fuel and oil, infrastructure, property and investments in car distributorship and banking. The relationship of SMC Global Power with San Miguel Corporation allows it to draw on the extensive business networks, local business knowledge, relationships and expertise of senior key executive officers of San Miguel Corporation.

**Competitive Strengths**

SMC Global Power believes its competitive strengths are the following:

- leading power company in the Philippines with a strong growth platform;
- stable and predictable cash flows underpinned by long-term offtake agreements;
- flexible and diversified power portfolio;
- established and strong relationships with world class partners;
- strong parent company support;
- experienced management, operating, trading and marketing teams; and
- well-positioned to capitalize on the anticipated growth of the Philippine electricity market.

**Business Strategies**

The principal strategies of SMC Global Power are set out below:

- optimize the generation capacity of its power portfolio;
- continue to grow its power portfolio through the development and acquisition of power generation capacity;
- integrate complementary businesses; and
- leverage on commercial and operational synergies with San Miguel Corporation affiliates.

**Risk of Investing**

Prospective investors should also consider the following risks of investing in the Offer:

- Macroeconomic risks, including the current and immediate political and economic factors in the Philippines and the experience of the country with natural catastrophes, as a principal risk for investing in general;
- Risks relating to San Miguel Corporation, its subsidiaries and their business and operations; and

- The nature, the absence of a liquid secondary market and volatility, and other risks relating to the Offer.

For a more detailed discussion, see “Risk Factors and Other Considerations” in the Prospectus.

**CORPORATE INFORMATION**

SMC Global Power is incorporated under the laws of the Philippines. The registered office and principal place of business of SMC Global Power is located at SMC Global Power Holdings Corp., 155 EDSA, Wack-Wack, Mandaluyong City, Philippines. The telephone number of SMC Global Power is (632) 702 4500.

## Summary of Financial Information

*Prospective purchasers of the Offer should read the summary financial data below together with the financial statements, including the notes thereto, included in this Offer Supplement and "Management's Discussion and Analysis of Results of Operations and Financial Condition". The summary financial data for the 3 years ended 31 December 2017, 2016 and 2015 are derived from the audited financial statements of SMC Global Power, including the notes thereto, which are found as Annex "B" of this Offer Supplement. The detailed financial information for the 3 years ended 31 December 2017, 2016 and 2015 are found on Annex "B" of this Offer Supplement and the 3 months ended 31 March 2018 and 2017 are found on Annex "A" of this Offer Supplement.*

The summary of financial and operating information presented below as of and for the years ended 31 December 2017, 2016 and 2015 were derived from the consolidated financial statements of SMC Global Power, audited by R.G. Manabat & Co. and prepared in compliance with the Philippine Financial Reporting Standards ("**PFRS**"). The financial and operating information presented below as of and for the three months ended 31 March 2018 and 2017 were derived from the unaudited consolidated financial statements of SMC Global Power prepared in compliance with Philippine Accounting Standards ("**PAS**") 34, "Interim Financial Reporting". The information below should be read in conjunction with the consolidated financial statements of SMC Global Power and the related notes thereto, which are included in Appendices "A" and "B" of this Offer Supplement. The historical financial condition, results of operations and cash flows of SMC Global Power are not a guarantee of its future operating and financial performance.

| | For the years ended December 31 | | | For the three months ended March 31 | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| | (Audited) | | | (Unaudited) | |
| | (in millions of ₱ except per share data) | | | | |
| **Consolidated Statements of Income Data** | | | | | |
| **Revenues** | 77,506.7 | 77,972.4 | 82,790.6 | 19,353.2 | 24,660.5 |
| **Costs and Expenses** | | | | | |
| Cost of power sold: | | | | | |
| Energy fees | 23,224.2 | 20,477.9 | 23,726.5 | 5,408.0 | 5,562.8 |
| Coal, fuel oil and other consumables | 10,376.6 | 10,046.7 | 13,039.1 | 3,828.3 | 5,256.6 |
| Power purchases | 8,330.6 | 7,836.6 | 10,725.5 | 1,473.4 | 2,579.1 |
| Depreciation and amortization | 6,466.4 | 6,164.9 | 5,842.4 | 1,410.1 | 1,765.3 |
| Plant operations and maintenance fees | 502.2 | 476.3 | 345.3 | 29.0 | 298.7 |
| Selling and administrative expenses | 4,904.1 | 6,239.7 | 4,835.5 | 1,164.1 | 1,206.9 |
| | 53,804.1 | 51,242.1 | 58,514.3 | 13,312.9 | 16,669.4 |
| | 23,702.6 | 26,730.3 | 24,276.3 | 6,040.3 | 7,991.1 |
| **Interest income** | 414.4 | 200.5 | 460.9 | 53.6 | 155.5 |
| **Gain on sale of property, plant and equipment** | - | 116.4 | - | - | - |
| **Equity in net earnings (losses) of associates and joint ventures – net** | (528.4) | (294.8) | (40.4) | 28.4 | (17.6) |
| **Interest expense and other financing charges** | (13,130.3) | (12,354.2) | (13,244.6) | (2,906.0) | (3,415.0) |
| **Other income (charges) - net** | (5,926.0) | (6,881.8) | 2,944.2 | (1,215.1) | (3,002.1) |
| **Income before income tax** | 4,532.3 | 7,516.4 | 14,396.4 | 2,001.2 | 1,711.9 |
| **Income tax expense – net** | 2,703.4 | 3,365.7 | 6,179.5 | 874.6 | 365.0 |
| **Net Income** | 1,828.9 | 4,150.7 | 8,216.9 | 1,126.6 | 1,346.9 |
| Attributable to: | | | | | |
| Equity holders of the Parent Company | 1,828.9 | 4,150.7 | 8,216.9 | 1,126.6 | 1,346.6 |
| Non-controlling interest | - | - | - | - | 0.3 |
| | 1,828.9 | 4,150.7 | 8,216.9 | 1,126.6 | 1,346.9 |
| Earnings per common share attributable to equity holders of the Parent Company basic/diluted | (₱0.07) | ₱0.97 | ₱4.11 | ₱0.29 | ₱0.37 |

| | As of December 31 | | | As of March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| | (Audited) | | | (Unaudited) | |
| | (in millions of ₱) | | | | |
| **Consolidated Statements of Financial Position Data** | | | | | |
| **ASSETS** | | | | | |
| **Current Assets** | | | | | |
| Cash and cash equivalents . . . . . . . . . | 22,241.4 | 21,491.4 | 28,655.3 | 12,924.3 | 32,465.7 |
| Trade and other receivables – net . . . . | 18,473.6 | 22,342.9 | 20,435.1 | 25,456.8 | 26,906.3 |
| Inventories . . . . . . . . . . . . . . . . . . . . . | 1,263.2 | 2,272.3 | 3,147.7 | 2,277.1 | 5,383.4 |
| Prepaid expenses and other current assets | 15,068.8 | 17,683.0 | 17,791.9 | 17,223.3 | 20,377.3 |
| Assets held for sale . . . . . . . . . . . . . . | - | 184.3 | - | 184.3 | - |
| **Total Current Assets** . . . . . . . . . . . . | 57,047.0 | 63,973.9 | 70,030.0 | 58,065.8 | 85,132.7 |
| **Noncurrent Assets** | | | | | |
| Investments and advances – net . . . . . | 10,612.9 | 16,245.4 | 16,621.1 | 16,436.1 | 16,884.2 |
| Property, plant and equipment – net . . | 255,453.0 | 246,488.0 | 250,961.3 | 248,049.6 | 312,707.2 |
| Deferred exploration and development costs . . . . . . . . . . . . . . . . . . . . . . . . | 689.6 | 693.4 | 699.0 | 694.2 | 700.0 |
| Intangible assets and goodwill – net . . | 2,413.2 | 2,572.1 | 2,594.2 | 2,583.2 | 72,587.1 |
| Deferred tax assets . . . . . . . . . . . . . . . | 2,746.0 | 2,955.6 | 1,316.9 | 2,889.6 | 1,633.8 |
| Other noncurrent assets – net . . . . . . . | 2,248.2 | 1,020.8 | 7,950.5 | 1,039.1 | 10,277.0 |
| **Total Noncurrent Assets** . . . . . . . . . . | 274,162.9 | 269,975.3 | 280,143.0 | 271,691.8 | 414,789.3 |
| | 331,209.9 | 333,949.2 | 350,173.0 | 329,757.6 | 499,922.0 |
| **LIABILITIES AND EQUITY** | | | | | |
| **Current Liabilities** | | | | | |
| Loans payable. . . . . . . . . . . . . . . . . . . | - | - | 5,930.0 | 10,032.0 | 8,277.2 |
| Accounts payable and accrued expenses . . | 32,841.0 | 37,729.4 | 31,074.8 | 34,902.1 | 41,192.4 |
| Finance lease liabilities - current portion . . . | 16,546.8 | 16,344.3 | 16,844.4 | 16,253.1 | 17,824.4 |
| Current maturities of long term debt – net of debt issue costs. . . . . . . . . . . . . . | 15,647.2 | 1,040.7 | 1,139.6 | 1,455.4 | 3,121.7 |
| Income tax payable . . . . . . . . . . . . . . | 99.3 | 127.2 | 151.9 | 383.7 | 525.4 |
| **Total Current Liabilities** . . . . . . . . . . . | 65,134.3 | 55,241.6 | 55,140.7 | 63,026.3 | 70,941.1 |
| **Noncurrent Liabilities** | | | | | |
| Long-term debt - net of current maturities and debt issue costs . . . . | 42,960.6 | 65,283.0 | 89,589.1 | 55,458.9 | 182,851.2 |
| Finance lease liabilities - net of current portion . . . . . . . . . . . . . . . . . . . . . . . | 162,646.5 | 153,745.3 | 137,949.3 | 150,834.5 | 136,568.8 |
| Deferred tax liabilities . . . . . . . . . . . . . | 3,882.9 | 4,785.2 | 7,324.1 | 5,128.3 | 7,468.6 |
| Other noncurrent liabilities – net of current portion . . . . . . . . . . . . . . . . | 150.3 | 223.5 | 404.3 | 233.0 | 8,451.1 |
| **Total Noncurrent Liabilities** . . . . . . . | 209,640.3 | 224,037.0 | 235,266.8 | 211,654.7 | 335,339.7 |
| **Total Liabilities** . . . . . . . . . . . . . . . . | 274,774.6 | 279,278.6 | 290,407.5 | 274,681.0 | 406,280.8 |
| **Equity** | | | | | |
| Capital stock . . . . . . . . . . . . . . . . . . . . | 1,062.5 | 1,062.5 | 1,062.5 | 1,062.5 | 1,062.5 |
| Additional paid-in capital . . . . . . . . . . . | 2,490.0 | 2,490.0 | 2,490.0 | 2,490.0 | 2,490.0 |
| Redeemable perpetual securities. . . . . | - | - | - | - | 33,127.7 |
| Undated subordinated capital securities . . | 26,933.6 | 26,933.6 | 26,933.6 | 26,933.6 | 26,933.6 |
| Equity reserves . . . . . . . . . . . . . . . . . . . . . | 769.7 | 758.9 | 761.6 | 758.9 | 796.1 |
| Retained earnings . . . . . . . . . . . . . . . | 25,179.5 | 23,425.6 | 28,517.8 | 23,831.6 | 29,033.0 |
| | 56,435.3 | 54,670.6 | 59,765.5 | 55,076.6 | 93,442.9 |
| Non-controlling interest . . . . . . . . . . . | - | - | - | - | 198.3 |
| **Total Equity** . . . . . . . . . . . . . . . . . . . | 56,435.3 | 54,670.6 | 59,765.5 | 55,076.6 | 93,641.2 |
| | 331,209.9 | 333,949.2 | 350,173.0 | 329,757.6 | 499,922.0 |

| | For the years ended December 31 | | | For the three months ended March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| | (Audited) | | | (Unaudited) | |
| | (in millions of ₱) | | | | |
| **Cash Flow Data** | | | | | |
| Net cash provided by (used in): | | | | | |
| Operating activities | 25,030.1 | 30,479.6 | 21,845.3 | 1,479.9 | 10,594.6 |
| Investing activities | (34,530.1) | (6,017.4) | (16,279.3) | (3,167.9) | (97,343.1) |
| Financing activities | (6,955.4) | (25,233.8) | 1,526.7 | (6,887.0) | 90,116.1 |
| Effect of exchange rates changes on cash and cash equivalents | 392.5 | 21.6 | 71.2 | 7.9 | 442.7 |
| Net increase (decrease) in cash and cash equivalents | (16,062.9) | (750.0) | 7,163.9 | (8,567.0) | 3,810.3 |
| Cash and cash equivalents at beginning of year | 38,304.3 | 22,241.4 | 21,491.4 | 21,491.4 | 28,655.4 |
| Cash and cash equivalents at end of period | 22,241.4 | 21,491.4 | 28,655.3 | 12,924.3 | 32,465.7 |

## Summary of the Offer

The terms and conditions of this Offer are as follows:

| | |
|---|---|
| Issuer…….............. | SMC Global Power Holdings Corp. |
| Instrument…………. | Fixed rate bonds constituting the direct, unconditional, unsecured and unsubordinated Peso-denominated obligations of SMC Global Power. |
| Offer Size………….. | ₱15,000,000,000 |
| The Offer………….. | The Offer Bonds will be issued in 1 series, namely, the 5-year Series G Bonds due 2023. |
| Manner of Distribution………… | Public offering in the Philippines to eligible investors. |
| Use of Proceeds…………... | The entire proceeds for this Offer will be used for: (i) refinancing the outstanding shareholder advances and partially refinancing existing loan obligations and/or re-denomination of US Dollar denominated obligations of the Company and (ii) payment of transaction-related fees, costs and expenses.<br><br>For a detailed discussion on the Use of Proceeds, please refer to the section on "*Use of Proceeds*" in this Offer Supplement and in the Prospectus. |
| Form and Denomination of the Bonds……….. | The Offer Bonds shall be issued in scripless form in minimum denominations of ₱50,000 each, and in integral multiples of ₱10,000 thereafter. |
| Purchase Price……. | The Offer Bonds shall be issued at 100% of face value. |
| Offer Period……….. | The Offer shall commence at 9:00 a.m., Manila time, on 6 August 2018 and end at 5:00 p.m. on 10 August 2018, or on such other date as the Issuer, Joint Issue Managers, Joint Lead Underwriters and Bookrunners may agree upon. |
| Issue Date of the Offer Bonds……….. | 17 August 2018 |
| Maturity Date……... | Series G Bonds: 17 August 2023 or the 5th anniversary of the Issue Date |
| Interest Rate……… | Series G Bonds: 6.75% per annum |

<table>
<tr><td>Interest Payment Dates and Interest Payment Computation………</td><td>Interest payment on the Offer Bonds shall commence on 17 November 2018 and thereafter, on February 17, May 17, August 17, and November 17 of each year, or the next Business Day if such date falls on a non-Business Day, during the term of the Offer Bonds (each, an “Interest Payment Date”).<br><br>Interest on the Offer Bonds shall be calculated on a European 30/360-day count basis regardless of the actual number of days in a month. Interest shall be paid quarterly in arrears.</td></tr>
<tr><td>Final Redemption…</td><td>The Offer Bonds shall be redeemed at par or 100% of face value on the Maturity Date, unless earlier redeemed or purchased and cancelled by the Company.<br><br>In the event the relevant Maturity Date is not a Business Day, payment of all amounts due on such date will be made by the Issuer through the Paying Agent, without adjustment for accrued interest, on the succeeding Business Day.</td></tr>
<tr><td>Optional Redemption……….</td><td>The Issuer shall have the right, but not the obligation, to redeem in whole (but not in part) the outstanding Series G Bonds on the dates set out below (each an “Optional Redemption Date”):<br><br>
<table>
<tr><th colspan="2">Series G Bonds</th></tr>
<tr><th>Optional Redemption Dates</th><th>Optional Redemption Price</th></tr>
<tr><td>On the 3rd year from Issue Date</td><td>101.0%</td></tr>
<tr><td>On the 4th year from Issue Date</td><td>100.5%</td></tr>
</table>
<br>Provided, that if the relevant Optional Redemption Date falls on a day that is not a Business Day, then the payment of the optional redemption price shall be made by the Issuer on the next Business Day, without adjustment to the amount of interest and Optional Redemption Price to be paid. For the avoidance of doubt, the Bondholders shall not have any right to cause the Issuer redeem the Offer Bonds pursuant to this Optional Redemption Option.<br><br>The amount payable to the Bondholders upon the exercise of the Optional Redemption Option by the Issuer shall be calculated, based on the principal amount of the Offer Bonds being redeemed, as the sum of: (i) accrued interest computed from the last Interest Payment Date up to and including the relevant Optional Redemption Date; and (ii) the product of the principal amount of the Offer Bonds being redeemed and the Optional Redemption Price in accordance with the above table.<br><br>The Issuer shall give no less than 30 nor more than 60 days’ prior written notice to the Trustee, the Registrar and Paying Agent of its intention to redeem the Offer Bonds which notice shall be irrevocable and binding upon the Issuer to effect such Optional Redemption of the Offer Bonds on the Optional Redemption Date stated in such notice.</td></tr>
</table>

| | |
|---|---|
| | For a detailed discussion on Optional Redemption please refer to the section on "*Description of the Offer Bonds – Optional Redemption*" in this Offer Supplement. |
| Redemption for Taxation Reasons... | If payments under the Offer Bonds become subject to additional or increased taxes other than the taxes and rates of such taxes prevailing on the Issue Date as a result of certain changes in law, rule or regulation, or in the interpretation thereof, and such additional or increased rate of such tax cannot be avoided by use of reasonable measures available to the Issuer, then the Issuer may redeem the Offer Bonds in whole, but not in part, on any Interest Payment Date (having given not more than 60 days nor less than 30 days' prior written notice to the Trustee, the Registrar and the Paying Agent) at par (or 100% of face value) and paid together with the accrued interest thereon, subject to the requirements of Applicable Law.<br><br>The Bondholders shall not have any right to cause the Issuer to redeem the Offer Bonds due to taxation reasons.<br><br>For a detailed discussion on Redemption for Taxation Reasons please refer to the section on "*Description of the Offer Bonds – Redemption for Taxation Reasons*" in this Offer Supplement. |
| Redemption by Reason of Change in Law or Circumstance…….. | Upon the occurrence of a Change in Law or Circumstance, the Issuer may redeem the Offer Bonds in whole, but not in part, having given not more than 60 days' nor less than 30 days' written notice to the Trustee, the Registrar and the Paying Agent, at par (or 100% of face value) and paid together with accrued interest thereon.<br><br>The Bondholders shall not have any right to cause the Issuer to redeem the Offer Bonds pursuant to a Change in Law or Circumstance.<br><br>For a detailed discussion on Redemption for Taxation Reasons please refer to the section on "*Description of the Offer Bonds – Redemption by Reason of Change in Law or Circumstance*" in this Offer Supplement. |
| Redemption by Reason of Change of Control……………. | Upon the occurrence of a Change of Control, Bondholders holding at least 2/3 of the outstanding principal amount of the Offer Bonds may require the Issuer to redeem all (but not some) of the Offer Bonds, at par (or 100% of face value) which shall be paid together with the accrued interest thereon. The decision of the Bondholders holding at least 2/3 of the outstanding principal amount of the Offer Bonds shall be conclusive and binding upon all the Bondholders.<br><br>For a detailed discussion on Redemption for Taxation Reasons please refer to the section on "*Description of the Offer Bonds – Redemption by Reason of Change of Control*" in this Offer Supplement. |

| | |
|---|---|
| Status of the Bonds | The Offer Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Issuer and shall at all times rank pari passu and ratably without any preference or priority amongst themselves and at least pari passu with all other present and future, unsecured and unsubordinated Debt of the Issuer, other than Debt mandatorily preferred by law, and preferred claims under any bankruptcy, insolvency, reorganization, moratorium, liquidation or other similar laws affecting the enforcement of creditors' rights generally and by general principles of equity (but not the preference or priority established by Article 2244(14)(a) of the Civil Code of the Philippines). |
| Negative Pledge | The Offer Bonds will have the benefit of a negative pledge on all properties and assets of the Issuer and its Material Subsidiaries, subject to the exceptions as described in this Offer Supplement. |
| Listing | The Issuer intends to list the Offer Bonds in the PDEx on Issue Date. |
| Purchase and Cancellation | The Issuer may purchase the Offer Bonds at any time at the open market or by tender or by contract, in accordance with PDEx rules, without any obligation to make pro rata purchased from all Bondholders. Offer Bonds so purchased shall be redeemed and cancelled and may not be reissued. Upon listing of the Offer Bonds in the PDEx, the Issuer shall disclose any such transaction in accordance with the applicable PDEx disclosure rules. |
| Bond Rating | The Offer Bonds have been rated PRS Aaa by the Philippine Rating Services Corporation ("**PhilRatings**") on 4 July 2018.<br><br>The rating is subject to regular annual reviews, or more frequently as market developments may dictate, while the Offer Bonds are outstanding. |
| Transfer of the Offer Bonds | Trading of the Offer Bonds will be coursed through a PDTC participant under the scripless book-entry system of the PDTC. Trading, transfer and/or settlement of the Offer Bonds shall be performed in accordance with the PDTC rules and procedures to be set by the Issuer and the Registrar. Upon any assignment, title to the Offer Bonds will pass by recording of the transfer from the transferor to the transferee in the Registry of Bondholders.<br><br>Please see the section on "*Description of the Offer Bonds – Transfer; Tax Status*" in this Offer Supplement for a more detailed discussion on the transfer of the Offer Bonds. |
| Joint Issue Managers | BDO Capital & Investment Corporation<br>BPI Capital Corporation<br>China Bank Capital Corporation<br>PNB Capital and Investment Corporation |
| Joint Lead Underwriters and Bookrunners | BDO Capital & Investment Corporation<br>BPI Capital Corporation<br>China Bank Capital Corporation<br>PNB Capital and Investment Corporation |

| | |
|---|---|
| Registry and Paying Agent | Philippine Depository & Trust Corp. |
| Trustee | Philippine National Bank – Trust Banking Group |
| Counsel to SMC Global Power | Picazo Buyco Tan Fider & Santos |
| Counsel to the Joint Lead Underwriters and Bookrunners | SyCip Salazar Hernandez & Gatmaitan |
| Incorporation by way of Reference | All disclosures, reports, and filings of the Company made after the date of the Prospectus and this Offer Supplement (the "**Company Disclosures**") and submitted to the SEC and/or PDEX pursuant to the Corporation Code, the Securities Regulation Code, and the disclosure rules of PDEX are incorporated or deemed incorporated by reference in this Offer Supplement. Copies of the Company Disclosures may be viewed at the website of the Company at http://www.smcglobalpower.com.ph. The Company Disclosures contain material and meaningful information relating to the Company and investors should review all information contained in the Prospectus, this Offer Supplement and the Company Disclosures incorporated or deemed incorporation herein by reference. |

# Description of the Offer Bonds

*The following does not purport to be a complete listing of all the rights, obligations, or privileges of the Offer Bonds. Some rights, obligations, or privileges may be further limited or restricted by other documents. Prospective investors are enjoined to carefully review the articles of incorporation, by-Laws and resolutions of the Board of Directors of SMC Global Power submitted to the SEC, the information contained in this Offer Supplement, the Trust Agreement, Registry and Paying Agency Agreement ("**RPAA**"), Issue Management and Underwriting Agreement (the "**Underwriting Agreement**"), and other documents relevant to the Offer, Applicable Law, rules and regulations of PDTC and PDEx relevant to the Offer, and to perform their own independent investigation and analysis of the Issuer and the Offer Bonds. Prospective Bondholders must make their own appraisal of the Issuer and the Offer, and must make their own independent verification of the information contained herein and the other aforementioned documents and any other investigation they may deem appropriate for the purpose of determining whether to participate in the Offer. They must not rely solely on any statement or the significance, adequacy or accuracy of any information contained herein. The information and data contained herein are not a substitute for the prospective investor's independent evaluation and analysis. Prospective Bondholders are likewise encouraged to consult their legal counsels and accountants in order to be better advised of the circumstances surrounding the Offer Bonds.*

The offer and issuance of the Bonds, in one or more tranches, was authorized by a resolution of the Board of Directors of the Company on 8 August 2017. The Offer Bonds, with an aggregate principal amount of ₱15,000,000,000.00, shall be issued as the second tranche of the shelf-registered Bonds. The Offer Bonds will be issued on the Issue Date, that is 17 August 2018, as 5-year Series G Bonds due 2023.

The Offer Bonds shall be governed by a Trust Agreement dated 2 August 2018 between the Issuer and Philippine National Bank – Trust Banking Group as Trustee. The Trustee has no interest in or relation to the Issuer which may conflict with the performance of its functions. The description of the terms and conditions of the Offer Bonds set out below includes summaries of, and is subject to, the detailed provisions of the Trust Agreement.

An RPAA in relation to the Offer Bonds was executed on 2 August 2018 between the Issuer and PDTC as Registrar and Paying Agent. PDTC has no interest in or relation to the Issuer which may conflict with the performance of its functions.

Copies of the Trust Agreement and the RPAA are available for inspection during normal business hours at the specified offices of the Trustee. The Bondholders are entitled to the benefit of, are bound by, and are deemed to have notice of all the provisions of the Trust Agreement and all the provisions of the RPAA applicable to them.

**Form and Denomination**

The Offer Bonds shall be issued in scripless form. A Master Certificate of Indebtedness representing the Series G Bonds sold in the Offer shall be issued to and registered in the name of the Trustee for the benefit of the Bondholders.

The Offer Bonds shall be issued in minimum denominations of ₱50,000.00 each, and in integral multiples of ₱10,000.00 thereafter, and traded in denominations of ₱10,000.00 in the secondary market.

**Title**

Legal title to the Offer Bonds will be shown in the Registry of Bondholders maintained by the Registrar. A notice confirming the principal amount of the Offer Bonds purchased by each applicant in the Offer shall be issued by the Registrar to all Bondholders following the Issue Date.

Upon any assignment, title to the Offer Bonds shall pass by recording of the transfer from the transferor to the transferee in the Registry of Bondholders maintained by the Registrar.

## BOND RATING

The Offer Bonds have been rated PRS Aaa with a Stable Outlook by PhilRatings. PRS Aaa is the highest rating assigned by PhilRatings. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating agency.

The rating is subject to regular annual review, or more frequently as market developments may dictate, for as long as the Offer Bonds are outstanding. After Issue Date, the Trustee shall monitor the compliance of the Offer Bonds with the regular annual reviews.

## TRANSFER OF BONDS

### Registry of Bondholders

The Issuer will cause the Registry of Bondholders to be kept by the Registrar, in electronic form. The names and addresses of the Bondholders and the particulars of the Offer Bonds held by them and of all transfers and assignments of the Offer Bonds, including any liens and encumbrances thereon, shall be entered into the Registry of Bondholders. Transfers of ownership shall be effected through book-entry transfers in the scripless Registry of Bondholders.

As required by Circular No. 428-04 issued by the BSP, the Registrar shall send each Bondholder a written statement of registry holdings at least every quarter (at the cost of the Issuer), and a written advice confirming every receipt or transfer of the Offer Bonds that is effected in the Registrar's system. Such statement of registry holdings shall serve as the confirmation of ownership of the relevant Bondholder as of the date thereof. Any requests of Bondholders for certifications, reports or other documents from the Registrar, except as provided herein, shall be for the account of the requesting Bondholder. No transfer of the Offer Bonds may be made during the period commencing on a Record Date

### Transfers; Tax Status

Settlement in respect of such transfers or change of title to the Offer Bonds, including the settlement of any documentary stamps taxes, if any, arising from subsequent transfers, shall be for the account of the relevant Bondholder or the transferee, as applicable.

Subject to the provisions of the RPAA, the relevant rules, conventions and guidelines of PDEx and PDTC, the Bondholders may not transfer their Offer Bonds as follows:

(a) transfers across Tax Categories on a date other than an Interest Payment Date that falls on a Business Day; provided, however, that transfers from a tax-exempt Tax Category to a taxable Tax Category on a date other than an Interest Payment Date shall be allowed using the applicable tax-withheld series name on PDEx, ensuring the computations are based on the final withholding tax rate of the taxable party to the trade. Should this transaction occur, the tax-exempt person shall be treated as being of the same Tax Category as its taxable counterparty for the interest period within which such transfer occurred; provided, finally, that this restriction shall be in force until a Non-Restricted Trading & Settlement Environment for Corporate Securities is implemented. For purposes hereof, "**Tax Categories**" shall refer to the 4 final withholding tax categories in the PDEx system covering, particularly, tax-exempt persons, 20% tax-withheld persons, 25% tax-withheld persons, and 30% tax-withheld persons, as such categories may be revised, amended or supplemented by PDEx in accordance with its rules and Applicable Law;

(b) transfers by Bondholders with deficient documents; and

(c) transfers during a Closed Period. For purposes hereof, "**Closed Period**" means the period during which the Registrar shall not register any transfer or assignment of the Offer Bonds, specifically: (i) the period of 2 Business Days preceding any Interest Payment Date or the due date for any payment of the Final Redemption Amount of the Offer Bonds; or (ii) the period when any of the Offer Bonds have been previously called for redemption.

Transfers taking place in the Registry of Bondholders after the Offer Bonds are listed in PDEx may be allowed between taxable and tax-exempt entities without restriction and observing the tax exemption of tax-exempt entities, if/and or when so allowed under and in accordance with the relevant rules, conventions and guidelines of PDEx and PDTC.

A Bondholder claiming tax-exempt status is required to submit to the Registry of Bondholders the required tax-exempt documents as detailed in the RPAA upon submission of the account opening documents to the Registrar. Please see the section on "*Description of the Offer Bonds –Tax-Exempt Status or Entitlement to Preferential Tax Rate*" for a detailed discussion on the requirements for claiming a preferential tax status.

Notwithstanding the submission by the Bondholder, or the receipt by the Issuer, the Registrar, the Joint Lead Underwriters and Bookrunners of documentary proof of tax-exempt status of a Bondholder, the Issuer may, in its sole and reasonable discretion, determine that such Bondholder is taxable and require the Registrar and Paying Agent to proceed to apply the tax due on the Offer Bonds. Any question on such determination shall be referred to the Issuer.

The Bondholders shall be responsible for monitoring and accurately reflecting their tax status in the Registry of Bondholders. The payment report to be prepared by the Registrar and submitted to the Issuer in accordance with the RPAA, which shall be the basis of payments on the Offer Bonds on any Interest Payment Date, shall reflect the tax status of the Bondholders as indicated in their accounts as of the Record Date.

### Secondary Trading of the Offer Bonds

The Issuer intends to list the Offer Bonds on PDEx for secondary market trading and, for that purpose, the Issuer has filed an application for such listing. However, there can be no assurance that such a listing will actually be achieved or whether such a listing will materially affect the liquidity of the Offer Bonds on the secondary market. Such listing would be subject to the Issuer's execution of a listing agreement with PDEx that may require the Issuer to make certain disclosures, undertakings and payments on an ongoing basis.

For so long as any of the Offer Bonds are listed on PDEx, the Offer Bonds will be traded in a minimum board lot size of ₱10,000.00, and in multiples of ₱10,000.00 in excess thereof. Secondary market trading in PDEx shall follow the applicable PDEx rules, including rules, conventions and guidelines governing trading and settlement between Bondholders of different tax status, and shall be subject to the relevant fees of PDEx and PDTC, all of which shall be for the account of the Bondholders.

## RANKING

The Offer Bonds shall constitute the direct, unconditional, unsecured and unsubordinated obligations of the Issuer ranking at least *pari passu* and ratably without any preference or priority among themselves and at least *pari passu* with all its other present and future, contingent or otherwise, unsecured and unsubordinated obligations of the Issuer, except for any statutory preference or priority established by law.

## INTEREST

### Interest Payment Dates

Each Series G Bond bear interest on its principal amount from and including Issue Date at the rate of 6.75% per annum, payable quarterly in arrears starting on 17 November 2018 as the first Interest Payment Date, and on February 17, May 17, August 17, and November 17 of each year at which the Series G Bonds are outstanding as the subsequent Interest Payment Dates, or the subsequent Business Day, without adjustment for accrued interest, if the relevant Interest Payment Date falls on a non-Business day.

The cut-off date in determining the existing Bondholders entitled to receive interest, principal or any amount due under the Offer Bonds shall be two (2) Business Days prior to the relevant Payment Date or such other date as the Issuer may duly notify PDTC (the "**Record Date**"). The Record Date shall be the reckoning date in determining the Bondholders entitled to receive interest, principal or any other amount due under the Offer Bonds. No transfers of the Bonds may be made during this period intervening between and commencing on the Record Date and the relevant Interest Payment Date.

### Interest Accrual

The Offer Bonds shall cease to bear interest from and including the relevant Maturity Date, as defined in the discussion on "*Description of the Offer Bonds - Final Redemption*" below, unless, upon due presentation, payment of the principal in respect of the Offer Bonds then outstanding is not made, is improperly withheld or refused, in which case the Penalty Interest (see "*Description of the Offer Bonds - Penalty Interest*" below) shall apply.

### Calculation of Interest

The interest shall be calculated on a European 30/360-day count basis, regardless of the actual number of days in a month.

## REDEMPTION AND PURCHASE

### Final Redemption

Unless earlier redeemed, purchased and cancelled, each of the Offer Bonds will be redeemed at par or 100.00% of their face value on their respective Maturity Dates. However, if the relevant Maturity Date is not a Business Day, payment of all amounts due on such date will be made by the Issuer through the Paying Agent, without adjustment for accrued interest, on the succeeding Business Day.

Each Bondholder in whose name the Offer Bonds are registered in the Registry of Bondholders at the close of business on the Record Date preceding any Maturity Date shall be entitled to receive the principal amount of the Offer Bonds. In all cases, repayment of principal shall be remitted to the Bondholders in accordance with the terms of the RPAA.

### Optional Redemption

The Issuer shall have the right, but not the obligation, to redeem in whole (but not in part), the outstanding Series G Bonds on the dates set out below (each an "**Optional Redemption Date**"):

| **Series G Bonds** | |
|---|---|
| **Optional Redemption Dates** | **Optional Redemption Price** |
| On the 3rd year from Issue Date | 101.0% |
| On the 4th year from Issue Date | 100.5% |

provided, that if the relevant Optional Redemption Date falls on a day that is not a Business Day, then the payment of the optional redemption price shall be made by the Issuer on the next Business Day, without adjustment to the amount of interest and optional redemption price to be paid. For the avoidance of doubt, the Bondholders shall not have any right to cause the Issuer redeem the Offer Bonds pursuant to this Optional Redemption Option.

The amount payable to the Bondholders upon exercise of the optional redemption by the Issuer shall be calculated based on the principal amount of the Offer Bonds being redeemed, as the sum of (i) the accrued interest computed from the last Interest Payment Date up to the relevant Optional Redemption Date; and (ii) the product of the principal amount of the Offer Bonds being redeemed and the optional redemption price in accordance with the table above.

The Issuer shall give no less than thirty (30) nor more than sixty (60) days prior written notice to the Trustee, the Registrar and Paying Agent of its intention to redeem the Offer Bonds, which notice shall be irrevocable and binding upon the Issuer to effect such optional redemption of the Offer Bonds on the Optional Redemption Date stated in such notice. Upon receipt by the Trustee of such notice, the Trustee shall, through the Issuer secure from the Registrar an updated list of Bondholders as of the Record Date indicated in the notice from the Issuer and provide written notices to all registered Bondholders of the intended optional redemption. Each Bondholder in whose name the Offer Bonds subject of the optional redemption are registered in the Registry of Bondholders at the close of business on the relevant Record Date shall be entitled to receive the interest and optional redemption price. The Issuer shall pay the Bondholders in accordance with the terms of the RPAA.

**Redemption for Taxation Reasons**

If payments under the Offer Bonds become subject to additional or increased taxes other than the taxes and rates of such taxes prevailing on the Issue Date as a result of certain changes in law, rule or regulation, or in the interpretation thereof, and such additional or increased rate of such tax cannot be avoided by use of reasonable measures available to the Issuer, the Issuer may redeem the relevant Offer Bond series in whole, and not in part only, on any Interest Payment Date (having given not more than 60 nor less than 30 days' written notice to the Trustee, Registrar and Paying Agent) at par (or 100% of face value) and paid together with the accrued interest thereon, subject to the requirements of Applicable Law; provided that if the Issuer does not redeem the Offer Bonds then all payments of principal and interest in respect of the Offer Bonds shall be made free and clear of, and without withholding or deduction for, any such new or additional taxes, duties, assessments or governmental charges, unless such withholding or deduction is required by Applicable Law. In that event, the Issuer shall pay to the Bondholders concerned, such additional amount as will result in the receipt by such Bondholders of such amounts as would have been received by them had no such withholding or deduction for new or additional taxes been required.

Upon receipt by the Trustee of a written notice from the Issuer hereunder, the Trustee through the Issuer shall secure from the Registrar an updated list of Bondholders as of the Record Date indicated in the notice from the Issuer and provide written notices to all registered Bondholders of the intended optional redemption. Each Bondholder in whose name the Offer Bonds subject of the optional redemption are registered in the Registry of Bondholders at the close of business on the relevant Record Date shall be entitled to receive the principal of the Offer Bonds subject of the optional redemption and the interest accrued thereon. The Issuer shall pay the Bondholders in accordance with the terms of the RPAA.

Accrued interest on the Offer Bonds to be redeemed under this section for the last Interest Payment Date up to the relevant redemption date shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

The Bondholders shall not have any right to cause the Issuer to redeem the Offer Bonds under this section.

**Redemption by Reason of Change in Law or Circumstance**

Upon the occurrence of a Change in Law or Circumstance (as enumerated below), the Issuer may redeem the Offer Bonds in whole, but not in part (having given not more than 60 days' nor less than 30 days' written notice to the Trustee, the Registrar and the Paying Agent, at par (or 100% of face value) and paid together with the accrued interest thereon.

The following events shall be considered as changes in law or circumstance (each a "**Change in Law or Circumstance**") as it refers to the obligations of the Issuer and to the rights and interests of the Bondholders under the Trust Agreement:

(a) Any government and/or non-government consent, license, authorization, registration or approval now or hereafter necessary to enable the Issuer to comply with its obligations under the Trust Agreement or the Offer Bonds shall be modified, withdrawn or withheld in a manner which shall materially and adversely affect the ability of the Issuer to comply with such obligations, or

(b) Any provision of the Transaction Documents (in whole or in part) is or becomes, for any reason, invalid, illegal or unenforceable to the extent that it becomes for any reason unlawful for the Issuer to give effect to its rights or obligations hereunder, or to enforce any provision hereunder or thereunder; or any law is introduced or any existing Applicable Law is modified or rendered ineffective or inapplicable to prevent or restrain the performance by the Issuer of its obligations under the Transaction Documents.

(c) Any concession, permit, right, franchise or privilege required for the conduct of the business and operations of the Issuer shall be revoked, cancelled or otherwise terminated, or the free and continued use and exercise thereof shall be curtailed or prevented, in such manner as to materially and adversely affect the financial condition or operations of the Issuer; or

(d) The Philippines or any competent authority thereof takes any action to suspend the whole or a substantial portion of the operations of the Issuer and to condemn, seize, nationalize or appropriate (either with or without compensation) the Issuer or any material portion of its properties or assets, unless such act, deed or proceedings are contested in good faith by the Issuer or the same does not materially and adversely affect the financial condition or operations of the Issuer.

Upon receipt by the Trustee of a written notice from the Issuer on the occurrence of any Change in Law or Circumstance, the Trustee shall secure from the Registrar an updated list of Bondholders as of the Record Date indicated in the notice from the Issuer and provide written notices to all registered Bondholders of the intended optional redemption. Each Bondholder in whose name the Offer Bonds subject of the optional redemption are registered in the Registry of Bondholders at the close of business on the relevant Record Date shall be entitled to receive the principal of the Offer Bonds subject of the optional redemption and the interest accrued thereon. The Issuer shall pay the Bondholders in accordance with the terms of the RPAA.

Accrued interest on the Offer Bonds to be redeemed under this section for the last Interest Payment Date up to the relevant redemption date shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

The Bondholders shall not have any right to cause the Issuer to redeem the Offer Bonds pursuant to a Change in Law or Circumstance under this section.

**Redemption by Reason of Change of Control**

Upon the occurrence of a Change of Control, Bondholders holding at least 2/3 of the outstanding principal amount of the Offer Bonds may require the Issuer to redeem all (but not some) of the Offer Bonds, at par (or 100% of face value), which shall be paid together with the accrued interest thereon. Within 15 days following a Change of Control, the Issuer shall notify the Trustee, which shall, in turn, notify the Bondholders (i) that a Change of Control has occurred and that the Bondholders holding at least 2/3 of the outstanding principal amount of the Offer Bonds may require the Issuer to redeem all (but not some) of the Offer Bonds, and (ii) the date set by the Issuer for such redemption (which shall not be earlier than 45 days and no later than 60 days from the date written notice is received by the Trustee). The decision of the Bondholders holding at least 2/3 of the outstanding principal amount of the Offer Bonds under this section shall be conclusive and binding upon all the Bondholders.

Each Bondholder in whose name the Offer Bonds are registered in the Registry of Bondholders at the close of business on the Record Date indicated in the notice to the Bondholders shall be entitled to receive the principal of the Offer Bonds and the interest accrued thereon. The Issuer shall pay the Bondholders in accordance with the terms of the RPAA.

Accrued interest on the Offer Bonds to be redeemed under this section for the last Interest Payment Date up to the relevant redemption date shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

**Purchase and Cancellation**

The Issuer may purchase the Offer Bonds at any time in the open market or by tender or by contract, in accordance with PDEx rules, without any obligation to make pro rata purchases from all Bondholders. Offer Bonds so purchased shall be redeemed and cancelled and may not be re-issued. Upon listing of the Offer Bonds in the PDEx, the Issuer shall disclose any such transaction in accordance with the applicable PDEx disclosure rules.

**Payments**

The principal of, interests on, and all other amounts payable on the Offer Bonds shall be paid to the Bondholders through the Paying Agent. The Paying Agent shall credit the proper amounts received from the Issuer via RTGS, net of final taxes and fees (if any), to the cash settlement banks of the Bondholders (nominated by the Bondholders in the Application to Purchase or as the Bondholder may notify the Paying Agent in writing), for onward remittance to the relevant cash settlement account of the Bondholder with the cash settlement bank. The principal of, and interest on, the Offer Bonds shall be payable in Philippine Pesos.

In the event that the details of the cash settlement account indicated by the relevant Bondholder in the Application to Purchase are incomplete or erroneous, or the cash settlement account of the relevant Bondholders has been closed, dormant, or inexistent, due to which payments to the Bondholders cannot be effected in a timely manner, the relevant cash settlement bank shall handle such funds in accordance with its own internal procedures until the correction of the cash settlement account is effected and until credit of the relevant cash entitlement is completed. In these cases, the Issuer and the Registrar and Paying Agent shall not be liable to the relevant Bondholder for any failure or delay in the Bondholder's receipt of such payments.

The Issuer shall ensure that so long as any of the Offer Bonds remain outstanding, there shall at all times be a Paying Agent for purposes of the Offer Bonds and the Issuer or the Paying Agent may only terminate the appointment of the Paying Agent as provided in the RPAA. In the event the appointed office of any institution shall be unable or unwilling to continue to act as the Paying Agent, the Issuer shall appoint such other leading institution in the Philippines authorized to act in its place.

**Payment of Additional Amounts – Taxation**

Interest income on the Offer Bonds is subject to a final withholding tax at rates of 20%, 25% or 30%, depending on the tax status of the relevant Bondholder under relevant law, regulation or tax treaty. Except for such final withholding tax and as otherwise provided, all payments of principal and interest are to be made free and clear of any deductions or withholding for or on account of any present or future taxes or duties imposed by or on behalf of the Philippines, including but not limited to, issue, registration or any similar tax or other taxes and duties, including interest and penalties, if any. If such taxes or duties are imposed, the same shall be for the account of the Issuer; provided however that, the Issuer shall not be liable for the following:

(a) The withholding tax applicable on interest earned on the Offer Bonds prescribed under the Tax Code, as amended and its implementing rules and regulations as may be in effect from time to time; provided, further, that all Bondholders are required to provide the Issuer through the Bondholders' Selling Agent or PDEx Trading Participant and endorsed to the Registrar and Paying Agent their validly issued tax identification numbers issued by the BIR;

(b) Gross Receipts Tax under Section 121 of the Tax Code;

(c) Taxes on the overall income of any securities dealer or Bondholder, whether or not subject to withholding;

(d) Value Added Tax under Sections 106 to 108 of the Tax Code, and as amended by Republic Act No. 9337; and

(e) Any applicable taxes on any subsequent sale or transfer of the Offer Bonds by any holder which shall be for the account of such holder (or its buyer, as the holder and the buyer may have agreed upon).

Documentary stamp tax for the primary issue of the Offer Bonds and the execution of the Transaction Documents, if any, shall be for the Issuer's account.

Please see the section on *"Taxation*" on page 120 of this Offer Supplement for a more detailed discussion on the tax consequences of the acquisition, ownership and disposition of the Offer Bonds.

**Tax-Exempt Status or Entitlement to Preferential Tax Rate**

An investor who is exempt from the aforesaid withholding tax, or is subject to a preferential withholding tax rate shall be required to submit the following requirements to the Registrar, subject to acceptance by the Issuer, as being sufficient in form and substance:

(a) BIR-certified true copy of a valid, current and subsisting tax exemption certificate, ruling or opinion issued by the BIR and addressed to the relevant applicant or Bondholder, confirming its exemption or preferential rate, as required under BIR Revenue Memorandum Circular No. 8-2014 including any clarification, supplement or amendment thereto;

(b) with respect to tax treaty relief,

(i) for Applicant investors, (1) 3 originals of a duly accomplished valid, current and subsisting Certificate of Residence for Tax Treaty Relief ("**CORTT**") Form or the prescribed certificate of residency of their country together with the CORTT Form as required under BIR Revenue Memorandum Order No. 8-2017 and (2) 3 originals of the Special Power of Attorney executed by the Bondholder in favor of its authorized representative (if the CORTT Form and other documents are accomplished by an authorized representative) shall be submitted by the Bondholder to the Issuer upon the submission of the Application to Purchase or no later than the 1st day of the month when the initial interest payment date shall fall due. For subsequent interests due, 3 originals of Part II (D) of the CORTT Form shall be submitted by the Bondholder to the Issuer through the Registrar no later than the 1st day of the month when such subsequent interest payment/s shall fall due and, if applicable, including any clarification, supplement or amendment thereto,

(ii) For transferee Bondholders, (1) 3 originals of a duly accomplished valid, current and subsisting CORTT Form or the prescribed certificate of residency of their country together with the CORTT Form as required under BIR Revenue Memorandum Order No.8-2017 and (2) 3 originals of the Special Power of Attorney executed by the Bondholder in favor of its authorized representative (if the CORTT Form and other documents are accomplished by an authorized representative) shall be submitted by the Bondholder to the Issuer through the Registrar upon the submission of the account opening documents or no later than the 1st day of the month when the first interest payment date shall fall due following the transfer of the Offer Bonds to the said transferee Bondholder. For subsequent interests due, 3 originals of Part II (D) of the CORTT Form shall be submitted by the Bondholder to the Issuer through the Registrar no later than the 1st day of the month when such subsequent interest payment/s shall fall due and, if applicable, including any clarification, supplement or amendment thereto.

(c) a duly notarized undertaking executed by (i) the corporate secretary or any authorized representative of such applicant or Bondholder, who has personal knowledge of the exemption based on his official functions, if the Applicant purchases, or the Bondholder holds, the Offer Bonds for its account, or (ii) the trust officer, if the applicant is a universal bank authorized under Philippine law to perform trust and fiduciary functions and purchase the Offer Bonds pursuant to its management of tax-exempt entities (i.e. Employee Retirement Fund, etc.), declaring and warranting such entities' tax-exempt status or preferential rate entitlement, undertaking to immediately notify the Issuer, the Registrar and the Paying Agent (1) of any suspension, revocation, amendment or invalidation (in whole or in part) of the tax exemption certificate, ruling or opinion issued by the BIR, executed using the prescribed form under the RPAA; (2) if there are any material changes in the factual circumstances of the Bondholder including but not limited to its character, nature and method of operation, which are inconsistent with the basis for its income tax exemption; or (3) if there is any change of circumstance, relevant treaty, law or regulation or any supervening event that may or would result in the interest income of the Offer Bonds being ineligible for exemption or preferential rate, with a declaration and warranty of its tax exempt status or entitlement to a preferential tax rate, and agreeing to indemnify and hold the Issuer, the Registrar and the Paying Agent free and harmless against any claims, actions, suits, and liabilities resulting from the non-withholding or incorrect withholding of the required tax; provided, that in case of corporate, partnership or trust account investors, such investor shall also submit an original certification from the corporate secretary or an equivalent officer of the investor, setting forth the resolutions of its board of directors or equivalent body authorizing the execution of the undertaking and designating the signatories, with their specimen signatures, for the said purpose. In the event that the Issuer is assessed by the relevant taxing authority or other authorities arising from the exemption, reduced withholding tax rate and/or an incorrect or non-withholding of tax due to the above representation of the Bondholder, the Issuer shall pay the said assessed amount to the relevant taxing authority or other authorities and the Bondholder shall immediately reimburse Issuer for any amount/s paid subject to the imposition of interest as may be deemed appropriate by the Issuer; and

(d) such other documentary requirements as may be required under the applicable regulations of the relevant taxing or other authorities which for purposes of claiming tax treaty relief, shall include a duly accomplished CORTT Form or the prescribed certificate of residency of their country together with the CORTT Form, consularized proof of the Bondholder's legal domicile in the relevant treaty state, and confirmation acceptable to the Issuer that the Bondholder is not doing business in the Philippines to support the applicability of a tax treaty relief; provided, that the Issuer shall have the exclusive discretion to decide whether the documents submitted are sufficient for purposes of applying the exemption or the reduced rate being claimed by the Bondholder on the interest payments to such Bondholder; provided, further, that all sums payable by the Issuer to tax exempt entities shall be paid in full without deductions for taxes, duties, assessments or government charges (or with reduced rates, as the case may be), subject to the submission by the Bondholder claiming the benefit of any exemption or preferential rate of the required documents and of additional reasonable evidence of such tax-exempt or preferential rate status to the Registrar.

Unless otherwise indicated above, the foregoing requirements shall be submitted, (i) in respect of an initial issuance of Offer Bonds, upon submission of the Application to Purchase to the Joint Lead Underwriters and Bookrunners or Selling Agents (if any) who shall then forward the same to the Registrar; or (ii) in respect of a transfer from a Bondholder to a purchaser, to the Registrar upon submission of the account opening documents.

Failure on the part of the Bondholder to submit the aforementioned document/s within the time prescribed shall result in the application of the regular tax rates.

**FINANCIAL RATIO**

The Issuer may incur Debt if on the Transaction Date, after giving effect to the incurrence of such Debt, but not giving any effect to the receipt or application of proceeds therefrom, provided its Net Debt to Equity Ratio does not exceed 3.25x and its Interest Coverage Ratio does not fall below 2.25x in respect of any incurrence of any Indebtedness.

For avoidance of doubt, any debt to be incurred to refinance, in the same currency or its equivalent amount, an existing debt outstanding on the date of the Trust Agreement, shall not be construed as an incurrence of additional debt.

The ratios shall be computed using the following formula:

Net Debt to Equity (all items being net of amounts attributable to Ring-Fenced Subsidiaries):

$$\frac{\textit{Consolidated Net Total Debt + Total PSALM Lease Liabilities}}{\textit{Consolidated Total Equity}}$$

Interest Coverage Ratio (all items being the amounts for the most recent Four Quarterly Period and excluding Ring-Fenced Subsidiaries):

$$\frac{\textit{Consolidated EBITDA}}{\textit{Consolidated Interest Expense}}$$

For the avoidance of doubt, any Indebtedness to be Incurred to refinance, in the same currency or its equivalent amount, an existing Indebtedness outstanding on the Issue Date, shall not be construed as an incurrence of additional Indebtedness.

In the determination of any particular amount of Indebtedness in connection with Financial Covenant, Guarantees, Security Interests or obligations with respect to letters of credit supporting Indebtedness otherwise included in the determination of such particular amount shall not be included.

## NEGATIVE PLEDGE

Until redemption or payment in full of the aggregate outstanding principal amount of the Offer Bonds, the Company will not and will ensure that none of its Material Subsidiaries will, without the prior written consent of the Majority Bondholders, create or have outstanding any Security Interest upon or with respect to, any of the present or future business, undertaking, assets or revenues (including any uncalled capital) of the Company or any of the Material Subsidiaries to secure any Indebtedness unless the Company, in the case of the creation of the Security Interest, before or at the same time and, in any other case, promptly, takes any and all action necessary to ensure that:

(a) All amounts payable by it under the Offer Bonds are secured by the Security Interest equally and ratably with the relevant Indebtedness to the satisfaction of the Majority Bondholders; or

(b) Such other Security Interest or other arrangement (whether or not it includes the giving of a Security Interest) is provided to the satisfaction of the Majority Bondholders;

provided, that the foregoing restriction shall not apply to any Permitted Security Interest.

## EVENTS OF DEFAULT

Each of the following events shall constitute an "**Event of Default**" under the Offer Bonds and the Trust Agreement:

(a) the Issuer defaults in the payment when due of any amount payable under the Trust Agreement, the Offer Bonds, or any other Transaction Document unless such failure arises solely as a result of an administrative or technical error or a Disruption Event and payment is made within 3 Business Days after the date such payment is due (a "**Payment Default**");

(b) the Issuer fails to perform, comply with, or violates any material provision, term, condition, covenant or obligation contained in the Transaction Documents (other than by reason of paragraph (a) above), and any such failure, non-compliance or violation is not remediable or, if remediable, continues unremedied for a period of 30 days (or such longer curing period granted to the Issuer by the Majority Bondholders) from the date after written notice thereof shall have been given to the Issuer by the Trustee;

(c) any representation or warranty which is made or deemed to be made by the Issuer or any of the Issuer's directors or officers herein or otherwise in connection herewith, or in any certificate delivered by the Issuer hereunder or in connection herewith, shall prove to have been untrue or incorrect in any material respect as of the time it was made or deemed to have been made;

(d) the Company or any of its Subsidiaries defaults in the performance or observance of, or compliance with, any one or more of its obligations under a Material Agreement and such default shall not have been remedied as provided therein and such event might reasonably be expected to have a Material Adverse Effect;

(e) a Material Agreement is terminated, repudiated, cancelled or revoked and such event might reasonably be expected to have a Material Adverse Effect;

(f) a Material Agreement or any provision thereof is or becomes invalid, illegal or unenforceable and there is a Material Adverse Effect as a result thereof which has not been remedied within 30 days of the occurrence thereof;

(g) any Indebtedness of the Issuer, whether singly or in the aggregate, in excess of One Billion Two Hundred Fifty Million Pesos (₱1,250,000,000.00) or its equivalent in other currencies is not paid on its due date or within any applicable grace period or is declared to be due and payable prior to its stated date of payment (except where liability for payment of that Indebtedness is being contested in good faith by appropriate means);

(h) a decree or order by a court or other Governmental Authority having jurisdiction over the premises is entered without the consent or application of the Issuer:

(i) adjudging the Issuer bankrupt or insolvent;

(ii) approving a petition seeking a suspension of payments by or a reorganization of the Issuer under any applicable bankruptcy, insolvency or reorganization law;

(iii) appointing a receiver, liquidator or trustee or assignee in bankruptcy or insolvency of the Issuer or of all or substantially all of the business or assets of the Issuer;

(iv) providing for the winding up or liquidation of the affairs of the Issuer;

(v) with a view to the rehabilitation, administration, liquidation, winding-up or dissolution of the Issuer; or

(vi) taking other action under Applicable Law which is similar to any of the events mentioned in paragraphs (i) to (v) above (inclusive);

*Provided*, that the issuance of any such decree or order shall not be an Event of Default if the same shall have been dismissed or stayed by injunction or otherwise within 90 days from issuance thereof;

(i) the Issuer:

(i) institutes voluntary proceedings to be adjudicated bankrupt or insolvent or consents to the filing of a bankruptcy or insolvency proceeding against it;

(ii) files a petition seeking a suspension of payments by it or its reorganization under any applicable bankruptcy, insolvency or reorganization law or consents to the filing of any such petition;

(iii) seeks or consents to the appointment of a receiver or liquidator or trustee or assignee in bankruptcy or insolvency of it or of all or substantially all of its business or assets;

(iv) makes an assignment for the benefit of its creditors or admits in writing its inability to pay its debts generally as they become due;

(v) files a petition seeking the winding up or liquidation of its affairs or consents to the filing of any such petition;

(vi) takes any other step with a view to its rehabilitation, administration, liquidation, winding-up or dissolution or a suspension of payments by it; or

(vii) takes other action under Applicable Law which is similar to any of the events mentioned in paragraphs (i) to (vi) above (inclusive);

(j) final and executory judgment(s) or order(s) are rendered by a court of competent jurisdiction against the Issuer or its properties or assets from which no appeal may be made for the payment of money which will have a Material Adverse Effect and such judgment or order shall continue unsatisfied or undischarged after 90 days;

(k) the Issuer shall suspend or discontinue all or a substantial portion of its business operations, whether voluntarily or involuntarily for a period of 30 consecutive days except in cases of strike or lockout when necessary to prevent business losses, or when due to fortuitous events or *force majeure*, *provided* that in any such event of strikes, lockouts or closure due to force majeure events, there is no Material Adverse Effect;

(l) any event or circumstance that will have a Material Adverse Effect has occurred and is continuing; and

(m) any Governmental Approval now or hereafter necessary to enable the Issuer to comply with its obligations under any Material Agreement to which it is party is not issued when required or is revoked, cancelled, withdrawn or withheld, not renewed, modified or amended or otherwise ceases to remain in full force and effect and such cancellation, withdrawal withholding, non-renewal, modification or amendment has a Material Adverse Effect; provided, that if the same is capable of being remedied, it shall not be an Event of Default if remedied within 90 days from occurrence thereof.

**Notice of Default**

The Trustee shall, within 5 Business Days after receipt of written notice from the Issuer or the Majority Bondholders of the occurrence of an Event of Default, give to all the Bondholders written notice of any such Event of Default unless the same shall have been cured before the giving of such notice; provided, that in the case of a Payment Default (as described in paragraph (a) of the "*Description of the Offer Bonds – Events of Default*") the Trustee shall immediately notify the Bondholders upon the occurrence of such Payment Default.

**Consequences of Default**

(a) If any one or more of the Events of Default shall have occurred and be continuing after the lapse of the period given to the Issuer within which to cure such Event of Default, if any, or upon the occurrence of such Event of Default for which no cure period is provided, (i) the Trustee upon the written direction of the Majority Bondholders, by notice in writing delivered to the Issuer, or (ii) the Majority Bondholders, by notice in writing delivered to the Issuer and the Trustee, may declare the Issuer in default ("**Declaration of Default**") and declare the principal of the Offer Bonds then outstanding, together with all accrued and unpaid interest thereon and all amounts due thereunder, to be due and payable not later than 5 Business Days from the receipt of the Declaration of Default ("**Default Payment Date**") with a copy to the Registrar and Paying Agent who shall then prepare a payment report in accordance with the RPAA. Thereupon, the Issuer shall make all payments due on the Offer Bonds in accordance with the RPAA.

(b) All the unpaid obligations under the Offer Bonds, including accrued interest, and all other amounts payable thereunder, shall be declared to be forthwith due and payable, whereupon all such amounts shall become and be forthwith due and payable without presentment, demand, protest or further notice of any kind, all of which are hereby expressly waived by the Issuer.

**Penalty Interest**

In case any amount payable by the Issuer under the Offer Bonds, whether for principal, interest, or otherwise, is not paid on the relevant due date, the Issuer shall, without prejudice to its obligations to pay the said principal, interest and other amounts, pay a penalty fee on the defaulted amount(s) at the rate 12% per annum (the "**Penalty Interest**") from the time the amount fell due until it is fully paid in accordance with the Terms and Conditions of this Offer and the Trust Agreement.

**Payments in the Event of Default**

Upon the occurrence of any Event of Default, and provided that there has been a Declaration of Default and acceleration of payment of the Offer Bonds by the Majority Bondholders, then in any such case, the Issuer will pay the Bondholders, through the Paying Agent, the whole amount which shall then have become due and payable on such outstanding Offer Bonds with interest at the rate borne by the Offer Bonds on the overdue principal and with Penalty Interest, where applicable, based on the payment report no later than the Default Payment Date. The Issuer also undertakes that it shall give the Trustee written notice of its intention to make any payments under this paragraph.

**Application of Payments**

Any money collected by the Trustee as a consequence of a Declaration of Default and any other funds held by it, subject to any other provision of the Trust Agreement relating to the disposition of such money and funds or to the RPAA, shall be applied by the Trustee in the order of preference as follows:

(a) First: To the pro-rata payment to the Trustee, the Registrar, Paying Agent and PDEx of the reasonable, actual and documented costs, expenses, fees, and other charges of collection, including reasonable compensation to them, their agents, attorneys, and all reasonable, actual and documented expenses and liabilities incurred or disbursements made by them, without gross negligence or bad faith in carrying out their respective obligations under their respective agreements with the Issuer in connection with the Offer Bonds.

(b) Second: to the payment of all outstanding interest, including any Penalty Interest, in the order of maturity of such interest.

(c) Third: to the payment of the principal amount of the Offer Bonds then due and payable.

(d) Fourth: the remainder, if any, shall be paid to the Issuer, its successors, or assigns, or to whoever may be lawfully entitled to receive the same, or as a court of competent jurisdiction may direct.

**Prescription**

Claims in respect of principal and interest or other sums payable under the Offer Bonds shall prescribe unless the claim is made within 10 years (in the case of principal or other sums) or 5 years (in the case of interest) from the date on which payment becomes due.

**Remedies**

All remedies conferred by the Trust Agreement to the Trustee and the Bondholders shall be cumulative and not exclusive and shall not be so construed as to deprive the Trustee or the Bondholders of any legal remedy by judicial or extra judicial proceedings appropriate to enforce the conditions and covenants of the Trust Agreement subject to the discussion under "*Description of the Offer Bonds – Ability to File Suit*."

No delay or omission by the Trustee or the Bondholders, to exercise any right or power arising from or on account of any default hereunder shall impair any such right or power, or shall be construed to be a waiver of any such default or an acquiescence thereto; and every power and remedy given by the Trust Agreement to the Trustee or the Bondholders may be exercised from time to time and as often as may be necessary or expedient.

### Ability to File Suit

No Bondholder shall have any right by virtue of or by availing of any provision of the Trust Agreement to institute any suit, action or proceeding for the collection of any sum due from the Issuer under the Trust Agreement on account of principal, interest, and other charges, or for the appointment of a receiver or trustee, or for any other remedy hereunder unless:

(a) such Bondholder previously shall have given to the Trustee written notice of an Event of Default and of the continuance thereof and the related request for the Trustee to convene a meeting of the Bondholders to take up matters related to their rights and interests under the Offer Bonds in accordance with the provisions of the Notice of Default (see *Description of the Offer Bonds – Notice of Default*);

(b) the Majority Bondholders shall have decided and made the written request upon the Trustee to institute such action, suit or proceeding in its own name;

(c) the Trustee, for 60 days after the receipt of such notice and request, shall have neglected or refused to institute any such action, suit or proceeding; and

(d) no directions inconsistent with such written request or rescission and annulment of a Declaration of Default by the Majority Bondholders has been made.

it being understood and intended, and being expressly covenanted by every Bondholder with every other Bondholder and the Trustee, that no Bondholder shall have any right in any manner whatsoever by virtue of or by availing of any provision of the Trust Agreement to affect, disturb or prejudice the rights of the holders of any other such Offer Bonds or to obtain or seek to obtain priority over or preference to any other such holder or to enforce any right under the Trust Agreement, except in the manner herein provided and for the equal, ratable and common benefit of all the Bondholders.

### Waiver of Default by the Bondholders

The Majority Bondholders may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred upon the Trustee, or may, on behalf of the Bondholder, waive any past default except the Events of Default defined as a Payment Default, insolvency default (paragraph (i)) or closure default (paragraph (k)), and its consequences. In case of any such waiver, the Issuer, the Trustee and the Bondholders shall be restored to their former positions and rights under the Trust Agreement; provided, that, no such waiver shall extend to any subsequent or other default or impair any right consequent thereto. Any such waiver by the Majority Bondholders shall be conclusive and binding upon all Bondholders and upon all future holders and owners thereof, irrespective of whether or not any notation of such waiver is made upon the certificate representing the Offer Bonds.

## SUBSTITUTION

Substitution of the Offer Bonds is not contemplated.

## TRUSTEE; NOTICES

The following discussion is qualified by the more detailed information as contained in the Trust Agreement.

## TRUSTEE

### Notice to the Trustee

All documents required to be submitted to the Trustee and all other notices, requests and other communications must be in writing and will be deemed to have been duly given only if delivered personally, by facsimile transmission, or mailed (first class postage prepaid) or emailed to the Trustee at the following address, facsimile number or email address; and addressed to the individuals named below:

To the Trustee:

**PHILIPPINE NATIONAL BANK – TRUST BANKING GROUP**
3/F PNB Financial Center, President Diosdado Macapagal Blvd. 1300 Pasay City, Metro Manila, Philippines
Attention: Ms. Josephine E. Jolejole
Telephone: (632) 573 4655/4665/4575
Email: rugall@pnb.com.ph/ jolejoleje@pnb.com.ph / evangelistaahr@pnb.com.ph

All such notices, requests and other communications will: (i) if delivered personally to the address as provided above, be deemed given upon delivery; (ii) if delivered by facsimile transmission to the facsimile number as provided above, be deemed given upon receipt in readable form; and (iii) if delivered by mail or email in the manner described above to the address as provided above, be deemed given upon receipt and in case of email if received in readable form (in each case regardless of whether such notice, request or other communication is received by any other Person on behalf of such individual to whom a copy of such notice, request or other communication is to be delivered). The Trustee may from time to time change its address, facsimile number or other information for the purpose of notices hereunder by giving notice specifying such change.

Any notice, report or communication received on a non-working day or after business hours in the place of receipt will only be deemed given on the next working day in that place.

**Notice to the Bondholders**

The Trustee shall send all notices to Bondholders to their mailing address as set forth in the Registry of Bondholders. Except where a specific mode of notification is provided for in the Transaction Documents, notices to Bondholders shall be sufficient when made in writing and transmitted in any one of the following modes: (i) registered mail; (ii) ordinary mail; (iii) by publication for at least once a week for 2 consecutive weeks in at least 2 newspapers of general circulation in the Philippines; (iv) personal delivery to the address of record in the Registry of Bondholders; or (v) disclosure through the Online Disclosure System of the PDEx. The Trustee shall rely on the Registry of Bondholders in determining the Bondholders entitled to notice. All notices shall be deemed to have been received (i) 10 days from posting if transmitted by registered mail; (ii) 15 days from mailing, if transmitted by ordinary mail; (iii) on the date of last publication, if notice is made by publication; or (iv) on the date of delivery, for personal delivery; or (v) on the date of disclosure, if notice is made by disclosure through the Online Disclosure System of the PDEX.

A notice made by the Issuer to the Trustee is notice to the Bondholders. The publication in a newspaper of general circulation in the Philippines of a press release or news item about a communication or disclosure made by the Issuer to the PDEx on a matter relating to the Offer Bonds shall be deemed a notice to the Bondholders of said matter on the date of the first publication or the date of the disclosure, as the case may be.

**Duties and Responsibilities of the Trustee**

The Trustee shall be responsible for performing, among others, the following duties for the benefit of the Bondholders, including but not limited to:

(a) The Trustee is appointed as trustee for and on behalf of the Bondholders and accordingly shall perform such duties and shall have such responsibilities as provided in the Trust

Agreement. The Trustee shall, in accordance with the terms and conditions of the Trust Agreement, monitor the compliance or non-compliance by the Issuer with all its representations and warranties, and the observance by the Issuer of all its covenants and performance of all its obligations, under and pursuant to the Trust Agreement. The Trustee shall observe due diligence in the performance of its duties and obligations under the Trust Agreement. For the avoidance of doubt, notwithstanding any actions that the Trustee may take, the Trustee shall remain to be the party responsible to the Bondholders, and to whom the Bondholders shall communicate with in respect to any matters that must be taken up with the Issuer.

(b) The Trustee shall, prior to the occurrence of an Event of Default or after the curing of all such defaults which may have occurred, perform only such duties as are specifically set forth in the Trust Agreement. In case of default, the Trustee shall exercise such rights and powers vested in it by the Trust Agreement, and use such diligence, judgment and care under the circumstances then prevailing that individuals of prudence, discretion and intelligence, and familiar with such matters will exercise in the management of their own affairs.

(c) None of the provisions contained in the Trust Agreement, the Prospectus and this Offer Supplement shall require or be interpreted to require the Trustee to expend or risk its own funds or otherwise incur personal financial liability in the performance of any of its duties or in the exercise of any of its rights or powers under the Trust Agreement.

**Resignation and Change of Trustee**

The Trustee may resign at any time by giving 90 days' prior written notice to the Issuer of such resignation.

Upon receipt of such notice of resignation of the Trustee, the Issuer shall immediately appoint a replacement trustee (the "**Replacement Trustee**") by written instrument in duplicate, executed by its authorized officers, 1 copy of which instrument shall be delivered to the resigning Trustee and 1 copy to the Replacement Trustee. If no Replacement Trustee shall have been so appointed and have accepted appointment within 30 days after the giving of such notice of resignation, the resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor, or any Bondholder who has been a bona fide holder for at least the immediately preceding 6 months may, for and in behalf of the Bondholders, petition any court of competent jurisdiction for the appointment of a Replacement Trustee. Such court may thereupon after notice, if any, as it may deem proper, appoint a Replacement Trustee.

The Issuer may, subject to the occurrence of any of the events specified in the Trust Agreement, within 30 days, remove the Trustee and appoint a Replacement Trustee, by written instrument in duplicate, 1 copy of which instrument shall be delivered to the Trustee so removed and 1 copy to the Replacement Trustee. If the Issuer fails to remove the Trustee and appoint a Replacement Trustee, any Bondholder may, on behalf of himself and all other Bondholders, petition any court of competent jurisdiction for the removal of the Trustee and the appointment of a Replacement Trustee. Such court may thereupon after such notice, if any, as it may deem proper and prescribe, remove the Trustee and appoint a Replacement Trustee.

The Majority Bondholders may at any time remove the Trustee for cause, and with consent of the Issuer, and appoint a Replacement Trustee, in accordance with the terms of the Trust Agreement, without prejudice to whatever remedies may be available to the Majority Bondholders under the law or in equity.

The Replacement Trustee must possess all the qualifications required under pertinent laws and the Trust Agreement.

Any resignation or removal of the Trustee and the appointment of a Replacement Trustee pursuant to any of the provisions in the Trust Agreement shall become effective upon the earlier of: (i) the effectivity of the resignation notice sent by the Trustee under the Trust Agreement; or (ii) the acceptance of appointment by the Replacement Trustee as provided in the Trust Agreement; provided, however, that until such Replacement Trustee is qualified and appointed, the resigning Trustee shall discharge duties and responsibilities solely as a custodian of records for turnover to the Replacement Trustee promptly upon the appointment thereof by the Issuer.

Within 10 days from the effectiveness of the resignation or removal of the outgoing trustee and the appointment of the Replacement Trustee, the outgoing trustee shall transfer and turn over to the Replacement Trustee, and shall make an accounting of, all the assets, documents or instruments which are in the custody of the outgoing trustee pursuant to the Trust Agreement, if any.

**Replacement Trustee**

The Replacement Trustee appointed shall execute, acknowledge and deliver to the Issuer and to its outgoing trustee an instrument accepting his/her appointment, and thereupon the resignation or removal of the outgoing trustee shall become effective and the Replacement Trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts, duties and obligations of its predecessor under the Trust Agreement. The foregoing notwithstanding, on the written request of the Issuer or of the Replacement Trustee, the outgoing trustee shall execute and deliver an instrument transferring to the Replacement Trustee, all the rights, powers and duties of the outgoing trustee. Upon request of any such Replacement Trustee, the Issuer shall execute any and all instruments in writing as may be necessary to fully vest in and confer to such successor trustee all such rights, powers and duties.

Upon acceptance of the appointment by the Replacement Trustee, the Issuer shall notify the Bondholders in writing and/or by publication once in a newspaper of general circulation in Metro Manila, Philippines of the succession of such trustee to the trusteeship. If the Issuer fails to notify the Bondholders within 10 days after the acceptance of appointment by the successor trustee, the latter shall cause the Bondholders to be notified at the expense of the Issuer.

**Reports to the Bondholders**

Only upon the existence of (a) and (b) below, the Trustee shall submit to the Bondholders on or before February 28 of each year from the Issue Date until full payment of the Offer Bonds a brief report dated as of December 31 of the immediately preceding year with respect to:

(a) the property and funds, if any, physically in the possession of the Paying Agent held in trust for the Bondholders on the date of such report which shall be based on the report to be given by the Paying Agent to the Trustee upon request by the Trustee through the Issuer; and

(b) any action taken by the Trustee in the performance of its duties under the Trust Agreement which it has not previously reported and which in its opinion materially affects the Offer Bonds, except action in respect of a default, notice of which has been or is to be withheld by it.

The Trustee shall submit to the Bondholders a brief report within 90 days from the making of any advance for the reimbursement of which it claims or may claim a lien or charge which is prior to that of the Bondholders on the property or funds held or collected by the Paying Agent with respect to the character, amount and the circumstances surrounding the making of such advance; provided that, the remaining unpaid amounts of such advance is at least 10% of the aggregate outstanding principal amount of the Offer Bonds at such time.

**Inspection of Documents**

Upon due notice to the Trustee, the following pertinent documents may be inspected during regular business hours on any Business Day at the principal office of the Trustee:

(a) the Trust Agreement;
(b) the RPAA;
(c) the Articles of Incorporation and By-laws of the Company; and
(d) the Registration Statement of the Company with respect to the Bonds (including the Offer Bonds) with the Prospectus and this Offer Supplement.

## MEETINGS OF THE BONDHOLDERS

A meeting of the Bondholders may be called at any time for the purpose of taking any actions authorized to be taken by or in behalf of the Bondholders of any specified aggregate principal amount of Offer Bonds under any other provisions of the Trust Agreement or under the law and such other matters related to the rights and interests of the Bondholders under the Offer Bonds.

The following discussion is qualified by the more detailed information as contained in the Trust Agreement.

### Notice of Meetings

The Trustee may at any time call a meeting of the Bondholders, on its own accord or upon the written request by the Issuer or the Majority Bondholders, for purposes of taking any actions authorized under the Trust Agreement. The meeting may be held at such time and at such place within Metro Manila as the party requesting such meeting may determine.

Unless otherwise provided in the Trust Agreement, the Trustee shall give notice of every meeting of the Bondholders (which notice must set forth the time, place, and purpose of such meeting in reasonable detail) to the Issuer and each of the registered Bondholders not earlier than 45 days nor later than 15 days prior to the date fixed for the meeting and shall publish such notice once in a newspaper of general circulation; provided, that the Trustee shall fix the record date for determining the Bondholders entitled to notice and vote during the meeting, which record date shall not be earlier than 45 days before the date of the meeting; provided, further, that all reasonable, actual and documented costs and expenses incurred by the Trustee for the proper dissemination of the requested meeting shall be reimbursed by the Issuer within 10 days from receipt of the duly supported billing statement, subject to obtaining prior written consent of the Issuer for reasonable, actual and documented costs and expenses in excess of Fifty Thousand Pesos (₱50,000.00) per occurrence.

### Failure of the Trustee to Call a Meeting

Failure of the Trustee to call a meeting upon the written request of either the Issuer or the Majority Bondholders within 3 Days from receipt of such request shall entitle the requesting party to send and publish the appropriate notice of Bondholders' meeting and fix the record date for determining the Bondholders entitled to attend and vote in accordance with the procedure set forth under "*Description of the Offer Bonds – Notice of Meetings*". The costs for calling such a meeting shall be for the Trustee's account.

### Quorum

The presence of Majority Bondholders, personally or by proxy, shall be necessary to constitute a quorum to do business at any meeting of the Bondholders. The Trustee shall determine and record the presence of the Majority Bondholders based on the list of Bondholders prepared by the Registrar in accordance with the RPAA (which list shall include all information necessary to the performance of the duties and powers of the Trustee under the Trust Agreement, such as, but not limited to, specimen signatures of the Bondholders' authorized signatories). The Registrar shall provide the Trustee through the Issuer with the foregoing list and information upon receipt of a written request from the Issuer.

**Procedure for Meetings**

The Trustee shall preside at all the meetings of the Bondholders, unless the meeting shall have been called by the Issuer or by the Majority Bondholders as provided under *"Description of the Offer Bonds – Failure of the Trustee to Call a Meeting"* in which case the Issuer or the Majority Bondholders calling the meeting, as the case may be, shall move for the election of the chairman and secretary of the meeting. The elected secretary shall take down the minutes of the meeting, covering all matters presented for resolutions by and the results of the votes cast by the Bondholders entitled to vote at the meeting and/or the Person appointed in writing by a public instrument as proxy or agent by any such Bondholder in accordance with the procedure set forth in "*Description of the Offer Bonds – Voting Rights*". The elected secretary shall immediately provide the Trustee with a copy of the minutes of the meeting which copy shall be made available at any time to the Issuer and all Bondholders upon receipt of written request.

Any meeting of the Bondholders may be adjourned from time to time for a period or periods not to exceed in the aggregate 1 year from the date for which the meeting shall originally have been called, and the meeting as so adjourned may be held without further notice. Any such adjournment may be ordered by Persons representing a majority of the aggregate principal amount of the Offer Bonds represented at the meeting and entitled to vote, whether or not a quorum shall be present at the meeting.

**Voting Rights**

To be entitled to vote at any meeting of the Bondholders, a Person should be a registered holder of the Offer Bonds as reflected in the Registry of Bondholders on the relevant record date fixed by the Trustee, the Issuer, or the Majority Bondholders, as the case may be, or a Person appointed in writing by a public instrument as proxy or agent by any such Bondholder (and, in case of corporate or institutional Bondholders, duly supported by the resolutions of its board of directors or equivalent body authorizing the appointment of the proxy or agent duly certified by its corporate secretary or an authorized officer) for the meeting. Bondholders shall be entitled to one vote for every Five Thousand Pesos (₱5,000.00). The only Persons who shall be entitled to be present or to speak at any meeting of the Bondholders shall be the Persons entitled to vote at such meeting, the Trustee, and any representative of the Issuer and its legal counsel.

**Voting Requirement**

Except as provided in the Trust Agreement, all matters presented for resolution by the Bondholders in a meeting duly called for the purpose shall be decided or approved by the affirmative vote of the Majority Bondholders present or represented in a meeting at which there is a quorum. Any resolution of the Bondholders which has been duly approved with the required number of votes of the Bondholders as herein provided shall be binding upon all the Bondholders and the Trustee as if the votes were unanimous.

**Role of the Trustee in Meetings of the Bondholders**

Notwithstanding any other provisions of the Trust Agreement, the Trustee may make such reasonable regulations (not inconsistent with the Trust Agreement) as it may deem advisable for any meeting of the Bondholders, with regard to proof of ownership of the Offer Bonds, the appointment of proxies by the Bondholders, the election of the chairman and the secretary, the appointment and duties of inspectors of votes, the submission and examination of proxies, certificates and other evidence of the right to vote and such other matters concerning the conduct of the meeting as it shall deem fit.

**Evidence Supporting the Action of the Bondholders**

Wherever in the Trust Agreement it is provided that the holders of a specified percentage of the aggregate outstanding principal amount of the Offer Bonds may take any action (including the making of any demand or request and the giving of any notice or consent or the taking of any other action), the fact that at the time of taking any such action the holders of such specified percentage have joined therein may be evidenced by: (i) any instrument executed by the Bondholders in person or by the agent or proxy appointed in writing in accordance with the Trust Agreement, or (ii) the duly authenticated record of voting in favor thereof at the meeting of the Bondholders duly called and held in accordance with the Trust Agreement; or (iii) a combination of such instrument and any such record of meeting of the Bondholders.

**Non-Reliance**

Each Bondholder represents and warrants to the Trustee and to the Issuer that it has independently and, without reliance on the Trustee or the Issuer, made its own credit investigation and appraisal of the financial position and affairs of the Issuer on the basis of such documents and information as it has deemed appropriate and that it has subscribed to the Offer Bonds and on the basis of such independent appraisal, and each Bondholder represents and warrants that it shall continue to make its own credit appraisal without reliance on the Trustee or the Issuer.

In the absence of willful misconduct, fraud, evident bad faith, or gross negligence on the part of the Trustee, the Bondholders agree to indemnify and hold the Trustee free and harmless from and against any and all claims, liabilities, damages, penalties, judgments, suits, expenses and other costs of any kind or nature including attorney's fees in case of litigation which may be suffered or incurred by the Trustee in respect of its obligations under the Trust Agreement, except for its gross negligence, fraud, evident bad faith or willful misconduct.

**Amendments**

The Issuer and the Trustee may, without prior notice to or the consent of the Bondholders or other parties, amend or waive any provisions of the Trust Agreement if such amendment or waiver is of a formal, minor, or technical nature or to correct a manifest error or inconsistency; provided, in all cases, that such amendment or waiver does not adversely affect the interests of the Bondholders; provided, further, that all Bondholders are notified of such amendment or waiver.

With the consent of the Majority Bondholders, the Issuer, when authorized by a resolution of its board of directors or the executive committee of its board of directors, and the Trustee may, from time to time and at any time, enter into an agreement or agreements supplemental to the Trust Agreement for the purpose of adding any provision to or changing in any manner or eliminating any of the provisions of the Trust Agreement; provided, that no such supplemental agreement shall:

(a) without the consent of all Bondholders affected thereby: (i) extend the maturity date of the Offer Bonds; or (ii) reduce the principal amount of the Offer Bonds; or (iii) reduce the rate or extend the time of payment of interest and principal thereon;

(b) impair the right of any Bondholder to (i) receive payment of principal of and interest on the Offer Bonds on or after the due dates therefore or (ii) to institute suit for the enforcement of any payment on or with respect to such Bondholder;

(c) affect the rights of some of the Bondholders without similarly affecting the rights of all the Bondholders;

(d) make any Offer Bond payable in money other than that stated in the Offer Bond;

(e) subordinate the Offer Bonds to any other obligation of the Issuer;

(f) amend or modify the provisions of the Terms and Conditions on Taxation, the Events of Default or the waiver of default by the Bondholders;

(g) reduce the percentage of the Bondholders required to be obtained under the Trust Agreement for their consent to or approval of any supplemental agreement or any waiver provided for in the Trust Agreement, without the consent of all the Bondholders; or

(h) make any change or waiver of the conditions under paragraphs (a) to (g) inclusive.

It shall not be necessary to obtain the consent of the Bondholders under the foregoing paragraphs for the purpose of approving the particular form of any proposed supplemental agreement but such consent shall be necessary for the purpose of approving the substance thereof.

Any consent given pursuant to this section shall be conclusive and binding upon all Bondholders and upon all future holders and owners of the Offer Bonds or of any Offer Bonds issued in lieu thereof or in exchange therefor, irrespective of whether or not any notation of such consent is made upon the Offer Bonds.

**GOVERNING LAW**

The Transaction Documents are governed by and are construed in accordance with Philippine law.

**VENUE**

Any suit, action, or proceeding arising out of, or relating to, the Offer Bonds or the Trust Agreement shall be brought before the proper courts in the Cities of Makati and Mandaluyong, to the exclusion of all other courts, and the parties submit to the exclusive jurisdiction of such courts for the purpose of any such suit, action, proceeding or judgment, the Issuer, Trustee and Bondholders expressly waiving other venue.

**WAIVER OF PREFERENCE**

The obligations created under the Transaction Documents and the Offer Bonds shall not enjoy any priority of preference or special privileges whatsoever over any Indebtedness or obligations of the Issuer. Accordingly, whatever priorities or preferences that the Transaction Documents may have or any Person deriving a right hereunder may have under Article 2244, paragraph 14(a) of the Civil Code of the Philippines are hereby absolutely and unconditionally waived and renounced. This waiver and renunciation of the priority or preference under Article 2244, paragraph 14(a) of the Civil Code of the Philippines shall be revoked if it be shown that any Indebtedness of the Issuer has a priority or preference under the said provision.

## Use of Proceeds

SMC Global Power expects to raise ₱15,000,000,000.00 as gross proceeds from the Offer. The Company estimates that the net proceeds from the Offer after deducting expenses payable by the Company, will be approximately ₱14,812,824,625.00, estimated as follows:

| Particulars | Total (₱) |
|---|---|
| **Estimated proceeds from the Offer……** | **15,000,000,000.00** |
| **Less: Estimated fees, commissions and expenses** | |
| *Gross Underwriting Fees* …………………………………… | 60,000,000.00 |
| *Documentary Stamp Taxes to be paid by the Company*……............................................................ | 112,500,000.00 |
| *SEC Registration fee* ……………………………………… | 3,787,500.00 |
| *SEC legal research fee* ……………………...…………….... | 37,875.00 |
| *PDEx Listing Application Fee* …………………………........ | 300,000.00 |
| *Listing and Maintenance Fee* …………………………........ | 150,000.00 |
| *Legal and other professional fees*……………………….…... | 5,500,000.00 |
| *Rating Fee*………………………………………………….. | 3,250,000.00 |
| *Printing Cost*……………………………………………….. | 200,000.00 |
| *Trustee Fees*………………………………………………… | 300,000.00 |
| *Paying Agency and Registry Fees*………………………… | 200,000.00 |
| *Other expenses*……………………………………………… | 950,000.00 |
| **Total estimated fees, commissions and expenses ….** | **187,175,375.00** |
| **Estimated net proceeds…………………………………………** | **₱ 14,812,824,625.00** |

Aside from the foregoing one-time costs, SMC Global Power expects the following annual expenses related to the Offer Bonds:

1. The Issuer will be charged by the PDEx for the first annual maintenance fee in advance upon approval of the listing and thereafter, the Issuer will pay PDEx an annual maintenance listing fee amounting to ₱150,000.00 per annum;

2. The Issuer will pay an annual retainer fee to the Trustee amounting to ₱120,000.00 per annum;

3. After the Issue Date, a Paying Agency fee amounting to approximately ₱150,000.00 is payable every Interest Payment Date. The Registrar will charge a monthly maintenance fee based on the face value of the Offer Bonds and number of Bondholders; and

4. The Issuer will pay an annual monitoring fee of ₱500,000.00 to PhilRatings.

The entire proceeds for this Offer will be used for: (i) refinancing the outstanding shareholder advances and partially refinancing existing loan obligations and/or re-denomination of US Dollar denominated obligations of the Company and (ii) payment of transaction-related fees, costs and expenses. The said shareholder advances, loan obligations and US Dollar denominated obligations were used to finance the following transactions:

(i) the acquisition of 100% equity interests of AES Phil and Gen Plus B.V. in MAPL, the indirect parent company of MPPCL;

(ii) the acquisition of 100% equity interest of AES Phil in ATPL; and

(iii) the acquisition of 100% equity interest of AES Phil in API.

In summary, the proceeds of the Offer will be used as follows:

| Use of Proceeds | Allocation | Estimated Timing of Disbursement |
|---|---|---|
| Refinancing the outstanding shareholder advances and partially refinancing existing loan obligations and/or re-denomination of US Dollar denominated obligations | ₱14,812,824,625.00 | Within 6 months from Issue Date |
| Payment of transaction-related fees, costs and expenses | ₱187,175,375.00 | Within 6 months from Issue Date |

For a detailed discussion on the foregoing transactions, please refer to the subsection *“2018 Significant Transactions”* under “*Management’s Discussion and Analysis of Results of Operations and Financial Condition*” in this Offer Supplement.

The foregoing discussion represents a best estimate of the use of proceeds of the Offer based on the Company’s current plans and anticipated expenditures. In the event of any substantial deviation/adjustment in the planned use of proceeds, the Company shall inform the SEC and the Bondholders in writing at least 30 days before such deviation, adjustment or reallocation is implemented.

Pending the above use of proceeds, the Company intends to invest the net proceeds from the Offer Bonds in short-term liquid investments including but not limited to short-term government securities, bank deposits and money market placements which are expected to earn prevailing market rates. In the event such investments should incur losses, any shortfall will be financed from the Company’s internally generated funds.

No material amount of proceeds shall be used to reimburse any officer, director, employee, or shareholder for services rendered, assets previously transferred, money loaned or advanced, or otherwise.

# Plan of Distribution

The Offer Bonds shall be the second tranche to be issued under the ₱35,000,000,000.00 Fixed Rate Bonds Shelf Registration Program of SMC Global Power. The Company shall issue the Offer Bonds to institutional and retail investors in the Philippines through a public offering to be conducted through the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners. The Offer does not include an international offering.

A total of ₱15,000,000,000.00 Bonds will be taken down from the shelf. Upon completion of the Offer, all Bonds of the Issuer under its shelf registration of ₱35,000,000,000.00 worth of fixed-rate bonds would have been issued.

**Joint Lead Underwriters and Bookrunners**

BDO Capital, BPI Capital, China Bank Capital and PNB Capital (the "**Joint Lead Underwriters and Bookrunners**") have agreed to distribute and sell the Offer Bonds at the Purchase Price, pursuant to an Underwriting Agreement with SMC Global Power dated 2 August 2018. Subject to the fulfillment of the conditions provided in the Underwriting Agreement, the Joint Lead Underwriters and Bookrunners have committed to underwrite the following amounts on a firm basis:

| **Joint Lead Underwriters and Bookrunners** | **Underwriting Commitment** |
|---|---|
| BDO Capital & Investment Corporation | ₱3,750,000,000.00 |
| BPI Capital Corporation | ₱3,750,000,000.00 |
| China Bank Capital Corporation | ₱3,750,000,000.00 |
| PNB Capital and Investment Corporation | ₱3,750,000,000.00 |
| **Total** | **₱15,000,000,000.00** |

The Underwriting Agreement may be terminated in certain circumstances prior to payment being made to SMC Global Power of the net proceeds of the Offer Bonds.

The underwriting fees and any selling fees to be paid by the Issuer in relation to the Offer shall be equivalent to 0.40% of the gross proceeds of the Offer. This shall be inclusive of fees to be paid to the Joint Lead Underwriters and Bookrunners and any commissions to be paid to the Selling Agents.

The Joint Lead Underwriters and Bookrunners have no direct relations with the SMC Global Power in terms of ownership by either of their respective major stockholder/s and have no right to designate or nominate any member of the Board of Directors of SMC Global Power.

The Joint Lead Underwriters and Bookrunners have no contract or other arrangement with SMC Global Power by which it may return to SMC Global Power any unsold Offer Bonds.

For the purpose of complying with their respective commitments under the Underwriting Agreement, each Joint Lead Underwriter and Joint Bookrunner may, under such terms and conditions not inconsistent with the provisions of the Underwriting Agreement, particularly the underwriting commitment of the Joint Lead Underwriters and Bookrunners, enter into agreements with co-lead managers and co-managers, and appoint Selling Agents for the sale and distribution to the public of the Offer Bonds; provided, that the Joint Lead Underwriters and Bookrunners shall remain solely responsible to the Issuer in respect of their obligations under the Underwriting Agreement entered into by them with the Issuer, and except as otherwise provided in the Underwriting Agreement, the Issuer shall not be bound by any of the terms and conditions of any agreements entered into by the Joint Lead Underwriters and Bookrunners with the co-lead managers, co- managers, and Selling Agents.

The Joint Issue Managers and the Joint Lead Underwriters and Bookrunners are duly-licensed by the SEC to engage in the underwriting or distribution of the Offer Bonds. The Joint Issue Managers and the Joint Lead Underwriters and Bookrunners may, from time to time, engage in transactions with and perform services in the ordinary course of its business, for SMC Global Power or any of its subsidiaries.

BDO Capital was incorporated in the Philippines in December 1998. It is duly licensed by the SEC to operate as an investment house and was licensed by the SEC to engage in underwriting or distribution of securities to the public. As of 31 December 2016, it had ₱3.3 billion and ₱3.24 billion in consolidated resources and capital, respectively. It has an authorized capital stock of ₱1.1 billion, of which approximately ₱1.0 billion represents its paid-up capital.

BPI Capital offers investment banking services in the areas of financial advisory, mergers and acquisitions, debt and equity underwriting, private placements, project finance and loan syndication. Founded in December of 1994, BPI Capital is duly licensed by the Philippine SEC to engage in the underwriting and distribution of securities. As of 31 December 2017, BPI Capital had total assets of ₱4.6 billion and total equity of ₱3.8 billion. The company operates as a wholly owned subsidiary of the Bank of the Philippine Islands.

China Bank Capital, a subsidiary of China Bank, provides a wide range of investment banking services to clients across different sectors and industries. Its primary business is to help enterprises raise capital by arranging or underwriting debt and equity transactions, such as project financing, loan syndications, bonds and notes issuances, securitizations, initial and follow-on public offerings, and private equity placements. China Bank Capital also advises clients on structuring, valuation, and execution of corporate transactions, including mergers, acquisitions, divestitures, and joint ventures. It was established and licensed as an investment house in 2015 as the spin-off of China Bank's investment banking group, which was organized in 2012.

PNB Capital, an investment house was incorporated on 30 July 1997 and commenced operations on 8 October 1997. It is a wholly-owned subsidiary of the Philippine National Bank. As of 31 December 2017, it had an authorized and paid-up capital of ₱850.0 million. Its principal business is providing investment banking services, namely: debt underwriting (bonds, commercial papers), equity underwriting, private placements, loan syndications and financial advisory services. PNB Capital is authorized to buy and sell for its own account, securities issued by private corporations and the government of the Philippines. As of 31 December 2017, total assets of PNB Capital were at ₱1,481.8 million while total capital was at ₱1,454.5 million.

## SALE AND DISTRIBUTION

The distribution and sale of the Offer Bonds shall be undertaken by the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners who shall sell and distribute the Offer Bonds to third party buyers/investors. Nothing herein shall limit the rights of the Joint Issue Managers and the Joint Lead Underwriters from purchasing the Offer Bonds for their own respective accounts.

There are no Persons to whom the Offer Bonds are allocated or designated. The Offer Bonds shall be offered to the public at large and without preference.

The obligations of each of the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners will be several, and not solidary, and nothing in the Underwriting Agreement shall be deemed to create a partnership or joint venture between and among any of the Joint Lead Underwriters. Unless otherwise expressly provided in the Underwriting Agreement, the failure by an Issue Manager and Underwriter to carry out its obligations thereunder shall neither relieve the other Issue Managers and Joint Lead Underwriters of their obligations under the same Underwriting Agreement, nor shall the Issue Manager or Underwriter be responsible for the obligation of another Issue Manager or Underwriter.

## OFFER PERIOD

The Offer Period shall commence at 9:00 a.m., Manila time, on 6 August 2018 and end at 5:00 p.m., Manila time, on 10 August 2018 or such other date as may be mutually agreed by the Company and the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners.

## APPLICATION TO PURCHASE

The procedure set out in this section and the succeeding sections should be read together with the more detailed procedure and other conditions set out in the Application to Purchase.

Applicants may purchase the Offer Bonds during the relevant Offer Period by submitting to the Joint Lead Underwriters properly completed Applications to Purchase, together with 2 signature cards, and the full payment of the Purchase Price of the Offer Bonds in the manner provided in the said Application to Purchase.

Corporate and institutional applicants must also submit, in addition to the foregoing:

(a) an original notarized certificate of the corporate secretary or an equivalent officer of the Applicant setting forth resolutions of the board of directors, partners or equivalent body (i) authorizing the purchase of the Offer Bonds indicated in the Application to Purchase; and (ii) designating the signatories, with their specimen signatures, for the said purposes;

(b) copies of its Articles of Incorporation and By-Laws and latest amendments thereof, together with the Certificate of Incorporation issued by the SEC or other organizational documents issued by an equivalent government institution, stamped and signed as certified true copies by the SEC or the equivalent government institution, or by the corporate secretary, or by an equivalent officer(s) of the Applicant who is/are authorized signatory(ies);

(c) 2 duly accomplished signature cards containing the specimen signatures of the authorized signatories of the Applicant, validated by its corporate secretary or by an equivalent officer(s) who is/are authorized signatory(ies) (whose authority(ies) and specimen signatures will be submitted to the Registrar);

(d) validly issued tax identification number issued by the BIR;

(e) identification document(s) of the authorized signatories of the Applicant, as specified in item (a) of the immediately succeeding paragraph below; and such other documents as may be reasonably required by any of the Joint Lead Underwriters, Selling Agents (if any) or the Registrar in the implementation of its internal policies regarding “know your customer” and anti-money laundering.

Individual applicants must also submit, in addition to accomplished Applications to Purchase and its required attachments:

(a) identification document (“**ID**”) of the Applicant which shall consist of any one of the following valid identification documents bearing a recent photo, and which is not expired: Passport, Driver’s License, Professional Regulation Commission ID, National Bureau of Investigation Clearance, Police Clearance, Postal ID, Voter’s ID, Barangay Certification, Government Service Insurance System e- Card, Social Security System Card, Senior Citizen Card, Overseas Workers Welfare Administration ID, OFW ID, Seaman’s Book, Alien Certification of Registration/Immigrant Certificate of Registration, MARINA ID, Government Office and government-owned and controlled corporation ID, *e.g.*, Armed Forces of the Philippines, Home Development Mutual Fund, Certification from the National Council for the Welfare of Disabled Persons, Department of Social Welfare and Development Certification, Integrated Bar of the Philippines ID, company IDs issued by private entities or institutions registered with or supervised or regulated either by the BSP, SEC or the Insurance Commission, or school ID duly signed by the principal or head of the school (for students who are beneficiaries of remittances/fund transfers who are not yet of voting age);

(b) 2 duly accomplished signature cards containing the specimen signature of the Applicant;

(c) validly issued tax identification number issued by the BIR; and

(d) such other documents as may be reasonably required by the Joint Lead Underwriters, Selling Agents (if any) or the Registrar in implementation of its internal policies regarding “know your customer” and anti-money laundering.

An Applicant who is claiming exemption from any applicable tax, or entitlement to preferential tax rates shall, in addition to the requirements set forth above, be required to submit the following requirements to the relevant Joint Lead Underwriter and Bookrunner or Selling Agent (if any) (together with their respective Applications to Purchase), subject to acceptance by the Issuer as being sufficient in form and substance:

(a) for Applicant investors, (1) 3 originals of a duly accomplished valid, current and subsisting Certificate of Residence for Tax Treaty Relief (“**CORTT**”) Form or the prescribed certificate of residency of their country together with the CORTT Form as required under BIR Revenue Memorandum Order No. 8-2017 and (2) 3 originals of the Special Power of Attorney executed by the Bondholder in favor of its authorized representative (if the CORTT Form and other documents are accomplished by an authorized representative) shall be submitted by the Bondholder to the Issuer upon the submission of the Application to Purchase or no later than the 1$^{st}$ day of the month when the initial interest payment date shall fall due. For subsequent interests due, 3 originals of Part II (D) of the CORTT Form shall be submitted by the Bondholder to the Issuer through the Registrar no later than the 1$^{st}$ day of the month when such subsequent interest payment/s shall fall due and, if applicable, including any clarification, supplement or amendment thereto.

(b) For transferee Bondholders, (1) 3 originals of a duly accomplished valid, current and subsisting CORTT Form or the prescribed certificate of residency of their country together with the CORTT Form as required under BIR Revenue Memorandum Order No.8-2017 and (2) 3 originals of the Special Power of Attorney executed by the Bondholder in favor of its authorized representative (if the CORTT Form and other documents are accomplished by an authorized representative) shall be submitted by the Bondholder to the Issuer through the Registrar upon the submission of the account opening documents or no later than the 1st day of the month when the first interest payment date shall fall due following the transfer of the Offer Bonds to the said transferee Bondholder. For subsequent interests due, 3 originals of Part II (D) of the CORTT Form shall be submitted by the Bondholder to the Issuer through the Registrar no later than the 1st day of the month when such subsequent interest payment/s shall fall due and, if applicable, including any clarification, supplement or amendment thereto

(c) a duly notarized undertaking executed by (i) the corporate secretary or any authorized representative of such applicant or Bondholder, who has personal knowledge of the exemption based on his official functions, if the Applicant purchases, or the Bondholder holds, the Offer Bonds for its account, or (ii) the trust officer, if the applicant is a universal bank authorized under Philippine law to perform trust and fiduciary functions and purchase the Offer Bonds pursuant to its management of tax-exempt entities (i.e. Employee Retirement Fund, etc.), declaring and warranting such entities' tax-exempt status or preferential rate entitlement, undertaking to immediately notify the Issuer, the Registrar and the Paying Agent (1) of any suspension, revocation, amendment or invalidation (in whole or in part) of the tax exemption certificate, ruling or opinion issued by the BIR, executed using the prescribed form under the RPAA; (2) if there are any material changes in the factual circumstances of the Bondholder including but not limited to its character, nature and method of operation, which are inconsistent with the basis for its income tax exemption; or (3) if there are any change of circumstance, relevant treaty, law or regulation or any supervening event that may or would result in the interest income of the Offer Bonds being ineligible for exemption or preferential rate, with a declaration and warranty of its tax exempt status or entitlement to a preferential tax rate, and agreeing to indemnify and hold the Issuer, the Registrar and the Paying Agent free and harmless against any claims, actions, suits, and liabilities resulting from the non-withholding or incorrect withholding of the required tax, provided, that in case of corporate, partnership or trust account investors, such investor shall also submit an original certification from the corporate secretary or an equivalent officer of the investor, setting forth the resolutions of its board of directors or equivalent body authorizing the execution of the undertaking and designating the signatories, with their specimen signatures, for the said purpose. In the event that the Issuer is assessed by the relevant taxing authority or other authorities arising from the exemption, reduced withholding tax rate and/or an incorrect or non-withholding of tax due to the above representation of the Bondholder, the Issuer shall pay the said assessed amount to the relevant taxing authority or other authorities and the Bondholder shall immediately reimburse Issuer for any amount/s paid subject to the imposition of interest as may be deemed appropriate by the Issuer; and

(d) such other documentary requirements as may be required under the applicable regulations of the relevant taxing or other authorities which for purposes of claiming tax treaty relief, shall include a duly accomplished Certificate of Residence for Tax Treaty Relief (CORTT) Form or the prescribed certificate of residency of their country together with the CORTT Form, consularized proof of the Bondholder's legal domicile in the relevant treaty state, and confirmation acceptable to the Issuer that the Bondholder is not doing business in the Philippines to support the applicability of a tax treaty relief; provided, that the Issuer shall have the exclusive discretion to decide whether the documents submitted are sufficient for purposes of applying the exemption or the reduced rate being claimed by the Bondholder on the interest payments to such Bondholder; provided, further, that all sums payable by the Issuer to tax exempt entities shall be paid in full without deductions for taxes, duties, assessments or government charges (or with reduced rates, as the case may be), subject to the submission by the Bondholder claiming the benefit of any exemption or preferential rate of the required documents and of additional reasonable evidence of such tax-exempt or preferential rate status to the Registrar.

Unless otherwise indicated above, the foregoing requirements shall be submitted, (i) in respect of an initial issuance of Offer Bonds, upon submission of the Application to Purchase to the Joint Lead Underwriters and Bookrunners or Selling Agents (if any) who shall then forward the same to the Registrar; or (ii) in respect of a transfer from a Bondholder to a purchaser, to the Registrar upon submission of the account opening documents.

Failure on the part of the Bondholder to submit the aforementioned document/s within the time prescribed shall result in the application of the regular tax rates.

The Purchase Price for each Offer Bond is payable in full upon submission of the duly executed Application to Purchase. Payments of the Purchase Price shall be made either in checks or appropriate debit instructions or payment instructions made out to the order of the relevant Joint Lead Underwriter and Bookrunner or Selling Agent (if any). All payments must be made or delivered to the Joint Lead Underwriter and Bookrunner or the Selling Agent (if any) to whom the Application to Purchase is submitted.

Completed Applications to Purchase and corresponding payments must reach the Joint Lead Underwriter and Bookrunner or the Selling Agent (if any) prior to the end of the Offer Period, or such earlier date as may be specified by the Underwriters. Acceptance by the Joint Lead Underwriter and Bookrunner or the Selling Agent (if any) of the completed Application to Purchase shall be subject to the availability of the Offer Bonds and the acceptance by SMC Global Power. In the event that any check payment is returned by the drawee bank for any reason whatsoever or the nominated bank account to be debited is invalid, the Application to Purchase shall be automatically canceled and any prior acceptance of the Application to Purchase shall be deemed revoked.

## MINIMUM PURCHASE

A minimum purchase of ₱50,000.00 shall be considered for acceptance. Purchases in excess of the minimum shall be in multiples of ₱10,000.00.

## ALLOTMENT OF THE OFFER BONDS

If the Offer Bonds are insufficient to satisfy all Applications to Purchase, the available Bonds shall be allotted in accordance with the chronological order of submission of properly completed and appropriately accomplished Applications to Purchase on a first-come, first-served basis, without prejudice and subject to the right of rejection of SMC Global Power.

## ACCEPTANCE OF APPLICATIONS

SMC Global Power and he Joint Lead Underwriters and Bookrunners reserve the right to accept or reject applications to purchase the Offer Bonds, and in case of oversubscription, allocate the Offer Bonds available to the applicants in a manner they deem appropriate.

## REJECTION OF APPLICATIONS

The Joint Lead Underwriters and Bookrunners shall accept, reduce or reject Applications to Purchase on behalf of the Issuer in accordance with the following provisions and the allocation plan. Reasons for rejection may include the following:

(a) Applications may be rejected if: (i) the Purchase Price is unpaid; (ii) payments are insufficient or where checks, as applicable, are dishonoured upon first presentation; (iii) the Application to Purchase is not received by the Joint Lead Underwriters and Bookrunners or the Selling Agent (if any) on or before the end of the Offer Period; (iv) the number of Offer Bonds subscribed is less than the minimum amount of subscription; (v) the applications do not comply with the terms of the Offer; or (vi) the applications do not have sufficient information or are not supported by the required documents.

(b) Applications may be reduced if the Offer is oversubscribed, in which case the number of Offer Bonds covered by the applications shall be reduced pro rata.

In the event an Application to Purchase is rejected or the amount of Offer Bonds applied for is scaled down for a particular Applicant, the relevant Joint Lead Underwriter and Bookrunner or the Selling Agent (if any) shall notify the Applicant concerned that his/her application has been rejected or that the amount of Offer Bonds applied for is scaled down.

## REFUNDS

If any application is rejected or accepted in part only, payments made by the Applicant or the appropriate portion thereof shall be returned without interest to such Applicant through the relevant Joint Lead Underwriter and Bookrunner or the Selling Agent (if any) with whom such Application to Purchase was made.

Refunds shall be made, at the option of each Joint Lead Underwriter and Bookrunner or the Selling Agent (if any), either (i) through the issuance of check(s) payable to the order of the relevant Applicant and crossed “Payee’s Account Only” and mailed or delivered, at the risk of the Applicant, to the address specified in the Application to Purchase, or (ii) through the issuance of instructions for automatic credit payments to the accounts of the relevant Applicants, as indicated in their respective Applications to Purchase.

## PAYMENTS

The Paying Agent shall open and maintain a Payment Account for each series of the Offer Bonds, which shall be operated solely and exclusively by the said Paying Agent in accordance with the RPAA, provided that beneficial ownership of the Payment Accounts shall always remain with the Bondholders. The Payment Account shall be used exclusively for the payment of the principal, interest and other payments due on the Offer Bonds on the relevant Payment Date. The Paying Agent shall maintain the relevant Payment Account while the relevant series of the Offer Bonds are outstanding, and until 6 months past the relevant Maturity Date or date of Optional Redemption, as applicable. Upon closure of the Payment Accounts, any balance remaining in such Payment Account shall be returned to the Issuer and shall be held by the Issuer in trust and for the irrevocable benefit of the Bondholders with unclaimed interest and principal payments and such other payments that due on the relevant series of the Offer Bonds.

## UNCLAIMED PAYMENTS

Any payment of interest on, or the principal of the Offer Bonds which remain unclaimed after the same shall have become due and payable, shall be held in trust by the Paying Agent for the

Bondholders at the latter's risk and shall be dealt with in accordance with the relevant provisions of the RPAA.

**PURCHASE AND CANCELLATION**

The Issuer may purchase the Offer Bonds at any time in the open market or by tender or by contract, in accordance with PDEx rules, as may be amended from time to time, without any obligation to make pro rata purchases from all Bondholders. Offer Bonds so purchased shall be redeemed and cancelled and may not be re-issued.

Upon listing of the Offer Bonds on PDEx, the Issuer shall disclose any such transactions in accordance with the applicable PDEx disclosure rules.

**SECONDARY MARKET**

SMC Global Power intends to list the Offer Bonds in the PDEx.

For a more detailed discussion, please refer to the section *"Description of the Offer Bonds – Secondary Trading of the Offer Bonds".*

**REGISTRY OF BONDHOLDERS**

The Offer Bonds shall be issued in scripless form. A Master Certificate of Indebtedness representing the Series G Bonds sold in the Offer shall be issued in the name of the Trustee for the benefit of the Bondholders.

Legal title to the Offer Bonds shall be shown in the Registry of Bondholders to be maintained by the Registrar. The names and addresses of the Bondholders and the particulars of the Offer Bonds held by them and all transfers of the Offer Bonds shall be entered into the Registry of Bondholders. Transfers of ownership shall be effected through book-entry transfers in the scripless Registry of Bondholders.

For a more detailed discussion, please refer to the section *"Description of the Offer Bonds – Transfer of the Offer Bonds"*.

# Capitalization

*The following table sets forth the unaudited consolidated short-term and long-term debt and capitalization of SMC Global Power as of 31 March 2018 This table should be read in conjunction with the more detailed information and reviewed and unaudited financial statements, including notes thereto, found in Annex "B" of this Offer Supplement.*

| (in Millions of ₱) | As of 31 March 2018 (Unaudited) | Adjustments | Notes | As adjusted for maximum Offer Size of ₱15.00 billion (Upon issuance of Offer Bonds) |
|---|---|---|---|---|
| **Current Liabilities** | | | | |
| Loans payable…………………………….................. | 8,277.2 | | | 8,277.2 |
| Accounts payable and accrued expenses…………… | 41,192.4 | | | 41,192.4 |
| Finance lease liabilities – current portion……………. | 17,824.4 | | | 17,824.4 |
| Income tax payable…………………………………….. | 525.4 | | | 525.4 |
| Current maturities of long-term debt – net of debt issue costs …..……………………………........... | 3,121.7 | | | 3,121.7 |
| **Total Current Liabilities………………………………** | **70,941.1** | | | **63,117.1** |
| **Noncurrent Liabilities** | | | | |
| Long term debt – net of current maturities and debt issue costs…………………………………....... | 182,851.2 | 14,812.8 | *1* | 190,848.3 |
| Finance lease liabilities – net of current portion............................................................ | 136,568.8 | (6,815.7) | *3* | 136,568.8 |
| Deferred tax liabilities………...…………...……….…... | 7,468.6 | | | 7,468.6 |
| Other noncurrent liabilities – net of current portion…...…………………………………………… | 8,451.1 | (7,824.0) | *3* | 627.1 |
| **Total Noncurrent Liabilities…………………………** | **335,339.7** | | | **335,512.8** |
| **Equity** | | | | |
| Capital stock…………………………………………….. | 1,062.5 | | | 1,062.5 |
| Additional paid-in capital……………………………….. | 2,490.0 | | | 2,490.0 |
| Redeemable perpetual securities…………………...... | 33,127.7 | | | 33,127.7 |
| Undated subordinated capital securities……………... | 26,933.6 | | | 26,933.6 |
| Equity reserves………………………………………….. | 796.1 | | | 796.1 |
| Retained earnings……………………………………… | 29,033.0 | (173.1) | *3* | 28,859.9 |
| | 93,442.9 | | | 93,269.8 |
| Non-controlling interest………………………………… | 198.3 | | | 198.3 |
| **Total Equity……..……………………………………** | **93,641.2** | | | **93,468.1** |
| **Total Capitalization……….…………………………...** | **₱499,922.0** | | *4* | **₱499,922.0** |

*Notes:*

1. *Adjusted amount as of 31 March 2018 includes proceeds of ₱15 billion of the Offer, after deduction of fees, commissions and expenses*
2. *Repayment of US$150 million shareholder advances.*
3. *Partial repayment of US$134 million out of the US$500 million term loan. Reversal of principal loan amount and related debt issue cost.*
4. *Total capitalization is the sum of debt and equity.*

# The Company

**Overview**

SMC Global Power is a holding company which owns subsidiaries that are primarily engaged in the generation, supply and sale of electric power in the Philippines. The Group is one of the largest power companies in the Philippines, with a combined capacity of 4,153 MW as of 31 March 2018 and which benefits from diversified fuel sources, including natural gas, coal and hydroelectric. Based on the installed generating capacities under ERC Resolution No. 04, Series of 2018, the Group has a 19% market share of the power supply of the National Grid, a 25% market share of the Luzon Grid and a 9% market share of the Mindanao Grid, in each case as of March 31, 2018.

San Miguel Corporation entered the power industry in 2009 following the acquisition of rights to administer the output produced by IPPs in privatization auctions conducted by the government through PSALM.

The IPPA under the IPPA Agreement has the right to sell electricity generated by the power plants owned and operated by the IPPs without having to bear any of the large upfront capital expenditures for power plant construction or maintenance. As an IPPA, it also has the ability to manage both market and price risk by entering into bilateral contracts with offtakers while capturing potential upside from the sale of excess capacity through the WESM.

SMEC became the IPPA for the Sual Power Plant, a coal-fired thermal power plant located in Sual, Pangasinan in November 2009. On the other hand, SPDC became the IPPA for the San Roque Power Plant, a hydroelectric power plant located in San Manuel, Pangasinan in January 2010 while SPPC became the IPPA for the Ilijan Power Plant, a natural gas-fired combined cycle power plant located in Ilijan, Batangas in June 2010. The Sual Power Plant, San Roque Power Plant and the Ilijan Power Plant are collectively referred to herein as the IPPA Power Plants.

In order to consolidate its power generation business, San Miguel Corporation eventually transferred its equity interest in SMEC, SPDC and SPPC to SMC Global Power. In September 2010, SMC Global Power became a wholly-owned subsidiary of San Miguel Corporation. Since then, SMC Global Power controls the 2,545 MW combined contracted capacity of the Sual Power Plant, San Roque Power Plant, and Ilijan Power Plant through the IPPA Agreements executed by SMEC, SPDC and SPPC, respectively.

In August 2011, as part of the reorganization of the power-related assets of San Miguel Corporation, SMC Global Power acquired from San Miguel Corporation a 100% equity interest in SMELC, which is a grantee of a RES license issued by the ERC.

In April 2013, SMC Global Power, through SPGC, acquired a 35% equity stake in OEDC. In October 2013, SMC Global Power entered into a 25-year concession agreement with ALECO, which became effective upon the confirmation of the NEA in November 2013. SMC Global Power organized and established a wholly-owned and controlled subsidiary, APEC, which assumed, as the concessionaire, all the rights and interests and performs the obligations of SMC Global Power under the concession agreement with ALECO.

SMC Global Power also initiated two greenfield power projects in 2013, namely, the construction of the 2 x 150 MW Davao Greenfield Power Plant and the 4 x 150 MW Limay Greenfield Power Plant. Ground breaking for the Davao Greenfield Power Plant took place in July 2013, while ground breaking for Limay Greenfield Power Plant was held in October 2013. The Davao Greenfield Power Plant is owned by SMCPC, while the Limay Greenfield Power Plant is owned by SCPC, both wholly-owned subsidiaries of SMC Global Power. SCPC is also a RES licensee which obtained its license from the ERC in August 2016. Units 1, 2 and 3 of the Limay Greenfield Power Plant already attained commercial operations in May 2017, September 2017 and March 2018, respectively, while Unit 4 is expected to commence commercial operations next year. Units

1 and 2 of the Davao Greenfield Power Plant already attained commercial operations in July 2017 and February 2018, respectively.

The second 2 x 150 MW of the Limay Greenfield Power Plant was used to be owned by, the LPPC, a wholly-owned subsidiary of SMC Global Power, but this was later transferred to SCPC in June 2017.

In September 2013, SMC Global Power, through SPI, acquired 100% of the 140 MW Limay Co-Gen Power Plant located at the Petron Bataan Refinery, Barangay Alangan, Limay Bataan from Petron Corporation. On 23 December 2016, the Limay Co-Gen Power Plant was sold back by SPI to Petron Corporation.

In November 2014, SMC Global Power, through its subsidiary PVEI, acquired a 60% stake in AHC, the owner and operator of the 218 MW AHEPP.

On 16 June 2016, MGen, a subsidiary of Meralco, and Zygnet subscribed to 2,500 and 102 common shares of MPGC, then a wholly-owned subsidiary of SMC Global Power, respectively. As a result, SMC Global Power’s ownership was reduced to 49% of the outstanding capital stock of MPGC while MGen and Zygnet each owns 49% and 2% equity interest in MPGC, respectively. MPGC shall develop, construct, finance, own, operate and maintain a 4 x 150 MW circulating fluidized bed coal-fired power plant and associated facilities in Mariveles, Bataan.

On 20 March 2018, SMC Global Power acquired 51% and 49% equity interests in SMCGP Masin from AES Phil and Gen Plus B.V., respectively. SMCGP Masin indirectly owns, through its subsidiaries MPPCL and SMCGP Philippines Energy. MPPCL owns, operates and maintains the MPPCL Assets, while SMCGP Philippines Energy plans to construct the Kabankalan BES in Kabankalan, Negros Occidental.

As part of the sale, SMC Global Power also acquired SMCGP Transpower and SPI. SMCGP Transpower was a subsidiary of The AES Corporation which provides for the corporate support services to MPPCL through its Philippine Regional Office and Headquarters, while SPI was a wholly-owned subsidiary of AES Phil and provides energy marketing services to MPPCL.

SMC Global Power, through SMEC, SPDC, SPPC, AHC, SCPC, SMCPC and MPPCL, sells power through offtake agreements directly to customers, including Meralco and other distribution utilities, electric cooperatives and industrial customers, or through the WESM. The majority of the consolidated sales of SMC Global Power are through long-term take-or-pay offtake contracts which have provisions for passing on fuel costs, foreign exchange differentials and certain other fixed costs.

During the years ended 31 December 2015, 2016 and 2017 and the three months ended 31 March 2017 and 2018, respectively, SMC Global Power, through its subsidiaries, sold 14,714 GWh, 15,758 GWh, 15,707 GWh, 3,551 GWh, and 4,330 GWh of power pursuant to offtake agreements and 1,844 GWh, 1,588 GWh, 1,520 GWh, 410 GWH, and 460 GWh of power through the WESM, respectively. During the years ended 31 December 2015, 2016 and 2017, and the three months ended 31 March 2017 and 2018, SMC Global Power, through its subsidiaries, purchased 690 GWh, 767 GWh, 684 GWh, 125 GWh, and 213 GWh of power from the WESM, respectively.

For the year ended 31 December 2017, the total consolidated revenue, net income and EBITDA of SMC Global Power were ₱82,791 million, ₱8,217 million and ₱7,654 million, respectively, and for the three months ended 31 March 2018, the total consolidated revenue, net income and EBITDA of SMC Global Power were ₱24,661 million, ₱1,347 million, and ₱3,093 million, respectively. As of 31 December 2017 and 31 March 2018, SMC Global Power had total consolidated assets of ₱350,173 million and ₱499,922 million, respectively.

SMC Global Power is considering further expansion of its power portfolio of additional capacity nationwide through greenfield power projects over the next few years, depending on market demand. With the increased development of greenfield power plants, an increasing portion of the portfolio of SMC Global Power is expected from Company-owned and Company-operated IPPs. SMC Global Power would also continue to identify strategic acquisitions of existing power generation capacity by participating in the bidding of selected NPC-owned power generation plants that are scheduled for privatization as asset sales or under the IPPA framework, and privately-owned plants with commercial and technical profile that fit its existing portfolio of power assets.

Furthermore, to the extent viable and allowed under prevailing industry regulations, SMC Global Power is open to opportunities for vertical integration of its power business by expanding into businesses along the power sector value chain that complement its current power generation operations. In particular, SMC Global Power intends to pursue downstream integration by capitalizing on changes in the Philippine regulatory structure which allow the expansion into the sale of power to a broader range of customers, including retail customers. With open access and retail competition already implemented, the RES license will allow SMC Global Power, through SMELC, SCPC and MPPCL, to enter into RSCs with Contestable Customers.

SMC Global Power, through SMEC and its subsidiaries, Bonanza Energy, Daguma Agro and Sultan Energy, also owns coal exploration, production and development rights over approximately 17,000 hectares of land in Mindanao which, depending on prevailing global coal prices and the related logistical costs, may be tapped to eventually serve as a significant additional source of coal fuel for its planned and existing greenfield power plants.

SMC Global Power is a wholly-owned subsidiary of San Miguel Corporation, a diversified conglomerate in the Philippines, founded in 1890 that is listed in the Philippine Stock Exchange, Inc. (the "**PSE**") with market-leading businesses in the food, beverage, packaging, fuel and oil, infrastructure, property and investments in car distributorship and banking. The relationship of SMC Global Power with San Miguel Corporation allows it to draw on the extensive business networks, local business knowledge, relationships and expertise of senior key executive officers of San Miguel Corporation.

### IPPA Framework and Asset Transfer Process

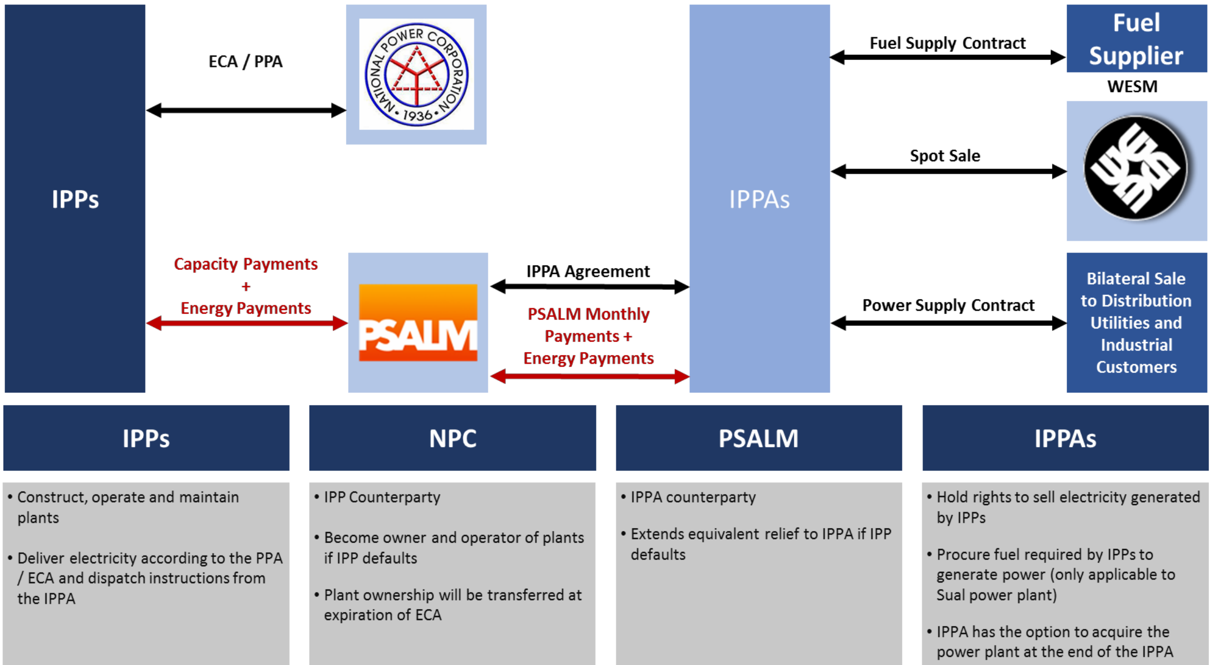
PSALM, together with NPC, has Energy Conversion Agreements ("**ECAs**") or other Power Purchase Agreements ("**PPAs**") in place with various IPPs in the Philippines. Under the EPIRA, PSALM is required to achieve, through open and competitive bidding, the transfer of the management and control of at least 70% of the total energy output of the IPP plants under contract with NPC to IPPAs pursuant to IPPA Agreements, such as those held by SMC Global Power, through SMEC, SPDC and SPPC.

Under IPPA Agreements, the IPPAs have the right to sell the electricity generated by such IPP in the WESM and enter into PSCs with specific customers. The IPPA has to pay PSALM a fixed monthly payment and a variable energy or generation fee (collectively, the "**IPPA Fees**"), the amount of which depends on the dispatch and performance of the IPP. PSALM/NPC in turn, pays the IPPs capacity and energy payments based on their respective ECAs or PPAs.

The IPPA framework is intended to provide successful bidders a way to enter and trade in the WESM for a minimal capital outlay without the expense of building a new power plant and for IPPAs to enjoy the benefits normally attributed to owners of power generation plants. Without maintenance costs or capital upgrades, which remain with the IPPs, IPPAs are permitted to trade in the WESM, and are also free to enter into bilateral contracts and seek other markets for the balance of their contracted capacities and energy, as well as enter into other forms of financial hedging instruments, if desired, to manage their position in and exposure to the market.

In effect, the IPPA framework permits an IPPA to assume the role of NPC as an offtaker of power generated by IPPs without affecting NPCs underlying agreements with the IPP. Also, many of the risks of owning a power plant are explicitly managed through the contract. If there is an extended outage at the power generation plants, for example, there is up to a 50% discount on the monthly fees, and PSALM bears the force majeure risks to the power generation plants.

Set forth below is a general illustration of the IPPA framework.



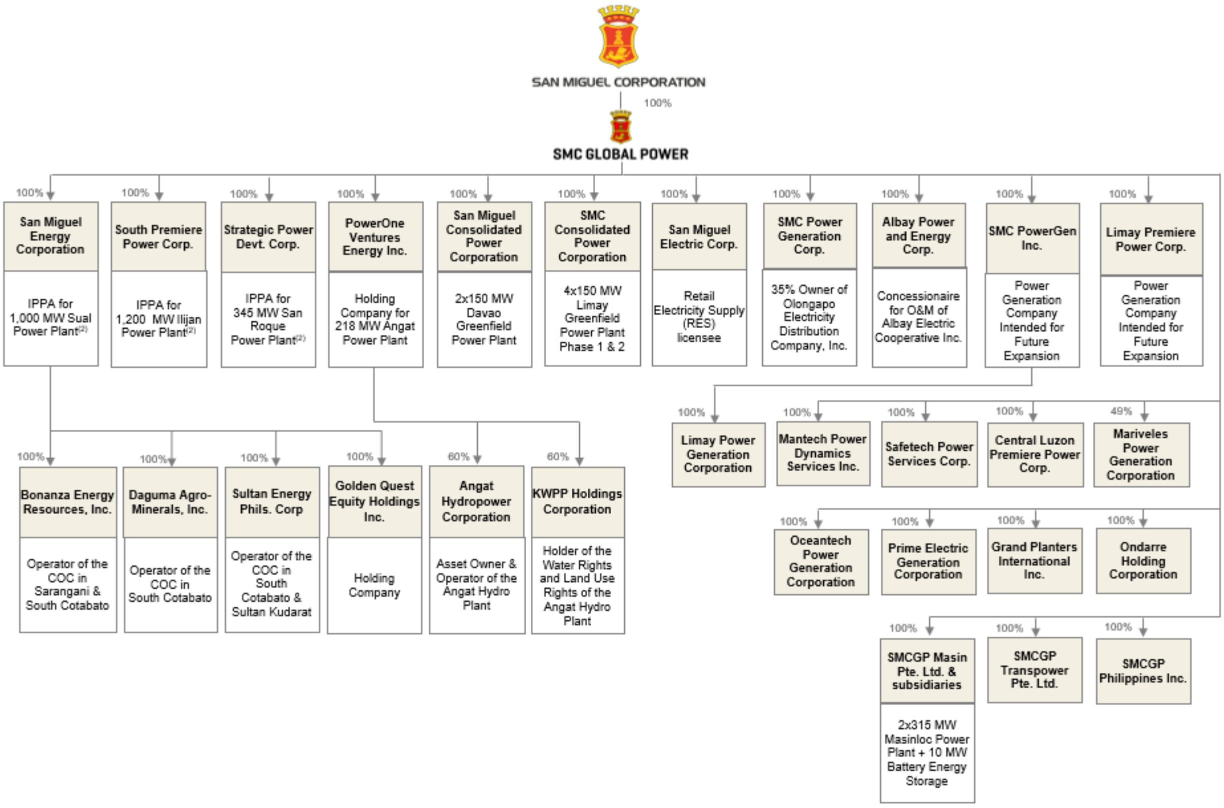

**Risk of pre-payment and cancellation of certain loan obligations**

Consistent with the discussion on page 43 of the Prospectus, the ability to make scheduled payments or interest payments on the Bonds may be affected by the Company's future performance and ability to generate cash, which to a certain extent is subject to general economic, financial, competitive, legislative, legal, regulatory, and other factors such as the terms and conditions of certain loan obligations of SMC Global Power. The terms and conditions of some of these loans may allow the lenders to require certain mandatory pre-payments from the Issuer under circumstances as such lenders and the Company agreed upon. As of 31 March 2018, the Company outstanding loans amounting to Php112,592,000,000.00 are covered by some form of pre-payment stipulation.

The Company employs a system of financial prudence and good corporate governance to manage the risks relating to its debt and equity financing and continuously monitors its compliance with the terms and conditions of the Company's loan obligations.

## Corporate Organization

Set forth below is the corporate organizational chart of SMC Global Power as of 31 March 2018.




(1) As of March 20, 2018
(2) SMC Global Power manages and controls the capacity of the plants under IPPA agreements with PSALM

## Strengths of SMC Global Power

**Leading power company in the Philippines with a strong growth platform.**

SMC Global Power and its subsidiaries is one of the largest power companies in the Philippines with a combined capacity of 4,153 MW as 31 March 2018. The subsidiaries of SMC Global Power, namely SMEC, SPDC and SPPC, are the IPPAs for the Sual, San Roque and Ilijan Power Plants, respectively, which have a combined contracted capacity attributable to SMC Global Power of 2,545 MW. SMC Global Power also owns a 60% stake in AHC, the owner and operator of the 218 MW AHEPP, and 100% ownership in SCPC, SMCPC, and SMCGP Masin Pte. Ltd. ("**SMPL**", previously MAPL), the owners of the Limay, Davao and Masinloc Power Plants, respectively. Based on the total installed capacity of the market, SMC Global Power, through its subsidiaries, on a contracted capacity basis for the Sual, San Roque and Ilijan Power Plants and with the full capacity of Units 1, 2 and 3 of the Limay Greenfield Power Plant, Units 1 and 2 of the Davao Greenfield Power Plant, Units 1 and 2 of the Masinloc Greenfield Power Plant, Masinloc BES and the AHEPP, has a 19% market share of the power supply of the National Grid of the Philippines, a 25% market share of the Luzon Grid and a 9% market share of the Mindanao Grid in each case as of 31 March 2018, based on ERC Resolution No. 04, Series of 2018.

The IPPA business model provides SMC Global Power, through the IPPA subsidiaries, with the benefit of having the right to sell electricity generated by the IPPs without having to incur large upfront capital expenditures for the power plant construction, or to bear any related development risk or ongoing maintenance capital expenditures. The IPPA subsidiaries of SMC Global Power manage the amount of power to be produced by the IPP for supply to the customers of the IPPA and sell the power generated by the IPPs either pursuant to offtake agreements directly with customers or through the WESM. This business model provides SMC Global Power the ability to manage both market and price risk by entering directly into bilateral contracts with established customers while capturing potential upside through the sale of excess capacity through the WESM when spot market prices are attractive.

The experience of SMC Global Power, through its subsidiaries, in acting as IPPA and its history of power plant ownership and operation, has enabled SMC Global Power to gain significant expertise in the Philippine power generation industry. With this experience, SMC Global Power believes it is in a strong position to participate in the expected future growth of the Philippine power market, through both the development of greenfield power projects and the acquisition of existing power generation capacity of selected NPC-owned power generation plants that are scheduled for privatization as asset sales or under the IPPA framework.

In addition, capitalizing on changes in the Philippine regulatory structure, SMC Global Power, through SMELC, SCPC and MPPCL, holds RES licenses from the ERC allowing it to enter into offtake agreements with Contestable Customers. SMC Global Power, through SMEC and its subsidiaries, also maintains its coal concession assets which may serve as a back-up fuel source for its greenfield coal plants.

**Stable and predictable cash flows underpinned by long-term offtake agreements.**

SMC Global Power, through its subsidiaries, sells power either through offtake agreements directly to customers, including Meralco and other distribution utilities, electric cooperatives and industrial customers, or through the WESM. Revenue from bilateral contracts with off-takers contributed 92%, 95%, 95%, 95% and 93% of total revenue for the years ended 31 December 2015, 2016, 2017 and for the 3 months ended March 31, 2017 and 2018, respectively. The majority of the combined capacity of SMC Global Power, through its subsidiaries, has bilateral contracts that cover the term of the IPPA Agreements.

These offtake agreements provide SMC Global Power, through its subsidiaries, with stable and predictable cash flow, by enabling it to manage both market and price risks. Despite the general volatility in market prices for electric power due to supply and demand imbalances, SMC Global Power has been able to manage such risks through the contracted sale prices with offtakers which also provide a long-term stable source of demand. The tariffs under these agreements take into account adjustments for fuel, foreign exchange, and inflation, thereby allowing SMC Global Power to pass through these costs to its offtakers. In addition, SMC Global Power's diversified portfolio of base load and peaking power plants helps mitigate market risks through long- term, inter- company, replacement power contracts.

**Flexible and diversified power portfolio.**

SMC Global Power manages the capacity of a balanced portfolio of some of the newest and largest power plants in the Philippines, which benefit from diversified fuel sources. The IPPA Power Plants have an average age of 15 years. In terms of installed capacity in the Philippines, the Sual Power Plant is the largest coal-fired power plant, the San Roque Power Plant is one of the largest and newest hydroelectric power plants, and the Ilijan Power Plant is the largest natural gas-fired power plant.

The existing power portfolio of SMC Global Power consists of (i) IPPAs, covering coal-fired (Sual Power Plant through SMEC), which represents 24% of the capacity of SMC Global Power, hydro-powered (San Roque Power Plant through SPDC), which represents 8% of the capacity of SMC Global Power, and natural gas- fired (Ilijan Power Plant through SPPC), which represents 29% of the capacity of SMC Global Power, (ii) the AHEPP, through AHC, which represents 6% of the capacity of SMC Global Power, and (iii) power plants owned by SMC Global Power, particularly the Limay Greenfield Power Plant of SCPC, which represents 11% of the capacity of SMC Global Power, the Davao Greenfield Power Plant, which represents 7% of the capacity of SMC Global Power, and the Masinloc Greenfield Power Plant (with Masinloc BES), which represents another 15% of the capacity of SMC Global Power as of March 31, 2018. Power generated by the Sual, Ilijan, Limay, Davao, and Masinloc Power Plants are primarily used as base load supply, and sold to customers pursuant to offtake agreements. Power generated by the San Roque Power

Plant and the AHEPP is used as peaking supply, and sold through the WESM or as replacement power to affiliates.

SMC Global Power believes that the size and diversity of the fuel supply of its power portfolio reduces the exposure of SMC Global Power and its customers to fuel-type specific risks such as variations in fuel costs, and regulatory concerns that are linked to any one type of power plant or commodity price. SMC Global Power believes that its management of the capacity of this diverse portfolio of power plants allows it to respond efficiently to market requirements at each point of the electricity demand cycle. This diversity helps it to improve the profitability of its portfolio by flexibly dispatching electricity in response to market demand and fuel cost competitiveness. SMC Global Power and its subsidiaries can enter into bilateral contracts and trade in the WESM for the balance of its contracted capacities and energy. By managing the IPPA Power Plants as a single portfolio and actively managing the energy output of the plants, SMC Global Power seeks to offer more competitive electricity rates compared to other power companies with smaller and less diverse portfolios.

**Established relationships with world class partners.**

The IPPA Power Plants are owned, operated and maintained by world-class partners, such as Marubeni Corporation, Tokyo Electric Power Corporation, Korea Electric Power Corporation and Mitsubishi Corporation. Since entering the power business, SMC Global Power has established relationships with internationally recognized fuel suppliers in Indonesia and Australia, as well as with its customers, including Meralco, its largest customer. SMC Global Power believes that these well-established relationships provide a strong foundation for its existing business and a platform of potential partners for future expansion.

**Strong Parent Company support.**

San Miguel Corporation, the principal shareholder of SMC Global Power, is a diversified conglomerate with 128 years of operations in the Philippines. San Miguel Corporation today is one of the largest and most diversified conglomerate in the Philippines in terms of revenues and assets and is listed in the PSE. In addition to its power business, San Miguel Corporation has market-leading businesses in vital industries that support the economic development of the country, including the food and beverage, packaging, fuel and oil, infrastructure, property and investments in car distributorship and banking.

Under the stewardship of San Miguel Corporation, SMC Global Power has become one of the market leaders in the Philippine power industry in a relatively short period of time. San Miguel Corporation provides SMC Global Power with key ancillary and support services in areas that promote operational efficiency, such as human resources, corporate affairs, legal, finance, and treasury functions. SMC Global Power believes it will continue to benefit from the extensive business networks of San Miguel Corporation, its in-depth understanding of the Philippine economy and expertise of its senior management to identify and capitalize on growth opportunities. Given the substantial electricity requirements of the other businesses of San Miguel Corporation, SMC Global Power believes that it can benefit from potential revenue and operational synergies within the SMC group of companies, and it can potentially provide a large captive energy demand base for SMC Global Power.

**Experienced management, operating, trading and marketing teams.**

The senior management of SMC Global Power has extensive experience in the Philippine power industry and has a deep understanding of the Philippine electricity markets with respect to the operational, financial, regulatory, and business development aspects of the operation and management of power plants. The senior management team of SMC Global Power has strong professional relationships with key industry participants, such as the DOE, PSALM, NPC, National Transmission Corporation ("**TransCo**"), National Grid Corporation of the Philippines ("**NGCP**"), PEMC and ERC, as well as people from other government offices and agencies. The employees of SMC Global Power include experienced energy traders who pioneered WESM trading and marketing executives who have established strong relationships with the extensive customer base of NPC. The members of the Executive Committee of SMC Global Power have on average more than 25 years of experience in executive management and related government experience in the power industry, including strengths in key areas of engineering and finance. The executive and senior management have displayed a strong track record of growth and delivery since SMC Global Power commenced operations in November 2009.

**Well-positioned to capitalize on the anticipated growth of the Philippine electricity market.**

Over the period from 2015 to 2020, growth in demand for electricity in the Philippines is expected to exceed the growth rate of the Philippines' gross domestic product, according to the DOE. Construction of new power plants on average takes a minimum of 3 years. Given the gap between projected electricity demand and committed power projects, SMC Global Power expects that there will be a power supply shortage in the medium term until new capacity is built to meet the growing consumption.

SMC Global Power believes it is well-positioned to take advantage of opportunities from continued growth in the Philippine electricity market, as well as from the existing power supply shortage. The latter is exacerbated by an existing base of old Government-owned power plants, which are nearing the end of their useful life, as well as a large base of seasonal power supply such as the hydropower plants particularly in Mindanao. To meet this need, SMC Global Power has a defined roadmap to increase capacity by developing greenfield power plants and bidding for selected NPC-owned power generation plants that are scheduled for privatization.

SMC Global Power, through its subsidiaries, SCPC,MPPCL and SMCGP Philippines Energy, is in the process of completing the construction of two greenfield power plants, the Limay and Masinloc Greenfield Power Plants and battery energy storage facilities, the Kabankalan BES, with a total of 460MW of plants' combined generation capacity commissioned in 2017 and 2018 and the last 525 MW is expected to be commissioned in 2019 for Unit 4 of Limay with 150 MW capacity, Unit 3 of Masinloc with 335 MW capacity and 2 x 20 MW Kabankalan BES. In addition, as a leading power company in the Philippines with a large customer base, SMC Global Power believes that it is in a strong position to leverage its relationships with its existing customers to service their expected increased electricity demand.

**Business Strategies**

**Optimize the generation capacity of its power portfolio.**

SMC Global Power and its subsidiaries intends to actively manage its sales and optimize the operations of its power plant portfolio in order to achieve a balanced mix of power sales through (i) contractual arrangements with electricity customers including distribution utilities, industrial and commercial customers, and the contestable market and (ii) opportunistic sales through the WESM. This approach provides SMC Global Power with the certainty and predictability of sales from contracted sales while being able to capture sales upside from the WESM. The objective of SMC Global Power is to supply customers based on the least cost while dispatching according to the requirements of the IPPA Agreements, and to sell available excess energy of the IPPA Power Plants through the WESM at favorable prices.

Specifically, in case of high prices in the WESM, SMC Global Power can optimize its portfolio and take advantage of such pricing and sell the excess output of the Power Plants to the WESM after delivering the contractual amounts required under its offtake agreements. Alternatively, in case of low prices in the WESM, SMC Global Power can minimize the generation output of its power plants and deliver the contractual amounts required under its offtake agreements either with output from the San Roque and Angat Power Plants or with energy purchased from the WESM. In the event of tripping or shutdown of either the Sual or Ilijan Power Plant, SMC Global Power can maximize the dispatch of its remaining units by lowering the bid prices so that the bilateral contract quantity requirements will be served without buying at high prices from the WESM.

SMC Global Power also leverages on the diversity of its portfolio to create operational synergies and improve its supply offers to offtakers. Having a portfolio of base load, mid-merit, and peaking power plants utilizing different fuel sources allows SMC Global Power to actively respond to the needs of its offtakers and the market, particularly with regards to replacement power and pricing competitiveness.

**Grow its power portfolio through the development and acquisition of power generation capacity.**

SMC Global Power intends to utilize its strong platform, extensive relationships and experienced management team to address the growing demand for power in the Philippines. SMC Global Power plans to continue its strategic development of greenfield power projects in parallel with its plan to acquire existing power generation capacity by bidding for selected NPC-owned power generation plants that are scheduled for privatization as asset sales or under the IPPA framework. SMC Global Power seeks to capitalize on regulatory and infrastructure developments by scheduling the construction of greenfield power projects to coincide with the planned improvements in the interconnectivity of the Luzon and Visayas grids, as well as the eventual interconnectivity and implementation of WESM in Mindanao. In addition, SMC Global Power seeks to maintain the cost competitiveness of these new projects by strategically locating them in high- demand areas and in proximity to the grid. SMC Global Power is considering the further expansion of its power portfolio of new capacity nationwide through greenfield power plants over the next few years, depending on market demand. SMC Global Power plans to carry out the expansion of its power portfolio in phases across Luzon, Visayas and Mindanao. SMC Global Power is using and will continue to use clean coal technology for its planned and existing greenfield power plants.

**Integrate complementary businesses.**

SMC Global Power intends to continue to expand into businesses along the power sector value chain that complement its current power generation business. SMC Global Power has obtained a RES license, through SMELC, SCPC and MPPCL, to expand its customer base and diversify its sales. With the open access and retail competition fully implemented, the RES license allows SMC Global Power through SMELC, SCPC and MPPCL, to enter into retail electricity supply agreements with Contestable Customers. In addition, SMC Global Power has invested in distribution assets, namely OEDC and APEC, which create a competitive advantage through integrated generation and distribution operations.

On the other hand, SMC Global Power, through SMEC and its subsidiaries, Bonanza Energy, Daguma Agro and Sultan Energy, has acquired coal exploration, development and production rights over approximately 17,000 hectares of land in Mindanao. Depending on the prevailing global coal prices and the related logistical costs, SMC Global Power could develop these assets which could potentially provide a significant additional source of coal fuel for its planned and existing greenfield power plants. SMC Global Power believes that a successful integration of viable coal mining operations into its power generation business could provide it with an additional competitive advantage over its competitors in the local power industry.

**Leverage operational synergies.**

SMC Global Power intends to establish a track record of reliability by partnering with world-class IPP partners. SMC Global Power believes that the high caliber of these IPP partners enhances the likelihood that the IPPA Power Plants are in good working condition if SMEC, SPDC and SPPC exercise their respective options to purchase them upon the expiration of their IPPA Agreements. SMC Global Power, through PVEI, also gains knowledge and expertise with its joint venture partnership with K-Water in AHEPP. SMC Global Power believes that this approach complements its strategic development of greenfield power projects. Further, SMC Global Power creates operational synergies within and among its subsidiaries by performing key management functions at the holding company level under management agreements. Key management functions include sales and marketing, energy trading, finance, legal, human resources, and billing and settlement. This allows all the subsidiaries to benefit from the wealth of experience of the management team of SMC Global Power while optimizing initiatives at a portfolio level. SMC Global Power also intends to establish customer relationships with other subsidiaries and affiliates of SMC for the sale and supply of power.

The table below sets forth the gross profit margin, EBITDA margin and net income before tax margin of SMC Global Power for the periods indicated:

| | As of and for the years ended December 31 | | | As of and for the three months ended March 31 | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| | **(₱ in millions, except percentages)** | | | | |
| Revenues | 77,507 | 77,972 | 82,791 | 19,353 | 24,661 |
| Operating income | 23,703 | 26,730 | 24,276 | 6,040 | 7,991 |
| Operating income margin(1) | 30.6% | 34.3% | 29.3% | 31.2% | 32.4% |
| EBITDA(2) | 5,458 | 10,475 | 7,654 | 1,454 | 3,093 |
| EBITDA margin(3) | 7.0% | 13.4% | 9.2% | 7.5% | 12.5% |
| Net income before tax | 4,532 | 7,516 | 14,396 | 2,001 | 1,712 |
| Net income before tax margin(4) | 5.8% | 9.6% | 17.4% | 10.3% | 6.9% |

*Notes:*
*(1) Calculated as operating income divided by revenues.*
*(2) EBITDA is Calculated as (a) net income (excluding items between any or all of the company and its subsidiaries) plus (b) income tax expense (benefit), finance cost (less interest income) and depreciation, in each case excluding amounts attributable to ring- fenced subsidiaries less (c) foreign exchange gain (loss), gain on sale of investment and aggregate fixed payments made to PSALM.*
*(3) Calculated as EBITDA divided by revenues.*
*(4) Calculated as net income before income tax divided by revenues.*

In addition, SMC Global Power, through its subsidiaries, Daguma Agro, Bonanza Energy and Sultan Energy, owns various coal properties that it may develop as a hedge against international coal price fluctuations.

**Extent of Power Generation Facilities**

**Sual Power Plant**

*Background*

The Sual Power Plant is a 2 x 647 MW coal-fired thermal power plant located in Sual, Pangasinan on the Lingayen Gulf that commenced commercial operations in October 1999. It is the largest coal-fired thermal power plant in the Philippines in terms of installed capacity. The Sual Power Plant was built by CEPA Pangasinan Electric Limited pursuant to an ECA with NPC under a 25-year Build-Operate-Transfer ("**BOT**") scheme that expires on 24 October 2024. On 1 September 2009, SMEC, was declared the winning bidder and received the notice of award for the IPPA for the Sual Power Plant. On 6 November 2009, SMEC assumed the administration of the Sual Power Plant in accordance with the provisions of the Sual IPPA Agreement.

**Sual IPPA**

*Power Plant Capacity and Fuel Supply*

SMC Global Power, through its wholly-owned subsidiary, SMEC, has the contractual right to manage, control, trade, sell or otherwise deal in up to 1,000 MW of the generation capacity of the Sual Power Plant pursuant to the Sual IPPA Agreement. Under the Sual IPPA Agreement, SMEC has the option to acquire the Sual Power Plant in October 2024 without additional consideration. SMEC may exercise the option to acquire the Sual Power Plant prior to October 2024 under certain circumstances, such as changes in law or non-performance by TeaM Energy of its obligations under the ECA. In this case, the transfer price will be the net present value of the sum of the agreed monthly payments remaining unpaid at the date of termination of the Sual IPPA Agreement.

*Power Offtakers*

Unit 1 of the Sual Power Plant is fully contracted to Meralco under a long-term offtake agreement expiring in 2019, subject to extension up to 2024, while the capacity of Unit 2 of the Sual Power Plant is contracted to various distribution utilities, electric cooperatives and industrial customers under existing PSCs.

*Operations Review*

The table below is a summary of operating statistics of the Sual Power Plant for the periods indicated.

| | **Year ended December 31** | | | **Three months ended March 31** | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| Actual Energy Generated (GWh) . . . . . . . . . . . . . . . . . . | 6,066 | 6,341 | 5,333 | 1,775 | 1,536 |
| Electricity sold (GWh): . . . . . . . . . . . . . . . . . . . . . . . . . . . | 7,617 | 8,015 | 8,388 | 2,111 | 2,109 |
| of which: bilateral offtake agreements . . . . . . . . . . . . . | 7,048 | 7,480 | 7,850 | 1,869 | 1,955 |
| of which: WESM sales . . . . . . . . . . . . . . . . . . . . . . . . | 569 | 535 | 538 | 242 | 154 |
| Average realized electricity prices(₱/MWh): | | | | | |
| for electricity sold under bilateral offtake agreements . . . | 4,439 | 4,401 | 4,940 | 5,142 | 5,198 |
| for electricity sold on WESM . . . . . . . . . . . . . . . . . . . . . | 3,609 | 2,401 | 2,213 | 2,161 | 3,962 |
| Net Capacity Factor (%) . . . . . . . . . . . . . . . . . . . . . . . . . | 69 | 72 | 61 | 82 | 71 |
| Availability Factor (%) . . . . . . . . . . . . . . . . . . . . . . . . . . | 82 | 84 | 71 | 94 | 88 |
| Reliability Factor (%) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 99 | 97 | 74 | 93 | 99 |
| Average Net Dependable Capacity (MW) . . . . . . . . . . . . . . | 915 | 955 | 830 | 997 | 999 |
| Net Heat Rate (Kilo-Calorie/Kilowatt hour or "**Kcal/KWh**") (Lower heating value or "**LHV**") . . . . . . . . . . . . . . . . . . . . . . . | 2,427 | 2,419 | 2,448 | 2,450 | 2,444 |

*Fuel Supply*

The table below sets forth certain information regarding the supply of coal to the Sual Power Plant as of the periods indicated.

| | **Year ended December 31** | | | **Three months ended March 31** | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| Metric tons (thousands) . . . . . . . . . . . . . . . . . . . . . . | 2,381.8 | 2,459.0 | 2,086.1 | 698.2 | 607.8 |
| Average calorific value (kcal/kg) . . . . . . . . . . . . . . . . | 6,131.0 | 6,233.2 | 6,200.9 | 6,204.0 | 6,176.5 |
| (in millions ₱) . . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 7,811.7 | 7,799.3 | 10,562.3 | 3,586.1 | 3,485.8 |
| Average price per metric ton (₱) . . . . . . . . . . . . . . . | 3,279.7 | 3,171.7 | 5,063.1 | 5,136.0 | 5,734.7 |

SMEC has an existing coal supply agreement with KPC which will ensure a steady supply of coal for SMEC. For the period 2017 to 2021, KPC will be supplying coal to SMEC. For 2017, KPC supplied 8 panamax shipments which will be increased to 12 panamax shipments per year from 2018 to 2021. Each shipment shall comprise 65,000 metric tons +/- 10%. Pricing under the coal supply agreement will be subject to adjustment based on certain standards applicable to the quality or grade of the coal delivered by KPC. SMEC also has other coal supply contracts with other suppliers.

*Operations and Maintenance*

The Sual Power Plant is operated by TeaM Energy. Under the Sual ECA, TeaM Energy is responsible, at its own cost, for the management, operation, maintenance, including the supply of consumables and spare parts, and the repair of the Sual Power Plant. TeaM Energy is required to use its best endeavors to ensure that the Sual Power Plant is in good operating condition and capable of converting fuel supplied by SMEC under the Sual IPPA Agreement, into electricity in a safe and reliable manner.

The maintenance plan for the Sual Power Plant is agreed upon annually between SMEC, NPC, PSALM, NGCP and TeaM Energy. The maintenance plan includes scheduled inspections and overhauls, including scheduled periods of outage. Planned outages for maintenance are scheduled in such a way that only 1 unit is scheduled for shut down at any given time. The maintenance plan is established with consideration given to the dispatch requirements of SMEC and recommendations of the plant manufacturer. TeaM Energy is required to execute the maintenance plan in accordance with the recommendations of the original equipment manufacturer and good utility practice. TeaM Energy performs periodic maintenance activities on the generating units of the Sual Power Plant during the operations of the plant. The Sual ECA requires TeaM Energy to conduct an annual test to check the capacity and heat rate of the generating units of the Sual Power Plant, if requested by SMEC.

Each of the generating units of the Sual Power Plant historically has been, and is expected to continue to be, shut down for routine maintenance for approximately 30 days per calendar year. SMEC also expects that TeaM Energy will shut down these units for more significant maintenance and repair work for a total of approximately 60 days in every 5th calendar year.

The table below sets forth actual planned outages of the Sual Power Plant for the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| Unit 1 . . . . . . . . . . . . . . . . . . . . . . . . . . . | 27 days | 74 days | 27 days | 0 day | 0 day |
| Unit 2 . . . . . . . . . . . . . . . . . . . . . . . . . . . | 60 days | 20 days | 0 day | 0 day | 24 day |

In 2016, Unit 1 of the Sual Power Plant underwent 60 days major scheduled maintenance which occurs once every 5 years but requested for 14 days more extension. Unit 2, on the other hand, was scheduled to undergo its 30-day scheduled maintenance in 2016 but the actual repair was only 20 days.

In 2017, Unit 1 underwent 27 days of planned maintenance outage.

In 2018, Unit 2 was shut down for 24 days for the installation of main unit of transformer.

The table below sets forth unplanned outages of the Sual Power Plant for the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| Unit 1 . . . . . . . . . . . . . . . . . . . . . . . . . . . | 7 days | 9 days | 33 days | 7 days | 0 day |
| Unit 2 . . . . . . . . . . . . . . . . . . . . . . . . . . . | 34 days | 14 days | 158 days | 4 days | 1 day |

In 2016, Unit 1 of the Sual Power Plant underwent 9 days forced outages which were mostly due to boiler tube leaks, stuck-up gland seal valve and switchyard hot spot on Phase C of XCT connector XCT301 and DS301. Unit 2, on the other hand, experienced 14 days forced outages which were mostly due to boiler tube leaks and Generator Current Transformer Differential Fault.

In 2017, 33 days forced outages in Unit 1 were mostly due to condenser tube leaks, water wall tube leaks and boiler tube leaks on panel area while 158 days forced outages in Unit 2 during the same year were due to generator main transformer failure for 150 days from June 14 to November 10 and condenser tube leaks and boiler tube leaks for 8 days.

*Power Transmission*

Power from the Sual Power Plant is transmitted through a 25-kilometer 230 kV transmission line from the Sual Power Plant switchyard to the Kadampat Substation located at Labrador, Pangasinan. The transmission line is owned by the TransCo and operated and maintained by its concessionaire, NGCP.

**San Roque Power Plant**

*Background*

The 345 MW San Roque multi-purpose hydroelectric power plant in San Manuel, Pangasinan commenced operations on 1 May 2003 and is a peaking plant that was constructed by a consortium composed of Marubeni Corporation, Sithe Philippines Holdings, Ltd., and Italian-Thai Development Public Company Limited pursuant to a power purchase agreement with NPC under a BOT scheme (the "**San Roque PPA**").

The San Roque Power Plant utilizes the Agno River for peaking power, irrigation, flood control and water quality improvement for the surrounding region, and comprises 3 power generation units of 115 MW each. The San Roque Power Plant provides an annual energy generation of 1,065 GWh from the 345 MW hydroelectric power plant, the irrigation of approximately 34,450 hectares of agricultural land, storage of water that would otherwise flood the Pangasinan plains, and improvement of water quality of the Agno River which, otherwise, would pollute the downstream rivers.

On 15 December 2009, SPDC, a wholly owned subsidiary of SMC Global Power, successfully bid for the appointment to be the IPPA for the San Roque Power Plant and received a notice of award on 28 December 2009. SPDC assumed administration of the San Roque Power Plant on 26 January 2010 in accordance with an IPPA Agreement with PSALM (the "**San Roque IPPA Agreement**"). PSALM remains responsible under the San Roque PPA to remunerate the IPP of the San Roque Power Plant for the electricity it produces.

**San Roque IPPA**

*Power Plant Capacity*

Under the San Roque IPPA Agreement, SPDC has the right to manage, control, trade, sell or otherwise deal in the electrical generation capacity of the San Roque Power Plant, while NPC, which owns and operates the dam and related facilities thereof, obtained and maintains water rights necessary for the testing and operation of the power plant. SPDC is required to assist PSALM so that the San Roque Power Plant can draw water from the Agno River required by the power plant and necessary for it to generate the electricity required to be produced under the San Roque PPA of NPC with San Roque Power Corporation ("**SRPC**").

Under the San Roque IPPA Agreement, SPDC has the right to acquire the San Roque Power Plant in May 2028, which is the end of the cooperation period between NPC and SRPC, or on some earlier date due to certain events such as changes in law or non-performance by SRPC pursuant to the San Roque PPA.

The San Roque Power Plant is a peaking plant. Under the terms of the San Roque PPA, power and energy are delivered to SPDC at the delivery point (the high voltage side of the step-up transformers) located at the perimeter fence of the San Roque Power Plant site. SPDC is responsible for contracting with the NGCP to wheel power from the delivery point.

*Operations Review*

The table below is a summary of operating statistics of the San Roque Power Plant during the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| Actual Energy Generated (GWh) . . . . . . . . . . . . . | 1,066 | 798 | 692 | 189 | 163 |
| Electricity sold (GWh): . . . . . . . . . . . . . . . . . . . . | 1,589 | 1,435 | 1,026 | 293 | 248 |
| of which: bilateral offtake agreements . . . . . . . | 863 | 971 | 827 | 257 | 191 |
| of which: WESM sales . . . . . . . . . . . . . . . . . . | 726 | 464 | 199 | 36 | 57 |
| Average realized electricity prices(₱/MWh): | | | | | |
| for electricity sold under bilateral offtake agreement . . . . . . . . . . . . . . . . . . . . . . . . . . . . | 5,096 | 5,464 | 5,844 | 5,211 | 6,343 |
| for electricity sold on WESM . . . . . . . . . . . . . . . | 3,965 | 3,251 | 4,395 | 4,278 | 4,499 |
| Net Capacity Factor (%) . . . . . . . . . . . . . . . . . . . | 35 | 26 | 23 | 25 | 22 |
| Availability Factor (%) . . . . . . . . . . . . . . . . . . . . . | 98 | 99 | 97 | 100 | 100 |
| Reliability Factor (%) . . . . . . . . . . . . . . . . . . . . . | 100 | 100 | 100 | 100 | 100 |
| Average Net Dependable Capacity (MW) . . . . . . | 415 | 433 | 374 | 435 | 435 |

*Water Rights*

The generated output energy of the San Roque Power Plant is limited by the "Irrigation Diversion Requirements" set by the National Irrigation Administration of the Philippines. Water allocation is usually dictated by rule curve that is derived from historical data of river flows and water demands. A rule curve shows the minimum water level requirement in the reservoir at a specific time to meet the needs for which the reservoir is designed. The rule curve must generally be followed except during periods of extreme drought and when public interest requires.

Generally, the output energy of San Roque Power Plant is high during planting seasons which covers the months of December through April (dry planting season) and July through September (wet planting season). The water releases from the dam, and thus, energy generation, during the dry planting season is much higher due to the absence of rain. The water rights of NPC are used by the San Roque Power Plant, and NPC, until the date of transfer of the San Roque Power Plant to NPC (or SPDC, as the case may be), must obtain such renewals or extensions as may be required to maintain the water rights in full force and effect at all times. NPC derives its water rights from a permit granted by the National Water Resources Board.

*Operations and Maintenance*

SRPC is responsible for the operations and maintenance of the San Roque Power Plant for 25 years effective 1 May 2003. SRPC is owned by Marubeni Corporation and Kansai Electric Power Company Ltd. Under the San Roque PPA, SRPC is responsible for the management, operation, maintenance and repair of the San Roque Power Plant at its own cost until transfer to NPC or SPDC, as the case may be. As operator, SRPC is entitled to conduct the normal inspection, regular maintenance, repair and overhaul for a period of 15 days for each unit comprising the San Roque Power Plant. In addition, SRPC has the right to enter into contracts for the supply of materials and services, including contracts with NPC; appoint and remove consultants and professional advisers; purchase replacement equipment; appoint, organize and direct staff; manage and supervise the power plant; establish and maintain regular inspection, maintenance and overhaul procedures; and otherwise run the power plant within the operating parameters set out in the San Roque PPA.

The maintenance plan for the San Roque Power Plant is agreed upon annually between SPDC, NPC, PSALM, NGCP and SRPC. The maintenance plan includes scheduled inspections and overhauls, including scheduled periods of outage and details as to the personnel required to complete each inspection. Planned outages for maintenance of the generating units are scheduled in such a way that only 1 unit is shut down at any given time. The power tunnel that delivers water from the reservoir to the generating units also undergoes routine annual maintenance inspections, during which all units are shut down. The maintenance plan is established with consideration given to the dispatch requirements of SPDC and recommendations of the plant manufacturer. SRPC is required to execute the maintenance plan in accordance with the recommendations of the original equipment manufacturer and good utility practice. SRPC performs periodic maintenance activities on the generating units of the San Roque Power Plant during the course of the operation of the plant. The San Roque PPA requires SRPC to conduct an annual test to check the capacity of the generating units of the San Roque Power Plant. As of the date of this Offer Supplement, the generating units of the San Roque Power Plant have attained and maintained the required contracted capacity specified in the San Roque PPA.

Each of the generating units of the San Roque Power Plant historically has been, and is expected to continue to be, shut down for routine maintenance for approximately 15 days per calendar year sometime between April to June of each year, when water levels at the reservoir are low. Since 2010, during periods when a generating unit is shut down for routine maintenance, the San Roque Power Plant has historically been, and is expected to continue to be, able to generate power at the applicable minimum run rate from the other generating units. The San Roque Power Plant does not have a regular schedule for significant maintenance and repair work.

The power tunnel that delivers water from the reservoir to the generating units also undergoes routine maintenance inspections for approximately 15 days per calendar year. Power tunnel inspections historically have been, and are expected to continue to be, conducted between April to June of each year, after the end of the irrigation period and when water levels at the reservoir are low.

The table below sets forth the actual planned outages of the power tunnel for the San Roque Power Plant for the periods indicated.

| Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|
| **2015** | **2016** | **2017** | **2017** | **2018** |
| 6 days (May 26 to June 1) | 4 days (May 26 to May 30) | 11 days (May 27 to June 6) | 0 day | 0 day |

The 4 days planned outages of the San Roque Power Plant during the year 2016 were due to power tunnel inspection, repair of revenue meter repair and installation of individual electronic meter of NGCP.

In 2017, 11 days planned outages of the San Roque Power Plant were due to power tunnel, inspection and annual preventive maintenance of San Roque-San Manuel 230 KV lines.

*Power Transmission*

Power from the San Roque Power Plant is transmitted through a nine-kilometer 230 kV transmission line from the San Roque Power Plant switchyard to the San Manuel substation located in Pangasinan. The transmission line is owned by TransCo, and operated and maintained by NGCP.

**Ilijan Power Plant**

*Background*

The Ilijan Power Plant commenced commercial operations on 5 June 2002, and is located on a 60-acre site at Arenas Point, Barangay Ilijan, Batangas City. The Ilijan Power Plant was constructed and is owned by KEPCO Ilijan Corporation ("**KEILCO**") pursuant to a 20-year ECA with NPC ("**Ilijan ECA**") under a BOT scheme that expires on 4 June 2022. NPC/PSALM supplies natural gas to the Ilijan Power Plant from the Malampaya gas field in Palawan under a gas supply agreement with Shell Exploration Philippines BV. The Ilijan Power Plant consists of 2 blocks with a rated capacity of 600 MW each.

The Ilijan Power Plant can also run on diesel oil stored on site. On 16 April 2010, SMC successfully bid for the appointment to be the IPP Administrator for the Ilijan Power Plant and received a notice of award on 5 May 2010. On 10 June 2010, SMC and SPPC, entered into an assignment agreement with assumption of obligations whereby SMC assigned all of its rights and obligations with respect to the Ilijan Power Plant to SPPC. SPPC assumed administration of the Ilijan Power Plant on 26 June 2010 in accordance with the Ilijan IPPA Agreement.

**Ilijan IPPA**

*Power Plant Capacity and Fuel Supply*

SMC Global Power, through its wholly-owned subsidiary, SPPC, has the contractual right to manage, control, trade, sell or otherwise deal in the generation capacity of the Ilijan Power Plant pursuant to the Ilijan IPPA Agreement. Although the installed capacity of the Ilijan Power Plant totals 1,271 MW, ERC records attribute to SPPC a capacity of 1,200 MW for the Ilijan Power Plant. Accordingly, for purposes of this Offer Supplement, the contracted capacity of the Ilijan Power Plant is referred to as 1,200 MW.

Under the Ilijan ECA, NPC/PSALM is required to deliver and supply to KEILCO the fuel necessary to operate the Ilijan Power Plant. If natural gas is unavailable, SMC Global Power, through SPPC, may require KEILCO to run the Ilijan Power Plant using diesel fuel. NPC/PSALM remains responsible for securing the natural gas and diesel fuel supply to the Ilijan Power Plant.

Under the Ilijan IPPA Agreement, SPPC has the option to acquire the Ilijan Power Plant in June 2022 without any additional payment by SPPC. SPPC may exercise the option to acquire the Ilijan Power Plant prior to June 2022 under certain circumstances, such as changes in law or non-performance by KEILCO of its obligations pursuant to the Ilijan ECA. In this case, the transfer price will be the net present value of the sum of the agreed monthly payments remaining unpaid at the date of termination of the Ilijan IPPA Agreement.

*Power Offtakers*

The entire capacity of the Ilijan Power Plant is contracted to Meralco under a long-term power supply agreement up to 2019, which can be extended up to the end of the IPPA Agreement.

In the year ended 31 December 2015, 2016, 2017, and three months ended 31 March 2017 and 2018, 93%, 93%, 92%, 92% and 89%, respectively, of the volume of power sold from the Ilijan Power Plant were derived from sales made under offtake agreements. In the year ended 31 December 2015, 2016, 2017, and three months ended 31 March 2017 and 2018, 7%, 7%, 8%, 8% and 11% of the volume of power sold from the Ilijan Power Plant, respectively, were derived from sales made through the WESM.

*Operations Review*

The table below is a summary of operating statistics of the Ilijan Power Plant for the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| Actual Energy Generated (GWh) . . . . . . . . . . | 7,434 | 8,363 | 8,143 | 1,702 | 1,892 |
| Electricity sold (GWh): . . . . . . . . . . . . . . . . . . . . | 7,832 | 8,630 | 8,308 | 1,732 | 1,941 |
| of which: bilateral offtake agreements . . . . . | 7,284 | 8,041 | 7,606 | 1,600 | 1,733 |
| of which: WESM sales . . . . . . . . . . . . . . . . . | 549 | 589 | 702 | 132 | 208 |
| Average realized electricity prices(₱/MWh): | | | | | |
| for electricity sold under bilateral offtake agreements . . . . . . . . . . . . . . . . . . . . . . . . . | 4,145 | 3,657 | 4,154 | 4,564 | 4,422 |
| for electricity sold on WESM . . . . . . . . . .. . . . | 2,339 | 2,301 | 3,070 | 2,348 | 3,444 |

| | | | | | |
|---|---|---|---|---|---|
| Net Capacity Factor (%) . . . . . . . . . . . . . . . . . | 71 | 79 | 77 | 66 | 73 |
| Availability Factor (%) . . . . . . . . . . . . . . . . . . | 85 | 95 | 94 | 66 | 88 |
| Reliability Factor (%) . . . . . . . . . . . . . . . . . . | 97 | 99 | 99 | 100 | 100 |
| Average Net Dependable Capacity (MW) . . . . | 1,025 | 1,140 | 1,122 | 998 | 1,062 |
| Net Heat Rate (Kilo-Joule/KWh) . . . . . . . . . . . | 6,463 | 6,897 | 6,870 | 6,917 | 6,852 |

*Fuel Supply*

NPC is responsible for securing the natural gas and diesel fuel supply to the Ilijan Power Plant. Under a fuel supply and management agreement between Shell Exploration B.V. and Occidental Philippines, Inc., NPC supplies natural gas to the Ilijan Power Plant through a 480-km undersea pipeline from the Camago- Malampaya field in Palawan to the Shell Refinery in Tabangao. From there, the natural gas is transported through a 16-in-diameter onshore pipeline running 15 km to the power plant.

*Operations and Maintenance*

KEILCO is responsible for the operations and maintenance of the Ilijan Power Plant for 20 years from June 2002. Under the Ilijan ECA, KEILCO is required to operate the Ilijan Power Plant pursuant to certain operating criteria and guidelines, including the output of 1,200 MW guaranteed contracted capacity, base load operation, and spinning reserve capability. Under the Ilijan ECA, KEILCO is responsible, at its own cost, for the management, operation, maintenance, including the supply of consumables and spare parts, and the repair of the Ilijan Power Plant.

The maintenance plan for the Ilijan Power Plant is agreed upon annually between SPPC, NPC, PSALM, NGCP and KEILCO. The maintenance plan includes scheduled inspections and overhauls, including scheduled periods of outage and details as to the personnel required to complete each inspection. Planned outages for maintenance are scheduled in such a way that only 1 unit is scheduled for shut down at any given time. The maintenance plan is established with consideration given to the dispatch requirements of SPPC and recommendations of the plant manufacturer. KEILCO is required to execute the maintenance plan in accordance with the recommendations of the original equipment manufacturer and good utility practice. KEILCO performs periodic maintenance activities on the generating units of the Ilijan Power Plant during the operations of the plant. The Ilijan ECA requires KEILCO to conduct an annual test to check the capacity of the generating units of the Ilijan Power Plant.

Each of the generating units of the Ilijan Power Plant historically has been, and is expected to continue to be, shut down for routine maintenance for approximately 26 days per calendar year. SPPC also expects that KEILCO will shut down these units for more significant maintenance and repair work for a total of 35 to 43 days in every 5th calendar year.

The table below sets forth actual planned outages of the Ilijan Power Plant for the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2017** | **2018** |
| Block 1 . . . . . . . . . . . . . . . . . . . . . . . . . | 50 days | 6 days | 18 days | 17 days | 5 days |
| Block 2 . . . . . . . . . . . . . . . . . . . . . . . . . | 32 days | 26 days | 9 days | 6 days | 16 days |

The maintenance of the Ilijan Power Plant is conducted once the minimum equivalent operating hours of 12,000 hours has been met. The minimum equivalent operating hours were not met and therefore there was no planned outage for the year 2016 for Block 1. However, interim combustor inspection of GT1-2, from 18 to 30 September 2016, occurred. The 26-day 2016 planned outage for Block 2 was due to Class B turbine inspection on 4 to 30 August 2016.

In 2017, Blocks 1 and 2 was shutdown for 18 days and 9 days, respectively, due to Malampaya gas restriction from 28 January to 16 February.

In 2018, Block 1 was shutdown for 5 days due to turbine inspection while Block 2 underwent combustor inspection for 16 days.

The table below sets forth unplanned outages of the Ilijan Power Plant for the periods indicated.

| | Year ended December 31 | | | Three months ended March 31 | |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017 | 2018 |
| Block 1 | 16 days | 0 day | 2 day | 1 day | 0 day |
| Block 2 | 4 days | 5 days | 10 days | 0 day | 0 day |

During 2016, no significant outages occurred for Block 1. In contrast, Block 2 underwent a 5-day forced outage during the year due to suspected faulty control signal that triggered the loss of running boiler feed water pumps.

In 2017, there were no significant outages for Block 1 while Block 2 experienced a 10-day forced outage due to debris filter inspection.

*Power Transmission*

Power from the Ilijan Power Plant is transmitted through a 500-kV transmission line that connects to the Luzon grid through the Ilijan-Dasmarinas line and Ilijan-Tayabas line. The transmission line is owned by TransCo, and operated and maintained by NGCP.

**Angat Hydroelectric Power Plant**

AHEPP is an operating hydroelectric power plant located at the Angat reservoir in San Lorenzo, Norzagaray, Bulacan, approximately 58 km northeast of Metro Manila. AHEPP was privatized through an asset purchase agreement between PSALM and K-Water. K-Water assigned its rights in favor of AHC, a joint venture between K-Water and PVEI.

The project has a total electricity generating capacity of 218 MW, comprising of 4 main units and 3 auxiliary units of 6-MW capacity each. The Main Units 1 and 2 were commissioned in 1967 and the Main Units 3 and 4 in 1968. The Auxiliary Units 1 and 2 were commissioned in 1967 and the Auxiliary Unit 3 in 1978. The Auxiliary Unit 3 was manufactured by Allis-Chalmer and Ebara and all the other units were manufactured by Toshiba Corporation of Japan. All units are run by the Francis-type turbines, which is the most commonly used model in hydroelectric power generation.

*Fuel Supply & Water Rights*

The AHEPP utilizes water resources of the Angat reservoir. The Angat reservoir is 35-km long and 3-km wide at its widest points, and has surface of 2,300 hectares and viable storage volume of 850 million cubic meters. The water discharged by the project is used for the following 2 purposes: (i) water resources from water discharged through Auxiliary Units and through the spillway flows to the Ipo reservoir are used to supply 97% of the residential drinking water of Metro Manila; and (ii) water resources from water discharged through Main Units flows downstream to the Bustos reservoir are utilized for irrigation purposes.

Water rights surrounding the project are co-owned and governed by the following entities, pursuant to the Water Code of the Philippines, Angat Reservoir Operation Rules issued and regulated by NWRB as implemented by a Memorandum of Agreement on the Angat Water Protocol between MWSS, NIA, AHC, PSALM, NPC and NWRB: (i) MWSS, for domestic water supply to Metro Manila; (ii) Provincial government of Bulacan, for water supply in the Bulacan Province; (iii) NIA, for irrigation diversion requirements; and (iv) AHC/KWPP, for power generation.

*Power Offtakers*

AHC sells majority of its generated capacity to the WESM at the prevalent spot price. The main units are being operated as peaking units. The strategy for the Main Units is to allocate daily water release during the peak hours. Auxiliary Units are being operated as base load units, as the water requirement from MWSS is continuous throughout the day, thus eliminating any discrete optionality to choose the hour of allocation. AHC is exploring options to contract the capacity of its Auxiliary Units.

*Operations & Maintenance*

AHC undertakes the operation and maintenance of AHEPP in-house. The operations and maintenance team consist of the incumbent local technical team who have been operating the AHEPP supported by technical experts seconded from K-Water.

AHC has entered into technical services agreements with K-Water and PVEI respectively to ensure that the appropriate level of technical and management support will be provided to support operation and maintenance requirements of AHC.

**Limay Greenfield Power Plant**

*Background*

The Limay Greenfield Power Plant owned by SMC Global Power through its subsidiary, SCPC, is a 4 x 150 MW coal-fired thermal power plant located in Limay, Bataan that commenced constructions in October 2013. Units 1, 2 and 3 of the Limay Greenfield Power Plant achieved commercial operations in May 2017, September 2017 and March 2018, respectively. Unit 4 is expected to go on-line in 2019. The engineering, procurement, and construction contractors of the Limay Greenfield Power Plant are Formosa Heavy Industries and True North Manufacturing Services Corporation. In June 2017, SCPC acquired all of the rights and obligations of Units 3 and 4 of the Limay Greenfield Power Plant from another wholly-owned subsidiary, Limay Premiere Power Corp. Mantech Power Dynamics Services Inc., another wholly-owned subsidiary of SMC Global Power, is responsible for the operation and maintenance of the plant.

*Power Offtakers*

Units 1 and 2 of the Limay Greenfield Power Plant is fully contracted to various distribution utilities, electric cooperatives and industrial customers under long-term offtake agreements mostly expiring in 10 years from effective date subject to extension upon mutual agreement between the parties. Units 3 and 4 of the Limay Greenfield Power Plant are also contracted with distribution utilities and industrial customers. SCPC was granted a RES license on 24 August 2016, which gave it the ability to directly contract with industrial customers.

*Fuel Supply*

SCPC has executed two long-term coal supply agreements with Bayan and KPC, with terms of until 2022 and 5 years from effectivity date, respectively. As base quantity, Bayan is required to supply 5 panamax shipments during the term of the contract, with an optional additional quantity of 3 shipments. KPC on the other hand will supply 4 panamax shipments, with an option on the part of SCPC to add 4 more shipments upon prior notice. Each shipment shall comprise 65,000 metric tons +/- 10% vessel tolerance. Pricing under the coal supply agreement will be subject to adjustment based on certain standards applicable to the quality or grade of the coal delivered by the supplier. SCPC also has executed spot coal supply contracts with other suppliers. SCPC also has a 3-year contract of affreightment with D’Amico Shipping Singapore Pte. Ltd. from 1 January 2017 to 31 December 2019.

**Davao Greenfield Power Plant**

*Background*

The Davao Greenfield Power Plant owned by SMC Global Power through its subsidiary, SMCPC, is a 2 x 150 MW coal-fired thermal power plant located in Malita, Davao Occidental that commenced constructions in September 2013. Units 1 and 2 of the Davao Greenfield Power Plant achieved commercial operations in July 2017 and February 2018, respectively.

The engineering, procurement, and construction contractors of the Davao Greenfield Power Plant are Formosa Heavy Industries and True North Manufacturing Services Corporation. Safetech Power Services Corp., another wholly-owned subsidiary of SMC Global Power, is responsible for the operation and maintenance of the plant.

*Power Offtakers*

Units 1 and 2 of the Davao Greenfield Power Plant are substantially contracted to various distribution utilities, electric cooperatives and industrial customers under long-term offtake agreements mostly expiring in 10 years from effective date subject to extension upon mutual agreement between the parties.

*Fuel Supply*

SMCPC has existing spot coal supply contracts with Bayan and KPC among others. Currently, SMCPC is evaluating opportunities to lock-in long-term coal supply agreements.

**Masinloc Greenfield Power Plant**

*Background*

The Masinloc Greenfield Power Plant comprises of 2 x 315 MW (Units 1 and 2) and a 335 MW (Unit 3) coal-fired power plant located in Masinloc, Zambales. Units 1 and 2 of the Masinloc Greenfield Power Plant commenced commercial operations in June 1998 and December 1998, respectively, and were originally developed and owned by the NPC. Unit 3 is envisaged as a brown-field/expansion project within the Masinloc Power Plant Complex and is expected to be completed by April 2019.

On 20 March 2018, SMC Global Power completed the acquisition of 51% and 49% equity interests in MAPL from AES Phil Investment Pte. Ltd. and Gen Plus B.V., respectively. In addition to the Masinloc Greenfield Power Plant, SMC Global Power, through MAPL, acquired the Masinloc BES, located within the Masinloc Power Plant Complex, and the pre-developed Kabankalan BES, located in Kabankalan, Negros Occidental.

The engineering, procurement, and construction contractors of Unit 3 of the Masinloc Greenfield Power Plant are Posco Engineering & Construction and Ventanas Philippine Construction.

*Power Offtakers*

Units 1, 2 and 3 of the Masinloc Greenfield Power Plant are substantially contracted through medium to long-term bilateral contracts with Meralco, electric cooperatives and industrial customers. The RES license of MPPCL was renewed on 27 June 2016, and is valid until 1 August 2021.

*Fuel Supply*

MPPCL has coal supply contracts with reputable international companies with durations ranging from 6 months to 3 years. All supplies are governed by a 5-year Master Agreement which terms apply for all contracts to be entered into between MPPCL and a coal supplier.

## Distribution and Retail Services

### *Albay Power and Energy Corp.*

On 29 October 2013, after the open and competitive bidding, SMC Global Power entered into a concession agreement for the operation and maintenance of ALECO which is the franchise holder for the distribution of electricity in the province of Albay, Luzon. There is no transfer of the franchise to operate the distribution system or the ownership of the distribution assets. At the end of the concession period, the distribution system will be turned over back to ALECO. Under the concession agreement, SMC Global Power established APEC as its wholly-owned subsidiary, and in January 2014, SMC Global Power assigned all its rights and obligations under the concession agreement to APEC. On 26 February 2014, APEC assumed the role of SMC Global Power under the concession agreement.

### *Retail Electric Supply*

SMCGP is pursuing downstream integration by capitalizing on changes in the Philippine regulatory structure to expand its sales of power to a broader range of customers, including retail customers. The three RES licenses issued to SMC Global Power, through SMELC, SCPC and MPPCL, allow it to enter into RSCs with contestable customers and expand its customer base. As of 31 March 2018, SMELC, SCPC and MPPCL supply an equivalent of 394 MW to various facilities of SMC and other contestable customers.

## Coal Investments

Pursuant to its strategy of integrating viable complementary business to its power generation business, SMCGP, through SMEC and its subsidiaries, Bonanza Energy, Daguma Agro and Sultan Energy, has acquired coal exploration, production and development rights over approximately 17,000 hectares of land in Mindanao, which depending on prevailing coal prices and the related logistical costs, may provide a significant additional source of coal fuel for its planned and existing greenfield power plants. Such assets remain in the preparatory stage of its mining activities as of 31 March 2018.

The table below sets forth certain information regarding these assets.

| Subsidiary | Description of Asset | Mining Site | Coal Operating Contract (“COC”) |
|---|---|---|---|
| Bonanza Energy | COC with the DOE covering eight coal blocks with a total area of approximately 8,000 hectares | Lake Sebu South Cotabato and Maitum, Saranggani Province | COC for exploration awarded in May 2005, converted to COC for development and production in December 2009 |
| Daguma Agro | COC with the DOE covering two coal blocks with a total area of approximately 2,000 hectares. | Lake Sebu, South Cotabato | COC for exploration awarded in November 2002; converted to COC for development and production in March 2008 |
| Sultan Energy | COC with the DOE covering seven coal blocks with a total area of 7,000 hectares | Lake Sebu, South Cotabato and Bagumbayan, Sultan Kudarat | COC for exploration awarded in February 2005; converted to COC for development and production in February 2009 |

The DOE approved the conversion of the COC for Exploration to COC for Development and Production of Daguma Agro, Sultan Energy and Bonanza Energy, respectively, effective on the following dates:

| Subsidiary | COC No. | Effective Date | Term(1) |
|---|---|---|---|
| Daguma Agro | 126 | November 19, 2006 | 20 years |
| Sultan Energy | 134 | February 23, 2009 | 10 years |
| Bonanza Energy | 138 | May 26, 2009 | 10 years |

(1) The term is renewable as may be agreed with and approved by the DOE.

## SALES STRATEGY AND CUSTOMERS

SMC Global Power seeks to sell substantially all of the power generated by Sual and Ilijan Power Plants and its Limay and Davao greenfield power plants to customers pursuant to offtake agreements.

Currently, the entire capacity of the Ilijan Power Plant and Unit 1 of the Sual Power Plant are contracted under long-term offtake agreements with Meralco and its affiliates, while the capacity of Unit 2 of the Sual Power Plant is contracted to various distribution utilities, electric cooperatives, and industrial customers under existing offtake agreements. These agreements typically include take-or-pay provisions whereby a customer is required to pay for a minimum contracted amount of power, regardless of whether or not the customer takes delivery of the entire amount, with the result that revenue from these offtake agreements is relatively stable during the duration of the agreements. If the generation output available to the subsidiaries of SMC Global Power from these plants exceeds the amount deliverable under their offtake agreements, such subsidiaries of SMC Global Power offer the excess power for sale through the WESM at the market clearing price.

The power generation capacity of the San Roque Power Plant and the AHEPP at any given time depends on the water levels in the reservoir and downstream irrigation requirements. As such, these plants sell majority of their generated capacity to the WESM at the prevailing spot prices. The San Roque Power Plant and the Main Units of the AHEPP are being operated as peaking units. Available water is used to generate power during peak hours when prices are higher.

The Auxiliary Units of AHEPP are being operated as base load units, as the water requirement from MWSS is continuous throughout the day, thus eliminating any discretion to choose the hour of allocation. AHC is exploring options to contract the capacity of its Auxiliary Units.

In the years ended 31 December 2015, 2016 and 2017 and the for the three months ended 31 March 2017 and 2018, approximately 89%, 91%, 91%, 90%, and 90% respectively, of consolidated volume of power sold by the Company are to customers pursuant to offtake agreements. Sales to Meralco accounted for approximately 62%, 60%, 56%, 57%, and 50% of the total consolidated sales volume of SMC Global Power for the years ended 31 December 2015, 2016 and 2017 and for the three months ended 31 March 2017 and 2018, respectively. Sales through the WESM accounted for approximately 11%, 9%, 9%, 10%, and 10% of SMC Global Power's total consolidated sales volume for the years ended 31 December 2015, 2016 and 2017 and for the three months ended 31 March 2017 and 2018, respectively. In 2017 and for the three months ended 31 March 2018, 2% of the consolidated sales volume of SMC Global Power was for distribution customer sales through APEC.

## EXPANSION PLANS

SMC Global Power identifies potential investments by analyzing the demand for power and power-related services. Factors such as Philippine GDP and population growth, customer profile and mix, accessibility to the grids, and industrial expansion are considered. SMC Global Power also looks at commercial viability, potential costs (whether for development or acquisition) and competitive costs, as well as land acquisition and environmental protection issues and the impact of environmental protection requirements on overall profitability of the project, and the availability of government incentives for a particular project.

Over the period from 2015 to 2020, growth in demand for electricity in the Philippines is expected to exceed the growth rate of the Philippine GDP, according to the DOE. Construction of new power plants on average takes a minimum of three years. Given the gap between projected electricity demand and committed power projects, SMC Global Power expects that there will be a power supply shortage in the medium term until new capacity is built to meet the growing consumption.

SMC Global Power believes it is well-positioned to take advantage of opportunities from continued growth in the Philippine electricity market, as well as from the existing power supply shortage. The latter is exacerbated by an existing base of old government-owned power plants, which are nearing the end of their useful life, as well as a large base of seasonal power supply such as the hydropower plants particularly in Mindanao. To meet this need, SMC Global Power has a defined roadmap to increase capacity by developing greenfield power plants and bidding for selected NPC-owned power generation plants that are scheduled for privatization.

SMC Global Power through its subsidiaries, SCPC, MPPCL and SMCGP Philippines Energy, is in the process of completing the construction of two greenfield power plants, the Limay and Masinloc Greenfield Power Plants and battery energy storage facilities, the Kabankalan BES, with total of 460 MW of plants' combined generation capacity commissioned in 2017 and 2018 and the last 525 MW is expected to be commissioned in 2019 for Unit 4 of Limay with 150MW capacity, Unit 3 of Masinloc with 335 MW capacity and 2 x 20MW Kabankalan BES. In addition, as a leading power company in the Philippines with a large customer base, SMC Global Power believes that it is in a strong position to leverage its relationships with its existing customers to service their expected increased electricity demand.

**Power Generation Capacity**

***Greenfield Power Plants***

SMC Global Power is currently expanding its power portfolio nationwide through greenfield power plants over the next few years, depending on market demand, including the following two coal-fired circulating fluidized bed ("**CFB**") power projects which are under construction:

The following timeline sets forth key project milestones for the Davao Greenfield Power Plant:

| | |
|---|---|
| January 2013 . . . . . . . . . . . . . . . . . . . . . . . | Executed engineering, procurement and construction contract ("**EPC Contract"**) with Formosa Heavy Industries, for the construction of the Davao Greenfield Power Plant. |
| June 2013 . . . . . . . . . . . . . . . . . . . . . . . . . | Obtained Environmental Compliance Certificate ("**ECC**") and Pioneer Status from Board of Investments ("**BOI**") (tax holiday). |
| July 2013 . . . . . . . . . . . . . . . . . . . . . . . . . . | Obtained Customs Accreditation and Registration from Bureau of Customs, subject to annual renewal. |
| August 2013 . . . . . . . . . . . . . . . . . . . . . . . | Site hand over. |
| September 2013 . . . . . . . . . . . . . . . . . . . . | Obtained Certificate of Authority to Import Capital Equipment, Spare Parts and Accessories from BOI. |
| 2014 to 2018 . . . . . . . . . . . . . . | Construction and engineering of Units 1 and 2, and signing of offtake agreements. |
| October 2016 . . . . . . . . . . . . . . . . . . . . . . | Granted the Provisional Authority to Operate by the ERC in favor of Unit 1. |
| June 2017 . . . . . . . . . . . . . . . . . . . . . . . . . | Granted the Provisional Authority to Operate by the ERC in favor of Unit 2. |
| July 2017 . . . . . . . . . . . . . . . . . . . . . . . . | Unit 1 commenced commercial operations. |
| February 2018 . . . . . . . . . . . . . . . . . . . . | Unit 2 commenced commercial operations. |

The following timeline sets forth key project milestones for the Limay Greenfield Power Plant:

| | |
|---|---|
| January 2013 . . . . . . . . . . . . . . . . . . . . . . . | Executed EPC Contract with Formosa Heavy Industries, for the construction of the Limay Greenfield Power Plant. |
| July 2013 . . . . . . . . . . . . . . . . . . . . . . . . . . | Obtained Customs Accreditation and Registration from Bureau of Customs, subject to annual renewal. |
| September 2013 . . . . . . . . . . . . . . . . . . . . | Obtained ECC and Pioneer Status from BOI (tax holiday). |
| January 2014 . . . . . . . . . . . . . . . . . . . . . . . | Site hand over. |
| 2014 to 2017. . . . . . . . . . . . . . . . . . . . . . . . | Construction and engineering of Units 1 and 2, and Signing of offtake agreements. |
| August 2016 . . . . . . . . . . . . . . . . . . . . . . . . | RES License was granted by the ERC. |
| March 2017 . . . . . . . . . . . . . . . . . . . . . . . . | Granted the Provisional Authority to Operate by the ERC in favor of Unit 1. |
| May 2017 . . . . . . . . . . . . . . . . . . . . . . . . . . | Unit 1 commenced commercial operations. |
| June 2017 . . . . . . . . . . . . . . . . . . . . . . . . . | SCPC acquired all the rights and obligations in the completion of Units 3 and 4 from Limay Premiere Power Corp. |
| September 2017 . . . . . . . . . . . . . . . . . . . . | Unit 2 commenced commercial operations. |
| March 2018 . . . . . . . . . . . . . . . . . . . . . . . . | Unit 3 commenced commercial operations. |

SMC Global Power employs CFB technology for each of the planned greenfield power plants. Coal-fired power plants generate power by burning coal, a process that generates carbon dioxide, sulfur dioxide and other pollutants. CFB technology is a type of technology employed to transform coal into a fuel source that is relatively low in such pollutant emissions compared with other coal-fired power plants. These low emissions are made possible by processes that are not used in non-CFB coal-fired power plants, such as chemically washing minerals and impurities from the coal, gasification, treating the flue gases with steam to remove sulfur dioxide, carbon capture and storage technologies to capture the carbon dioxide from the flue gas and dewatering lower rank coals (brown coals) to improve the calorific value, thereby improving the efficiency of the conversion into electricity. CFB technology permits relatively low emissions of carbon dioxide, sulfur dioxide and other pollutants. CFB technology also uses a low calorific value coal fuel, comparable with the type expected to be sourced from the coal mining assets of SMC Global Power in Mindanao.

In selecting CFB technology for these greenfield power plants, SMC Global Power is expected to save on costs via: 1) third party bulk order discounts for coal fuel supply, 2) inter-operability, 3) reduced training costs for operators, 4) spare parts exchange, and 5 ) common coal handling facilities, among other savings initiatives.

***Acquisition of Existing Power Generation Capacity***

SMC Global Power intends to continue its strategic acquisitions of existing power generation capacity by bidding for selected Government-owned power generation plants that may be privatized under the IPPA framework or pursuant to asset sales.

**COMPETITION**

SMC Global Power is one of the largest power companies in the Philippines, with a 19% share of the power supply of the National Grid, 25% share of the Luzon Grid and 9% share of the Mindanao Grid in each case as of 31 March 2018, based on ERC Resolution No. 04, Series of 2018. Its main competitors are the Lopez Group and the Aboitiz Group. The Lopez Group holds significant interests in First Gen Corporation and Energy Development Corporation, while the Aboitiz Group holds interests in Aboitiz Power Corporation and Hedcor, Inc., among others.

With the government committed to privatizing the majority of PSALM-owned power generation facilities and the establishment of WESM, the generation facilities of SMC Global Power will face competition from other power generation plants that supply the grid during the privatization phase. Multi-nationals that currently operate in the Philippines and could potentially compete against SMC Global Power in the privatization process include Korea Electric Power Corporation ("**KEPCO**"), Marubeni Corporation, Tokyo Electric Power Corporation, and Sumitomo, among others. Several of these competitors have greater financial resources, and have more extensive operational experience and other capabilities than SMC Global Power, giving them the potential ability to respond to operational, technological, financial and other challenges more quickly than SMC Global Power. SMC Global Power will face competition in both the development of new power generation facilities and the acquisition of existing power plants, as well as competition for financing for these activities. The performance of the Philippine economy and the potential for a shortfall in the Philippines' energy supply have attracted many potential competitors, including multinational development groups and equipment suppliers, to explore opportunities in the development of electric power generation projects within the Philippines. Accordingly, competition for and from new power projects may increase in line with the long-term economic growth in the Philippines.

## CUSTOMERS

SMC Global Power, through its subsidiaries, sells power, through power supply agreements, either directly to customers (distribution utilities, electric cooperatives and industrial customers) or through the WESM.

| Customers | Year ended December 31 | | | | | | Three months ended March 31 | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | 2016 | | 2017 | | 2017 | | 2018 | |
| | Volume Sold (GWh) | Revenue (in millions ₱) | Volume Sold (GWh) | Revenue (in millions ₱) | Volume Sold (GWh) | Revenue (in millions ₱) | Volume Sold (GWh) | Revenue (in millions ₱) | Volume Sold (GWh) | Revenue (in millions ₱) |
| Meralco | 10,317 | 40,889 | 10,402 | 39,566 | 9,664 | 43,404 | 2,267 | 10,986 | 2,389 | 11,693 |
| WESM | 1,844 | 6,217 | 1,588 | 4,154 | 1,520 | 4,468 | 410 | 987 | 460 | 1,751 |
| **Total Major Customers** | 12,161 | 47,106 | 11,990 | 43,720 | 11,184 | 47,872 | 2,677 | 11,973 | 2,849 | 13,444 |
| Others(1) | 4,397 | 30,401 | 5,356 | 34,252 | 6,043 | 34,919 | 1,284 | 7,380 | 1,941 | 11,217 |
| **Total Sales** | 16,558 | 77,507 | 17,346 | 77,972 | 17,227 | 82,791 | 3,961 | 19,353 | 4,790 | 24,661 |

(1) Includes Non-Meralco DUs, ECs, Directly Connected Customers, Contestable Customers, Sales to Distribution Customers, and sales to related parties.

## COMPLIANCE WITH ENVIRONMENTAL LAWS

Power operations are subject to extensive, evolving and increasingly stringent safety, health and environmental laws and regulations. These laws and regulations include the Philippine Clean Air Act of 1999 ("**Clean Air Act**"), the Philippine Clean Water Act of 2004 ("**Clean Water Act**"), Toxic Substances and Hazardous and Nuclear Waste Control Act of 1990, and the Department of Labor and Employment Occupational Safety and Health Standard of 1989, as amended. Such legislation addresses, among other things, air emissions, wastewater discharges as well as the generation, handling, storage, transportation, treatment and disposal of toxic or hazardous chemicals, materials and waste. It also regulates workplace conditions within power plants and employee exposure to hazardous substances. The Occupational Safety and Health Standard, meanwhile, was formulated to safeguard the workers' social and economic well-being as well as their physical safety and health.

SMC Global Power complies for its company-owned generation plants, and it believes that the IPPs for each of the IPPA Power Plants managed by SMC Global Power, through its subsidiaries, comply, in all material respects with all applicable safety, health and environmental laws and regulations.

The Sual Power Plant received its Environmental and Management System Certificate (ISO 14001) in 2004, its Occupational Standard on Health Safety Certificate (ISO 18001) in 2007 and its Quality Management System Certificate (ISO 9001) in 2008. The same ISO certifications were received by Davao Greenfield Power Plant and Limay Greenfield Power Plant in 2017 and 2018, respectively.

For each of its greenfield power plants, SMC Global Power will comply with all applicable safety, health and environmental laws and regulations, including securing the necessary ECC in accordance with Philippine law.

In addition, coal mining in the Philippines is subject to environmental, health and safety laws, forestry laws and other legal requirements. These laws govern the discharge of substances into the air and water, the management and disposal of hazardous substances and wastes, site clean-up, groundwater quality and availability, plant and wildlife protection, reclamation and rehabilitation of mining properties after mining is completed and the restriction of open-pit mining activities in conserved forest areas.

Notwithstanding the foregoing, the discharge of chemicals, other hazardous substances and pollutants into the air, soil or water by the power plants owned or managed by SMC Global Power or the coal mines of SMC Global Power may give rise to liabilities to the Government and to local Government units where such facilities are located, or to third parties. In addition, SMC Global Power may be required to incur costs to remedy the damage caused by such discharges or pay fines or other penalties for non-compliance.

Further, the adoption of new safety, health and environmental laws and regulations, new interpretations of existing laws, increased governmental enforcement of environmental laws or other developments in the future may require that SMC Global Power make additional capital expenditures or incur additional operating expenses in order to maintain the operations of its generating facilities at their current level, curtail power generation or take other actions that could have a material adverse effect on the financial condition, results of operations and cash flow of the Company.

**EMPLOYEES**

As of 31 March 2018, SMC Global Power has 130 employees, comprised of 35 executives and managers and 95 supervisors and rank & file. All employees are based in Philippines.

Employees of SMC Global Power are not members of any labor union since 2008. The Company has not experienced any work stoppages and considers its relationship with its employees to be good. In addition to the statutory benefits, SMC Global Power initiates benefits to provide for the increased security of its employees in the following areas: healthcare, leaves, miscellaneous benefits, loans and financial assistance applicable to a variety of uses, retirement benefits and survivor security and death benefits.

With the ensuing 12 months, SMC Global Power may require additional hiring of employees to support its business expansion, the number of which cannot be determined.

# Certain Legal Proceedings

The following are updates on certain legal proceedings involving the Group as disclosed in the Prospectus.

**Ilijan IPPA Agreement Dispute**

In an Order dated 27 June 2016, the Court denied PSALM's: (1) Motion for Reconsideration of the Order dated 28 September 2015, which issued a writ of preliminary injunction enjoining PSALM from further proceedings with the termination of the IPPA Agreement while the case is pending; (2) Motion for Reconsideration of the Order, which allowed Meralco to intervene in the case; and (3) Motion to Dismiss. In response to this Order, PSALM filed a petition for certiorari with the Court of Appeals seeking to annul the Court's Orders granting the writ of preliminary injunction, allowing Meralco's intervention, and the Orders denying PSALM's motions for reconsideration of said injunction and intervention orders. PSALM also prayed for the issuance of a TRO and/or writ of preliminary injunction "against public respondent Court and its assailed Orders." The Court of Appeals, however, denied the petition filed by PSALM in its Decision dated 19 December 2017. PSALM filed its Motion for Reconsideration dated 19 January 2018 to the 19 December 2017 Court of Appeals Decision. On 9 March 2018, SPPC filed its Opposition to PSALM's Motion for Reconsideration of the Court of Appeals' Decision of 19 December 2017. In a Resolution dated 12 July 2018, the Court of Appeals denied PSALM's Motion for Reconsideration of the CA Decision dated 19 December 2017.

**Complaints for plunder and corruption against PSALM, TPEC, and TeaM Energy**

The DOJ issued a Resolution, dated 25 October 2017, partially granting the Petition for Review filed by respondents Suguru Tsuzaki, TPEC, Koichi Tamura and TSC by ruling that the "assailed Resolution is REVERSED AND SET ASIDE insofar as the conduct of preliminary investigation." The resolution further affirmed the transmittal of the records of the case to the Office of the Ombudsman for its disposition. On 17 November 2017, SMEC filed a motion for partial reconsideration of the said Resolution.

On 22 May 2018, the Regional Trial Court issued an Order dismissing the complaint for consignation filed by SMEC on the ground that the court has no jurisdiction over the subject matter of the complaint. SMEC shall be filing a motion for reconsideration of the said Order.

# Security Ownership of Management and Certain Record and Beneficial Owners

Security Ownership of Certain Records and Beneficial Owners of more than 5% of the Voting Securities of the Company as at 31 March 2018

| Title of Class | Name of Record Owner and Relationship with Issuer | Name of Beneficial Owner and Relationship with Record Owner | Citizenship | No. of Shares Held by the Beneficial Owners (includes Common Shares held by their nominees) | % of Total Outstanding Shares |
|---|---|---|---|---|---|
| Common | San Miguel Corporation (Parent Company) | San Miguel Corporation (SMC) | Filipino | 1,250,000,500 | 100% |
| Common | Ramon S. Ang (Director) | SMC; Nominee-director of SMC in the Board | Filipino | 500 | 0% |
| Common | Ferdinand K. Constantino (Director) | SMC; Nominee-director of SMC in the Board | Filipino | 500 | 0% |
| Common | Aurora T. Calderon (Director) | SMC; Nominee-director of SMC in the Board | Filipino | 500 | 0% |
| Common | Virgilio S. Jacinto (Director) | SMC; Nominee-director of SMC in the Board | Filipino | 500 | 0% |
| | **Total** | | | **1,250,002,500** | |

**Security Ownership of Directors and Management as at 31 March 2018**

The following are the number of shares comprising the capital stock of the Company (all of which are voting shares) owned of record by Chief Executive Officer, the directors, key officers of the Company, and nominees for election as director, as of 31 March 2018:

| Name of Owner | Amount and Nature of Ownership | Citizenship | Total No. of Shares |
|---|---|---|---|
| | **Common** | | |
| Ramon S. Ang | 500 (D)(1) | Filipino | 500 (0%) |
| Ferdinand K. Constantino | 500 (D)(1) | Filipino | 500 (0%) |
| Aurora T. Calderon | 500 (D)(1) | Filipino | 500 (0%) |
| Virgilio S. Jacinto | 500 (D)(1) | Filipino | 500 (0%) |
| Jack G. Arroyo, Jr. | 500 (I)(2) | Filipino | 500 (0%) |
| Consuelo M. Ynares-Santiago | 500 (I)(2) | Filipino | 500 (0%) |
| Josefina Guevara-Salonga | 500 (I)(2) | Filipino | 500 (0%) |

*Notes:*
*(1) D stands for Director.*
*(2) I stands for Independent Director.*

None of the members of the Board of Directors and Management of SMC Global Power own 2.0% or more of the outstanding capital stock of SMC Global Power.

**Voting Trust Holders of 5% or more**

There is no person holding more than 5% of the Company’s voting securities under a voting trust arrangement.

**Changes in Control**

The Company is not aware of any change in control or arrangement that may result in a change in control of the Company.

# Ownership and Capitalization

**Share Capital**

The Company has an authorized capital stock of ₱2,000,000,000.00 comprised of 2,000,000,000 common shares with par value of ₱1.00 per common share. As of 31 March 2018, the Company had a total of 1,250,004,000 common shares issued and outstanding.

# Market Price of and Dividends on the Common Equity and Related Shareholder Matters

**Market Information**

The common shares of the Company are neither traded in any market, nor subject to outstanding warrants to purchase, or securities convertible into common shares of the Company.

**Dividends and Dividend Policy**

There were no cash dividend declarations during the periods ended 31 December 2017 and 31 March 2018.

Dividends may be declared at the discretion of the Board of Directors and will depend upon the future results of operations and general financial condition, capital requirements, its ability to receive dividends and other distributions and payments from its subsidiaries, foreign exchange rates, legal, regulatory and contractual restrictions, loan obligations and other factors the Board of Directors may deem relevant.

The Company and its subsidiaries are allowed under Philippine laws to declare dividends, subject to certain requirements. These requirements include, for example, that the Board is authorized to declare dividends only from its unrestricted retained earnings. Dividends may be payable in cash, shares or property, or a combination of the three, as the Board shall determine. A cash dividend declaration does not require any further approval from shareholders. The declaration of stock dividends is subject to the approval of shareholders holding at least two-thirds of the outstanding capital stock of the Company. The Board may not declare dividends which will impair its capital.

The Company and its subsidiaries declare dividends as determined by the Board, taking into consideration factors such as the implementation of business plans, debt service requirements, operating expenses, budgets, funding for new investments and acquisitions and appropriate reserves and working capital.

The table below sets forth the amount of dividends declared and paid since 2014.

Common Shares

| Year | Type | Per Share Amount (₱) | Amount (₱) | Date Declared | Record Date | Payment Date |
|---|---|---|---|---|---|---|
| 2014 | Cash | 1.20 | 1,500,000,000.00 | March 25 | March 25 | April 8 |
| | Cash | 2.80 | 3,500,000,000.00 | June 3 | June 3 | June 10 |
| | Cash | 2.00 | 2,500,000,000.00 | August 19 | August 19 | August 29 |
| | Cash | 2.00 | 2,500,000,000.00 | November 4 | November 4 | November 11 |
| Total: | | 8.00 | 10,000,000,000.00 | | | |
| 2015 | Cash | 1.20 | 1,500,000,000.00 | March 25 | March 25 | March 31 |
| | Cash | 1.20 | 1,500,000,000.00 | July 2 | July 2 | July 9f |
| | Cash | 1.20 | 1,500,000,000.00 | November 5 | November 5 | November 10 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total: | | 3.60 | 4,500,000,000.00 | | | |
| 2016 | Cash | 1.20 | 1,500,000,000.00 | June 7 | June 7 | June 14 |
| | Cash | 1.20 | 1,500,000,000.00 | August 11 | August 11 | August 18 |
| Total: | | 2.40 | 3,000,000,000.00 | | | |

**Sale of Unregistered or Exempt Securities Constituting an Exempt Transaction**

SMC Global Power has not sold unregistered or exempt securities nor has it issued securities constituting an exempt transaction within the past 3 years, except for the following:

1. SMC Global Power Shares

In 2017, the Company issued 500 qualifying shares to Josefina Guevara-Salonga, an Independent Director of the Company. The issuance of the said shares is an exempt transaction under Section 10.1(k) of the SRC.

2. Redeemable Perpetual Securities

| Name of Security Sold | Underwriter | Date of Sale | Amount of Securities | Basis for Exemption |
|---|---|---|---|---|
| Redeemable Perpetual Securities | N/A | 15 March 2018 | US$650,000,000.00 | Section 10.1(k) of the SRC |

The Company has not filed a notice with the SEC and has not obtained confirmation for the foregoing exempt transaction.

# Certain Relationships and Related Transactions

**Related Party Transactions**

The Parent Company, certain subsidiaries and their shareholders, associates and joint ventures purchase products and services from one another in the normal course of business. Transactions with related parties are made at normal market prices and terms. Amounts owed by/owed to related parties are collectible/will be settled in cash. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

The following are the transactions with related parties and the outstanding balances as of 31 March 2018 and 31 December 2017:

| | Year | Revenues from Related Parties | Purchases from Related Parties | Amounts Owed by Related Parties | Amounts Owed to Related Parties | Terms | Conditions |
|---|---|---|---|---|---|---|---|
| SMC | **2018** | **₱112,040** | **₱186,007** | **₱78,657** | **₱381,008** | On demand or | Unsecured; |
| | 2017 | 215,004 | 664,262 | 87,697 | 9,273 | 30 days; | no impairment |
| | | | | | | non-interest bearing | |
| | **2018** | **-** | **-** | **49,637** | **-** | More than 1 year; | Unsecured; |
| | 2017 | - | - | 61,903 | - | non-interest bearing | no impairment |
| | **2018** | **-** | **-** | **-** | **7,824,000** | More than 1 year; | Unsecured |
| | 2017 | - | - | - | - | interest bearing | |
| Entities Under Common Control | **2018** | **660,882** | **97,338** | **752,005** | **211,606** | On demand or | Unsecured; |
| | 2017 | 2,365,748 | 1,134,950 | 741,814 | 484,482 | 30 days; | no impairment |
| | | | | | | non-interest bearing | |
| | **2018** | **-** | **-** | **-** | **493** | More than 1 year; | Unsecured |
| | 2017 | - | - | - | - | non-interest bearing | |
| Associates | **2018** | **219,857** | **4,167** | **63,158** | **29,506** | On demand or | Unsecured; |
| | 2017 | 902,864 | - | 98,556 | 29,643 | 30 days; | no impairment |
| | | | | | | non-interest bearing | |
| | **2018** | **3,271** | **-** | **251,505** | **-** | 9 years; | Unsecured; |
| | 2017 | 13,458 | - | 250,603 | - | interest bearing | no impairment |
| Joint Venture | **2018** | **6,222** | **86,700** | **2,024** | **-** | 30 days; | Unsecured; |
| | 2017 | 24,183 | 416,058 | 1,937 | 18,522 | non-interest bearing | no impairment |
| | **2018** | **5,890** | **-** | **351,104** | **-** | 92 days; | Unsecured; |
| | 2017 | 64,797 | - | 635,163 | - | interest bearing | no impairment |
| Associates of Entities Under Common Control | **2018** | **229,313** | **-** | **224,181** | **-** | 30 days; | Unsecured; |
| | 2017 | 850,515 | 23,880 | 133,236 | - | non-interest bearing | no impairment |
| Others | **2018** | **333,049** | **-** | **235,098** | **-** | On demand or 30 | Unsecured; |
| | 2017 | 45,161 | - | 130,794 | - | days; | |
| | | | | | | non-interest bearing | no impairment |
| | **2018** | **₱1,570,524** | **₱374,212** | **₱2,007,369** | **₱8,446,613** | | |
| | 2017 | ₱4,481,730 | ₱2,239,150 | ₱2,141,703 | ₱541,920 | | |

a. Amounts owed by related parties consist of trade and other receivables, derivative asset and security deposits.

b. Amounts owed by associates mainly consist of interest bearing loan granted to OEDC included as part of “Trade and other receivables” and “Other noncurrent assets” accounts in the consolidated statements of financial position.

c. Amounts owed by a joint venture consist of interest bearing loan granted and management fees charged to AHC by PVEI, included as part of “Trade and other receivables” account in the consolidated statements of financial position.

d. Amounts owed to related parties consist of trade and non-trade payables pertaining to management fees, purchases of fuel, reimbursement of expenses, rent, insurance and services rendered by related parties, and shareholder advances.

e. The compensation of key management personnel of the Group, by benefit type, as follows:

| | 31 March 2018 | 31 December 2017 |
|---|---|---|
| Short-term employee benefits | ₱18,487 | ₱81,537 |
| Retirement cost | - | 1,398 |
| | ₱18,487 | ₱82,935 |

# Management's Discussion and Analysis of Results of Operations and Financial Condition

**INTRODUCTION**

The following discussion should be read in conjunction with the attached unaudited consolidated financial statements of SMC Global Power and the Group as of and for the period ended 31 March 2018 (with comparative figures as of 31 December 2017 and for the period ended 31 March2017). All necessary adjustments to present fairly the consolidated financial position, financial performance and cash flows of the Group as of 31 March 2018, and for all the other periods presented, have been made. Certain information and footnote disclosure normally included in the audited consolidated financial statements prepared in accordance with Philippine Financial Reporting Standards have been omitted.

## I. 2018 SIGNIFICANT TRANSACTIONS

**INVESTMENTS**

- **Acquisition of Subsidiaries, including the MPPCL Assets**

  On 20 March 2018, SMC Global Power completed the acquisition of 100% equity interest in Masin-AES Pte. Ltd. ("**MAPL**"), AES Transpower Private Ltd. ("**ATPL**", provider of corporate support services) and AES Philippines Inc. ("**API**", provider of energy marketing services) for a total consideration of US$1,900 million, subject to a post-closing purchase price adjustment. MAPL indirectly owns, through its subsidiaries [including Masinloc Power Partners Co. Ltd. ("**MPPCL**")], the 2 x 315 megawatts (MW) coal-fired power plant (Units 1 and 2), the under-construction project expansion of the 335 MW unit known as Unit 3, and the 10 MW battery energy storage project, all located in Masinloc, Zambales, Philippines (collectively, the "**MPPCL Assets**") and the 2 x 20 MW battery energy storage facility in Kabankalan, Negros Occidental, which is still at the pre-development stage.

  The transaction was financed by the following:

  a) Availment by SMC Global Power of a US$700 million (₱36,351 million) floating interest rate term loan* and a US$500 million (₱25,965 million) fixed interest rate (3.25% per annum) term loan maturing in March 2023;

  b) US$650 million Redeemable Perpetual Securities (RPS) issued by SMC Global Power and subscribed to by its parent company, San Miguel Corporation; and

  c) US$150 million (₱7,790 million) advanced by San Miguel Corporation to SMC Global Power.

  *Divided into Facility A Loan amounting to ₱10,386 million maturing in March 2021 and Facility B Loan amounting to ₱25,965 million maturing in March 2023. The loans are subject to repricing based on LIBOR plus spread of 1.05% and 1.30% for Facility A Loan and Facility B Loan, respectively.

  The MPPCL Assets add 640 MW capacity to the Group's existing portfolio, thereby increasing the total generating capacity of the Group to 4,153 MW accounting to 19% market share of power supply of the National Grid, 25% market share of the Luzon Grid and 9% market share of the Mindanao Grid as of 31 March 2018.

  From the acquisition date, the operations of the MPPCL Assets have contributed a total of 80 gigawatt hours (GWh) in offtake volumes, ₱542 million in revenues, and P178 million in operating income to the Group's results of operations for the first quarter ended 31 March 2018.

**AVAILMENT OF LOAN TO FINANCE CAPEX/PROJECTS**

- **Availment of ₱2,000 million Term Loan by SMC Consolidated Power Corporation (SCPC)**

  On 31 January 2018, SCPC has drawn the remaining ₱2,000 million balance of its ₱44,000 million 12-year Omnibus Loan and Security Agreement (OLSA), with various local banks dated 22 June 2017, to finance the ongoing construction of the 2 x 150 MW Limay Coal-fired Power Plant (Units 3 and 4) located in Bataan.

## II. FINANCIAL PERFORMANCE

**2018 vs. 2017**

***Revenues***

The Group's consolidated net revenues for the first quarter of 2018 registered at ₱24,661 million, 27% or ₱5,308 million higher than last year's ₱19,353 million for the same period. The increase was driven by: (i) additional revenues from the commercial operations of SCPC's Limay Power Plant Units 1 and 2 (starting in May 2017 and September 2017, respectively) and San Miguel Consolidated Power Corporation's (SMCPC) Malita, Davao Power Plant Units 1 and 2 (starting in July 2017 and February 2018, respectively); (ii) additional contracted customers of San Miguel Electric Corp. – Retail Electricity Supplier (SMELC - RES); (iii) higher sales quantity for Ilijan resulting from higher net generation attributable to shorter outage hours, and (iv) higher average prices for Sual bilateral offtake volumes.

***Cost of Power Sold***

Cost of power sold likewise increased by 27% or ₱3,314 million, from ₱12,149 million for the first quarter of 2017 to ₱15,463 million for the same period of 2018. The increase was mainly attributable to the following: (i) higher costs incurred by SCPC and SMCPC due to the start of the commercial operations of its power plants; (ii) higher power distribution costs incurred by RES-licensed companies (SMELC and SCPC) due to increase in its customers; and (iii) higher power purchases from external generators by SMEC to compensate for its low generation.

***Selling and Administrative Expenses***

Selling and administrative expenses slightly increased by 4% or ₱43 million, from ₱1,164 million for the first quarter of 2017 to ₱1,207 million in 2018. The increase was mainly due to additional professional fees incurred for legal and financial advisory services rendered by third parties which were engaged by SMC Global Power for the acquisition of MAPL, ATPL and API in March 2018.

***Operating Income***

As a result, consolidated income from operations of ₱7,991 million for the first quarter of 2018, grew by 32% or ₱1,951 million from last year's ₱6,040 million.

***Other Income (Charges)***

Net foreign exchange differential, arising mainly from the Group's United States (US) dollar-denominated liabilities, increased from ₱1,336 million loss in 2017 to ₱3,437 million loss in

2018 on account of the significant depreciation of the Philippine peso against the US dollar during the first quarter of 2018 as compared to same period last year.

Interest expense and other financing charges increased by 18% or ₱509 million due to the following: (i) higher financing charges expensed by SCPC since the start of commercial operations of its Limay Power Plant Units 1 and 2, which were previously capitalized during the aforesaid units' construction; and (ii) higher interests recognized by SMC Global Power on its redenominated loans and additional long-term borrowings obtained to finance its acquisition of MAPL, ATPL and API.

Miscellaneous income pertaining to reduction in Power Sector Assets and Liabilities Management Corporation (PSALM) fixed fee charges increased by ₱256 million as a result of longer maintenance outages of Sual Unit 2 from January 18 to February 9, 2018.

***Income Tax Expense***

Income tax expense of ₱365 million for the first quarter this year was lower by 58% or ₱510 million compared to last year's ₱875 million, mainly as a result of lower deferred income tax expense arising from the temporary differences relating to the IPPA entities' finance lease liability-related expenses.

***Net Income***

Consequently, the consolidated net income of the Group for the first quarter increased by 20% or ₱220 million from ₱1,127 million in 2017 to ₱1,347 million in 2018. Unrealized foreign exchange differential made a complete turnaround from a ₱31 million gain recognized in 2017 to a ₱1,611 million loss in 2018 brought by the movement of the Philippine peso against the US dollar.

**2017 vs. 2016**

***Revenues***

The Group's consolidated net revenues for the first quarter of 2017 registered at ₱19,353 million, 3% lower than the previous year's ₱19,931 million. The decline was due to the net effect of the following: (i) reduced net generation of the IPPA Power Plants by 7% (3,666 GWh in 2017 vs 3,962 GWh in 2016) mainly attributable to the maintenance shutdown of the Ilijan Power Plant and Malampaya gas facility from 28 January to 16 February 2017, (ii) lower offtake volumes by 11% from 4,443 GWh in 2016 to 3,961 GWh in 2017 on account of lower bilateral nominations from Meralco, and (iii) higher average bilateral prices due to increase in pass-through fuel costs.

***Cost of Power Sold***

Cost of power sold increased by 9%, from ₱11,173 million for the initial quarter of 2016 to ₱12,149 million for the same period of 2017. The increase was attributable to higher average price of coal for the Sual Power Plant and higher energy fees incurred by the Ilijan Power Plant due to its use of diesel resulting from the Malampaya shutdown.

***Selling and Administrative Expenses***

Selling and administrative expenses decreased by 20% from ₱1,448 million for the first quarter of 2016 to ₱1,164 million in 2017. The decrease was due to: (i) lower operating expenses incurred by SMC PowerGen Inc. (SPI) in 2017 by ₱142 million following the sale of its Limay Co-generation Solid Fuel-fired Power Plant (the "**Limay Co-gen Power Plant**") in December 2016, (ii) decline in corporate social responsibility project-related expenses by ₱124 million, and (iii) lower documentary stamp taxes incurred on short term loan in 2017 versus 2016.

***Operating Income***

As a result, consolidated income from operations of ₱6,040 million for the first quarter of 2017, fell by 17% from the previous year's ₱7,310 million.

***Other Income (Charges)***

Equity in net earnings decreased from ₱155 million in the first quarter of 2016 to ₱28 million in 2017, primarily due to the decline in the net income of Angat Hydropower Corporation (AHC).

Net foreign exchange differential from US dollar-denominated liabilities fell from ₱3,117 million gain in 2016 to ₱1,336 million loss in 2017 due to the depreciation of the Philippine peso against the US dollar during the first quarter of 2017 compared to 2016 for the same period.

***Income Tax Expense***

Income tax expense for the first quarter of 2017 declined by 57% to ₱875 million, compared to the previous year, as a result of: (i) lower operating income of the Group which consequently decreased the current income tax by ₱333 million and (ii) lower deferred income tax expense by ₱822 million recognized on the temporary difference between the actual fixed monthly payments of the IPPA entities to PSALM over the finance lease liability-related expenses.

***Net Income***

Consequently, the consolidated net income of the Group for the first quarter decreased from ₱5,525 million in 2016 to ₱1,127 million in 2017. Unrealized foreign exchange differential gain declined significantly from ₱4,250 million in 2016 to ₱31 million in 2017 brought by the movement of the Philippine peso against the US dollar.

## III. FINANCIAL POSITION

**2018 vs. 2017**

The Group's consolidated total assets as of 31 March 2018 amounted to ₱499,922 million, higher by 43% or P149,749 million than 31 December 2017 balance of ₱350,173 million. The increase is attributable to the following factors:

a. Higher cash balance from the remaining proceeds of the US$1,350 million (₱70,106 million) long-term borrowings availed and US$650 million (₱33,128 million, net of transaction costs) RPS issued by SMC Global Power on March 16, 2018 to finance the acquisition of the MAPL, ATPL and API entities for a total consideration of US$1,900 million (equivalent to ₱98,990 million) on March 20, 2018

b. Consolidation of the assets of MAPL, ATPL and API entities totaling to ₱73,558 million, to the Group's total assets (as a result of the acquisition of 100% interests in MAPL, ATPL and API), largely comprising of the Masinloc power plant and related facilities ₱62,274 million, trade and other receivables ₱2,439 million, inventories ₱2,378 million, prepaid expenses and other current assets ₱1,692 million, cash ₱1,656 million, and other noncurrent assets ₱3,119 million.

c. Initial goodwill amounting to ₱69,944 million recognized on the business combination arising from the aforesaid acquisition.

d. Higher trade receivables of SMEC and SPPC by ₱3,349 million.

The Group’s consolidated total liabilities as of 31 March 2018 amounted to ₱406,281 million, 40% or ₱115,874 million higher than the 31 December 2017 balance of ₱290,407 million. The major items accounting for the increase are as follows:

a. Increase in long-term debts and other noncurrent liabilities due to the various long-term borrowings availed by SMC Global Power totaling to US$1,350 million (₱70,106 million) which was used to finance the aforesaid acquisition.

b. Consolidation of the liabilities of MAPL, ATPL and API entities totaling to ₱44,315 million, to the Group’s total liabilities, consisting of: short and long-term debts ₱34,296 million, trade and other current payables ₱9,730 million, and other noncurrent liabilities ₱289 million.

**2017 vs. 2016**

The Group’s consolidated total assets as of 31 March 2017 amounted to ₱329,758 million, slightly lower by 1.3% or ₱4,191 million than the 31 December 2016 balance of ₱333,949 million. The decrease is attributable to the following factors:

a. Cash and cash equivalents decreased by ₱8,567 million due to the following: (i) payments to contractors/suppliers for the construction of the Limay and Malita Power Plants, (ii) granting of US$31.8 million loan to AHC, (iii) distributions paid to holders of SMC Global Power’s undated subordinated capital securities (USCS) issued in August 2015, and (iv) payments of finance lease liabilities.

b. Increase in trade and other receivables by ₱3,993 million is attributed to: (i) higher trade receivables from external customers arising from the increase in bilateral sales of SPPC, SMEC and SMELC for the month of March 2017 versus the month of December 2016, and (ii) the loan granted by PVEI to AHC in January 2017, amounting US$31.8 million.

The Group’s consolidated total liabilities as of 31 March 2017 amounted to ₱274,681 million, slightly lower by 1.6% or ₱4,598 million than the 31 December 2016 balance of ₱279,279 million. The decrease is attributable to the following factors:

a. Accounts payable and accrued expenses declined by ₱2,827 million following the payments of accrued energy fees to PSALM by the IPPA entities, remittance of the output VAT recognized on the sale of the Limay Co-gen Power Plant, and the payments made to contractors and suppliers in relation to the construction of the Limay and Malita Power Plants.

b. Long-term debt decreased by ₱9,824 million following the partial refinancing of the US$700 million, five-year term loan of SMC Global Power, with the US$200 million short-term loan availed from a local bank in March 2017.

c. The increase in income tax payable by ₱257 million mainly pertains to SMEC’s additional income tax due for the first quarter of 2017.

d. Deferred tax liabilities increased by ₱343 million due to the recognition by SPPC and SPDC of deferred income tax expense on the temporary difference between the actual fixed monthly payments to PSALM over the finance lease liability-related expenses for the period.

**Equity**

The increase in equity is due to:

| *(in Millions)* | March 31 | |
|---|---|---|
| | **2018** | 2017 |
| Issuance of RPS | **₱33,128** | ₱ - |
| Net income for the period | **1,347** | 1,127 |
| Non-controlling interest from acquisition of subsidiaries | **198** | - |
| Gain on exchange differences on translation of foreign operations | **34** | - |
| Adjustment due to PFRS 15 | **(85)** | - |
| Distributions paid to USCS holders | **(746)** | (721) |
| | **₱33,876** | ₱406 |

## IV. SOURCES AND USES OF CASH

A brief summary of cash flow movements is shown below:

| *(in Millions)* | March 31 | |
|---|---|---|
| | **2018** | 2017 |
| Net cash flows provided by operating activities | **₱10,595** | ₱1,480 |
| Net cash flows used in investing activities | **(97,343)** | (3,168) |
| Net cash flows provided by (used in) financing activities | **90,116** | **(6,887)** |

The effect of exchange rate changes on cash and cash equivalents amounted to ₱443 million, and ₱8 million on 31 March 2018 and 2017, respectively.

Net cash flows provided by operating activities for the period basically consists of income for the period and certain changes in current assets and current liabilities and others.

Net cash flows used in investing activities included the following:

| *(in Millions)* | March 31 | |
|---|---|---|
| | **2018** | 2017 |
| Decrease (increase) in other noncurrent assets | **₱1,046** | (₱18) |
| Additions to deferred exploration and development costs | **(1)** | (1) |
| Additions to intangible assets | **(22)** | (37) |
| Additions to investments and advances | **(281)** | (162) |
| Additions to property, plant and equipment | **(751)** | (2,950) |
| Acquisition of subsidiaries | **(97,334)** | - |

Net cash flows provided by (used in) financing activities included the following:

| *(in Millions)* | March 31 | |
|---|---|---|
| | **2018** | 2017 |
| Proceeds from long-term borrowings | **₱64,316** | ₱ - |
| Proceeds from issuance of RPS | **33,128** | - |
| Proceeds from short-term borrowing | **11,860** | 10,040 |
| Payments of long-term borrowings | **(263)** | (10,043) |
| Distributions paid to USCS holders | **(746)** | (721) |
| Payments of finance lease liabilities | **(6,319)** | (6,163) |
| Payments of short-term borrowings | **(11,860)** | - |

## IV. KEY PERFORMANCE INDICATORS

The following are the major performance measures that the Group uses. Analyses are employed by comparisons and measurements based on the financial data of the current period against the same period of previous year. Please refer to Item II "Financial Performance" for the discussion of certain Key Performance Indicators.

**LIQUIDITY RATIO**

$$\textbf{Current Ratio} = \frac{\textbf{Current Assets}}{\textbf{Current Liabilities}}$$

| (in Millions ₱) | Conventional March 2018 | Conventional December 2017 | Adjusted[1] March 018 | Adjusted[1] December 2017 |
|---|---|---|---|---|
| **(A) Current Assets** | **85,133** | 70,030 | **85,133** | 70,030 |
| **(B) Current Liabilities** | **70,941** | 55,141 | **53,117** | 38,297 |
| **Current Ratio (A) / (B)** | **1.20** | 1.27 | **1.60** | 1.83 |

(1) Current portion of finance lease liabilities, in relation to the IPPA Agreements with PSALM, are excluded from the total current liabilities as these current obligations on finance lease are pass-through charges billable to customers. As of 31 March 2018 and 31 December 2017, current portion of finance lease liabilities amounted to ₱17,824 million and ₱16,844 million, respectively.

**SOLVENCY RATIO**

$$\textbf{Net Debt-to-Equity Ratio} = \frac{\textbf{Net Debt}}{\textbf{Total Equity}}$$

| (in Millions ₱) | March 2018 | December 2017 |
|---|---|---|
| **(A) Net Debt[2]** | **277,747** | 187,173 |
| **(B) Total Equity[3]** | **96,804** | 62,980 |
| **Net Debt-to-Equity Ratio (A) / (B)** | **2.87** | 2.97 |

(2) Consolidated net total debt plus total PSALM lease liabilities.
(3) Consolidated total equity (excluding amounts attributable to ring-fenced subsidiaries as defined in the relevant credit facility agreement of the Parent Company).

**Asset-to-Equity Ratio** = $\dfrac{\textbf{Total Assets}}{\textbf{Total Equity}}$

| | *Conventional* | | *Adjusted*[4] | |
|---|---|---|---|---|
| *(in Millions ₱)* | **March 2018** | December 2017 | **March 2018** | December 2017 |
| **(A) Total Assets** | **499,922** | 350,173 | **328,645** | 177,600 |
| **(B) Total Equity** | **93,641** | 59,766 | **93,641** | 59,766 |
| **Asset-to-Equity Ratio (A) / (B)** | **5.34** | 5.86 | **3.51** | 2.97 |

(4) Net carrying amount value of the IPPA power plants, in relation to the IPPA Agreements with PSALM, was omitted in total assets as these power plant assets were capitalized with corresponding finance lease liabilities. As of 31 March 2018 and 31 December 2017, net carrying amount of IPPA power plant assets amounted to ₱171,277 million and ₱172,573 million, respectively.

## PROFITABILTY RATIO

**Return on Average Equity** = $\dfrac{\textbf{Net Income}}{\textbf{Total Equity}}$

| *(in Millions ₱)* | **March 2018** | December 2017 |
|---|---|---|
| **(A) Net Income**[5] | **8,437** | 8,217 |
| **(B) Total Equity** | **93,641** | 59,766 |
| **Return on Equity (A) / (B)** | **9.0%** | 13.7% |

(5) Annualized for quarterly reporting.

| | | |
|---|---|---|
| **Interest Coverage Ratio** | **=** | **Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)**<br>**---------------------------------------------**<br>**Finance Cost** |

| *(in Millions ₱)* | **March 2018** | December 2017 |
|---|---|---|
| **(A) EBITDA**[(6)] | **34,324** | 32,529 |
| **(B) Finance Cost**[(7)] | **11,529** | 11,296 |
| **Interest Coverage Ratio (A) / (B)** | **2.98** | 2.88 |

(6) Most recent four quarterly period consolidated EBITDA (gross of PSALM Payments and excluding amounts attributable to ring-fenced subsidiaries).

(7) Most recent four quarterly period consolidated interest expense (excluding amounts attributable to ring-fenced subsidiaries).

**<u>OPERATING EFFICIENCY</u>**

| | | |
|---|---|---|
| **Volume Growth (Decline)** | **=** | **Current Period Offtake Volume**<br>**--------------------------------------------- - 1**<br>**Prior Period Offtake Volume** |

| | **Periods Ended March 31** | |
|---|---|---|
| *(in GWh)* | **2018** | 2017 |
| **(A) Current Period Offtake Volume** | **4,790** | 3,961 |
| **(B) Prior Period Offtake Volume** | **3,961** | 4,457 |
| **Volume Growth (Decline) [( A / B ) – 1]** | **21.0%** | (11.1%) |

| | | |
|---|---|---|
| **Revenue Growth (Decline)** | **=** | **Current Period Revenue**<br>**--------------------------------------------- - 1**<br>**Prior Period Revenue** |

| | **Periods Ended March 31** | |
|---|---|---|
| *(in Millions ₱)* | **2018** | 2017 |
| **(A) Current Period Revenue** | **24,661** | 19,353 |
| **(B) Prior Period Revenue** | **19,353** | 19,931 |
| **Revenue Growth (Decline) [( A / B ) – 1]** | **27.4%** | (2.9%) |

| | | |
|---|---|---|
| **Operating Margin** | **=** | **Income from Operating Activities**<br>**----------------------------------------------**<br>**Revenues** |

| | **Periods Ended March 31** | |
|---|---|---|
| *(in Millions ₱)* | **2018** | 2017 |
| **(A) Income from Operating Activities** | **7,991** | 6,040 |
| **(B) Revenues** | **24,661** | 19,353 |
| **Operating Margin (A) / (B)** | **32.4%** | 31.2% |

## External Audit Fees and Services

The Parent Company was billed by the external auditor with aggregate audit fees amounting to ₱9.6 million, ₱6.2 million and ₱3.6 million in 2017, 2016 and 2015, respectively. Said fees include compensation for audit services, tax advisory and other related services such as review and agreed-upon procedures. There were no fees paid for accounting, compliance, and planning services. There were no other fees paid to the independent auditors other than for the above-described services.

The stockholders approve the appointment of the external auditors of the Company. The Audit and Risk Oversight Committee (formerly the Audit Committee and hereinafter referred to as the "**Committee**") reviews the audit scope and coverage, strategy and results for the approval of the Board of Directors and ensures that audit services rendered shall not impair or derogate the independence of the external auditors or violate SEC regulations. Likewise, the Committee evaluates and determines any non-audit work performed by external auditors, including the fees therefore, and ensures that such work will not conflict with External Auditors' duties as such or threaten its independence.

## Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There are no disagreements with the external auditors of the Company on accounting and financial disclosure.

# Independent Auditors and Counsel

## 1. Legal Matters

All legal opinions/matters in connection with the issuance of the Offer Bonds will be passed upon by Picazo Buyco Tan Fider & Santos ("**Picazo Law**") for the Company and SyCip Salazar Hernandez & Gatmaitan for the Joint Issue Managers and the Joint Lead Underwriters and Bookrunners ("**SyCip Law**"). Picazo Law and SyCip Law have no direct interest in the Company.

Picazo Law and SyCip Law may from time to time be engaged to advise in the transactions of the Company and perform legal services on the basis that Picazo Law and SyCip Law provide such services to its other clients.

## 2. Independent Auditors

The consolidated financial statements of the Company as at and for the years ended 31 December 2015, 2016, and 2017 have been audited by R.G. Manabat & Co., a member firm of KPMG, independent auditors, in accordance with Philippine Standards on Auditing as set forth in their report thereon appearing elsewhere in this Offer Supplement.

The Audit and Risk Oversight Committee of the Company reviews and monitors, among others, the integrity of all financial reports and ensures compliance with both internal financial management manual and pertinent accounting standards, including regulatory requirements. The Committee also performs the following duties and responsibilities relating to the services of the Company's external auditors:

- Prior to the commencement of the audit, discuss with the External Auditor the nature, scope and audit resources/expenses, and ensure proper coordination if more than one audit firm is involved in the activity to secure proper coverage and minimize duplication of efforts.

- Have a robust process for approving and recommending the appointment, reappointment, removal, and fees of the External Auditor duly accredited by the SEC, who undertakes an independent audit of the Company, and provides an objective assurance on the manner by which the financial statements should be prepared and presented to the stockholders. The appointment, reappointment, and removal of the External Auditor shall be recommended by the Committee and approved by Board and ratified by the shareholders.

- Be responsible for assessing the integrity and independence of the External Auditor and exercising effective oversight to review and monitor the External Auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant Philippine professional and regulatory requirements, as well as be responsible for reviewing and monitoring the External Auditor's suitability and effectiveness on an annual basis.

- Perform oversight functions with respect to the Internal and External Auditors of the Company, ensuring the independence of one from the other, freedom from interference from outside parties, and their unrestricted access to such records, properties and personnel of the Company necessary to enable them to perform their respective audit functions, and review the reports submitted by them.

- Evaluate and determine any non-audit work performed by the External Auditor, and periodically review the non-audit fees paid to the External Auditor in relation to the total fees paid to him and to the Company's overall consultancy expenses. The Committee shall disallow any non-audit work that will conflict with his duties as an External Auditor or may pose a threat to his independence. The Committee shall be alert for any potential conflict of interest situations, given the guidelines or policies on non-audit services, which could be viewed as impairing the External Auditor's objectivity and independence.

- Review the disposition of the recommendations in the External Auditor's management letter.

There is no arrangement that experts and independent counsels will receive a direct or indirect interest in the Issuer or was a promoter, underwriter, voting trustee, director, officer, or employee of the Issuer.

The accounting firm of R.G. Manabat & Co. served as the Company's external auditors for the last eight (8) fiscal years. R.G. Manabat & Co. has been appointed as the Company's external auditors for this fiscal year.

R.G. Manabat & Co. has no shareholdings in the Company, or any right, whether legally enforceable or not, to nominate or to subscribe to the securities of the Company, in accordance with the professional standards on independence set by the Board of Accountancy and Professional Regulation Commission.

R.G. Manabat & Co. auditor has not acted and will not act as promoter, underwriter, voting trustee, officer or employee of the Company.

SMC Global Power has no disagreements with R.G. Manabat & Co. on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

The Committee has an existing policy to review and pre-approve audit and non-audit services rendered by the independent auditors of the Company. The Committee does not allow SMC Global Power to engage independent auditors for certain non-audit services expressly prohibited by SEC regulations to be performed by an independent auditor for its audit clients. This is to ensure that such independent auditors maintain the highest level of independence from the SMC Global Power, both in fact and appearance.

# Taxation

*The following is a discussion of the material Philippine tax consequences of the acquisition, ownership and disposition of the Bonds. This general description does not purport to be a comprehensive description of the Philippine tax aspects of the Bonds and no information is provided regarding the tax aspects of acquiring, owning, holding or disposing of the Bonds under applicable tax laws of other applicable jurisdictions and the specific Philippine tax consequence in light of particular situations of acquiring, owning, holding and disposing of the Bonds in such other jurisdictions. This discussion is based upon laws, regulations, rulings, and income tax conventions (treaties) in effect at the date of this Offer Supplement.*

*The tax treatment applicable to a holder of the Bonds may vary depending upon such holder's particular situation, and certain holders may be subject to special rules not discussed below. This summary does not purport to address all tax aspects that may be important to a holder of the Bonds.*

***PROSPECTIVE PURCHASERS OF THE BONDS ARE URGED TO CONSULT THEIR OWN TAX ADVISORS AS TO THE PARTICULAR TAX CONSEQUENCES OF THE OWNERSHIP AND DISPOSITION OF THE BONDS, INCLUDING THE APPLICABILITY AND EFFECT OF ANY STATE, LOCAL OR FOREIGN TAX LAWS.***

*As used in this section, the term "resident alien" refers to an individual whose residence is within the Philippines and who is not a citizen of the Philippines; a "non-resident alien" is an individual whose residence is not within the Philippines and who is not a citizen of the Philippines. A non-resident alien who is actually within the Philippines for an aggregate period of more than 180 days during any calendar year is considered a "non- resident alien doing business in the Philippines." A non-resident alien who is actually within the Philippines for an aggregate period of 180 days or less during any calendar year is considered a "non-resident alien not doing business in the Philippines." A "resident foreign corporation" is a non-Philippine corporation engaged in trade or business within the Philippines; and a "non-resident foreign corporation" is a non-Philippine corporation not engaged in trade or business within the Philippines. The term "dividends" under this section refers to cash or property dividends. "Tax Code" means the Philippine National Internal Revenue Code of 1997, as amended.*

**Philippine Taxation**

On 1 January 2018, Republic Act No. 10963, otherwise known as the Tax Reform for Acceleration and Inclusion ("**TRAIN**") took into effect. The TRAIN amended provisions of the Philippine Tax Code including provisions on Documentary Stamp Tax, tax on interest income and other distributions, Capital Gains Tax on the sale and disposition of securities, Estate Tax, and Donor's Tax.

**TAXATION OF INTEREST**

The Tax Code provides that interest-bearing obligations of Philippine residents are Philippine sourced income subject to Philippine income tax. Interest income derived by Philippine citizens and alien resident individuals from the Bonds is thus subject to income tax, which is withheld at source, at the rate of 20% based on the gross amount of interest. Generally, interest on the Bonds received by non-resident aliens engaged in trade or business in the Philippines is subject to a 20% final withholding tax while that received by non-resident aliens not engaged in trade or business is subject to a final withholding tax rate of 25%. Interest income received by domestic corporations and resident foreign corporations from the Bonds is subject to a final withholding tax rate of 20%. Interest income received by non-resident foreign corporations from the Bonds is subject to a 30% final withholding tax.

The foregoing rates are subject to further reduction by any applicable tax treaties in force between the Philippines and the country of residence of the non-resident owner. Most tax treaties to which the Philippines is a party generally provide for a reduced tax rate of 15% in cases where the interest which arises in the Philippines is paid to a resident of the other contracting state. However, most tax treaties also provide that reduced withholding tax rates shall not apply if the recipient of the interest, who is a resident of the other contracting state, carries on business in the Philippines through a permanent establishment and the holding of the relevant interest-bearing instrument is effectively connected with such permanent establishment or perform in the Philippines professional services from a fixed base and the holding of the relevant interest-bearing instrument is effectively connected with such permanent establishment or fixed base.

Given the above, all Bondholders are required to provide the Issuer through the Paying Agent their valid Tax Identification numbers issued by the BIR.

**TAX-EXEMPT STATUS OR ENTITLEMENT TO PREFERENTIAL TAX RATE**

Bondholders who are exempt from or are entitled to a preferential rate on final withholding tax on interest income may avail of such exemption or preferential rate by submitting the necessary documents. Said Bondholder shall submit the following requirements to the Registrar, or to the Issue Manager, Underwriter and Bookrunner (together with their completed Application to Purchase) who shall then forward the same to the Registrar: (i) a BIR-certified true copy of a valid, current and subsisting tax exemption certificate, ruling or opinion issued by the BIR addressed to the Applicant confirming the exemption; (ii) with respect to tax treaty relief, (a) for initial interest due, 3 originals of a duly accomplished valid, current and subsisting Certificate of Residence for Tax Treaty Relief ("**CORTT**") Form or the prescribed certificate of residence of their country together with the CORTT Form as required under BIR Revenue Memorandum Order No. 8-2017 and/or 3 originals of the Special Power of Attorney executed by the Bondholder in favor of its authorized representative (if the CORTT Form and other documents are accomplished by an authorized representative); and (b) for subsequent interests due, 3 originals of Part II (D) of the CORTT Form shall be submitted by the Bondholder/Registrar to the Issuer no later than the 1st day of the month when such subsequent interest payment/s shall fall due and, if applicable, including any clarification, supplement or amendment thereto; (iii) a duly notarized undertaking, in the prescribed form, executed by (ii.a) the Corporate Secretary or any authorized representative, who has personal knowledge of the exemption based on his official functions, if the Applicant purchases the Bonds for its account, or (ii.b) the Trust Officer, if the Applicant is a universal bank authorized under Philippine law to perform trust and fiduciary functions and purchase the Bonds pursuant to its management of tax-exempt entities (i.e. Employee Retirement Fund, etc.), declaring and warranting such entities' tax-exempt status or preferential rate entitlement, undertaking to immediately notify the Issuer and the Registrar and Paying Agent (a) of any suspension, revocation, amendment or invalidation (in whole or in part) of the tax exemption certificates or preferential rate entitlement; (b) if there are any material changes in the factual circumstances of the Bondholder including but not limited to its character, nature and method of operation, which are inconsistent with the basis for its income tax exemption; or (c) if there are any change of circumstance, relevant treaty, law or regulation or any supervening event that may or would result in the interest income of the Bonds being ineligible for exemption or preferential rate, with a declaration and warranty of its tax exempt status or entitlement to a preferential rate, and agreeing to indemnify and hold the Issuer and Registrar and Paying Agent free and harmless against any claims, actions, suits, and liabilities arising from the non-withholding of the required tax; and (iv) such other documentary requirements as may be reasonably required under the applicable regulations of the relevant taxing or other authorities which for purposes of claiming tax treaty relief, shall include a duly accomplished CORTT Form or the prescribed certificate of residency of their country together with the CORTT Form consularized proof of the Bondholder's legal domicile in the relevant treaty state, and confirmation acceptable to the Issuer that the Bondholder is not doing business in the Philippines to support the applicability of a tax treaty relief; provided that the Issuer shall have the exclusive discretion to decide whether the documents submitted are sufficient for purposes of applying the exemption or the reduced rate being claimed by the Bondholder on the interest payments to such Bondholder; provided further that, all sums payable by the Issuer to tax-exempt entities shall be paid in full without deductions for Taxes, duties, assessments, or government charges (or with reduced rates, as the case may be), subject to the submission by the Bondholder claiming the benefit of any exemption or preferential rate of reasonable evidence of such exemption or preferential rate treatment to the Registrar and Paying Agent.

Transfers taking place in the Electronic Registry of Bondholders after the Bonds are listed in PDEx may be allowed between taxable and tax-exempt entities without restriction provided the same are in accordance with the relevant rules, conventions and guidelines of PDEx and PDTC. A selling or purchasing Bondholder claiming tax-exempt status is required to submit the following documents to the Issuer, upon submission of Account Opening documents to the Registry: (i) a written notification of the sale or purchase, including the tax status of the selling or buying party, and (ii) an indemnity agreement wherein the new Bondholder undertakes to indemnify the Issuer for any tax that may later on be assessed from the Issuer on account of such transfer.

## VALUE-ADDED TAX

Gross receipts arising from the sale of the Bonds in the Philippines by dealers in securities shall be subject to a 12% value-added tax. The term “gross receipt” means gross selling price less acquisition cost of the Bonds sold.

"Dealer in securities" means a merchant of stock or securities, whether an individual partnership or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom.

## GROSS RECEIPTS TAX

Bank and non-bank financial intermediaries performing quasi-banking functions are subject to gross receipts tax on gross receipts derived from sources within the Philippines in accordance with the following schedule:

On interest, commissions and discounts from lending activities as well as income from financial leasing, on the basis of remaining maturities of instruments from which such receipts are derived:

| | |
|---|---|
| Maturity period is five years or less | 5% |
| Maturity period is more than five years | 1% |

Non-bank financial intermediaries not performing quasi-banking functions doing business in the Philippines are likewise subject to gross receipts tax. Gross receipts of such entities derived from sources within the Philippines from interests, commissions and discounts from lending activities are taxed in accordance with the following schedule based on the remaining maturities of the instruments from which such receipts are derived:

| | |
|---|---|
| Maturity period is five years or less | 5% |
| Maturity period is more than five years | 1% |

In case the maturity period of the instruments held by banks, non-bank financial intermediaries performing quasi-banking functions and non-bank financial intermediaries not performing quasi-banking functions is shortened through pre-termination, then the maturity period shall be reckoned to end as of the date of pre-termination for purposes of classifying the transaction and the correct rate shall be applied accordingly.

Net trading gains realized within the taxable year on the sale or disposition of the Bonds by banks and nonbank financial intermediaries performing quasi-banking functions shall be taxed at 7%.

## DOCUMENTARY STAMP TAX

A documentary stamp tax is imposed upon the issuance of debt instruments issued by Philippine companies, such as the Bonds, at the rate of ₱1.50 for each ₱200, or fractional part thereof, of the issue price of such debt instruments; provided that, for debt instruments with terms of less than one year, the documentary stamp tax to be collected shall be of a proportional amount in accordance with the ratio of its term in number of days to 365 days.

The documentary stamp tax is collectible wherever the document is made, signed, issued, accepted, or transferred, when the obligation or right arises from Philippine sources, or the property is situated in the Philippines. Any applicable documentary stamp taxes on the original issue shall be paid by the Issuer for its own account.

## TAXATION ON SALE OR OTHER DISPOSITION OF THE BONDS

### Income Tax

Any gain realized from the sale, exchange or retirement of bonds will, as a rule, form part of the gross income of the sellers, for purposes of computing the relevant taxable income subject to the regular rates of 20-35% effective 1 January 2018 until 31 December 2022 and 15%-35% effective 1 January 2023 for individuals or 30% for domestic and foreign corporations, as the case may be. If the bonds are sold by a seller, who is an individual and who is not a dealer in securities, who has held the bonds for a period of more than 12 months prior to the sale, only 50% of any capital gain will be recognized and included in the sellers' gross taxable income.

However, under the Tax Code, any gain realized from the sale, exchange or retirement of bonds, debentures and other certificates of indebtedness with an original maturity date of more than five years (as measured from the date of issuance of such bonds, debentures or other certificates of indebtedness) shall not be subject to income tax.

Moreover, any gain arising from such sale, regardless of the original maturity date of the bonds, may be exempt from income tax pursuant to various income tax treaties to which the Philippines is a party, and subject to procedures prescribed by the BIR for the availment of tax treaty benefits.

### Estate and Donor's Tax

The transfer by a deceased person, whether a Philippine resident or a non-Philippine resident, to his heirs of the Bonds shall be subject to an estate tax which is levied on the net estate of the deceased at a fixed rate of 6%. A Bondholder shall be subject to donor's tax at the rate of 6% based on the total gifts in excess of ₱250,000 exempt gift made during the calendar year, whether the donor is a stranger or not.

The estate or donor's taxes payable in the Philippines may be credited with the amount of any estate or donor's taxes imposed by the authority of a foreign country, subject to limitations on the amount to be credited, and the tax status of the donor.

The estate tax and the donor's tax, in respect of the Bonds, shall not be collected (i) if the deceased, at the time of death, or the donor, at the time of the donation, was a citizen and resident of a foreign country which, at the time of his death or donation, did not impose a transfer tax of any character in respect of intangible personal property of citizens of the Philippines not residing in that foreign country; or (ii) if the laws of the foreign country of which the deceased or donor was a citizen and resident, at the time of his death or donation, allows a similar exemption from transfer or death taxes of every character or description in respect of intangible personal property owned by citizens of the Philippines not residing in the foreign country.

In case the Securities are transferred for less than an adequate and full consideration in money or money's worth, the amount by which the fair market value of the securities exceeded the value of the consideration may be deemed a gift and may be subject to donor's taxes. However, a sale, exchange, or other transfer made in the ordinary course of business (a transaction which is a bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth.

**Documentary Stamp Tax**

No documentary stamp tax is imposed on the subsequent sale or disposition of the Bonds, trading the Bonds in a secondary market or through an exchange. However, if the transfer constitutes a renewal of the Bonds, documentary stamp tax is payable anew.

# PARTIES TO THE OFFER

## THE ISSUER

**SMC Global Power Holdings Corp.**
155 EDSA, Wack-Wack
Mandaluyong City
Philippines

## TRUSTEE

**Philippine National Bank – Trust Banking Group**
**Fiduciary Services Division**
Philippine National Bank, 3rd Floor, PNB Financial Center, Pres. Diosdado Macapagal Blvd., Pasay City, Metro Manila 1300 Philippines

## REGISTRAR AND PAYING AGENT

**Philippine Depository & Trust Corp.**
37th Floor, Tower 1, The Enterprise Center
6786 Ayala Avenue corner Paseo de Roxas
Makati City 1226
Philippines

## LEGAL ADVISORS

***To the Joint Issue Managers, Joint Lead Underwriters and Bookrunners***

**SyCip Salazar Hernandez & Gatmaitan**
SyCipLaw Center
105 Paseo de Roxas
Makati City 1226
Metro Manila
Philippines

***To the Issuer***

**Picazo Buyco Tan Fider & Santos**
18th, 19th and 17th Floors, Liberty Center – Picazo Law
104 H.V. dela Costa Street
Salcedo Village, Makati City
Philippines

## AUDITORS OF THE ISSUER

**R.G. Manabat & Co., a member firm of KPMG**
9th Floor, The KPMG Center
6787 Ayala Avenue
Makati City 1226
Philippines

## LISTING AGENT

**Philippine Dealing & Exchange Corp.**
37th Floor, Tower 1, The Enterprise Center
6786 Ayala Avenue corner Paseo de Roxas
Makati City 1226
Philippines

# SMC GLOBAL POWER HOLDINGS CORP.
# AND SUBSIDIARIES
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONDENSED CONSOLIDATED**
**INTERIM FINANCIAL STATEMENTS**
**March 31, 2018 and December 31, 2017**

**REPORT OF INDEPENDENT AUDITORS ON REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

The Board of Directors and Stockholders
**SMC Global Power Holdings Corp.**
155 EDSA, Brgy. Wack-Wack
Mandaluyong City, Metro Manila

*Introduction*

We have reviewed the accompanying condensed consolidated interim financial statements of SMC Global Power Holdings Corp. and Subsidiaries (the "Group"), which comprise the condensed consolidated interim statement of financial position as at March 31, 2018, and condensed consolidated interim statements of income, condensed consolidated interim statements of comprehensive income, condensed consolidated interim statements of changes in equity and condensed consolidated interim statements of cash flows for the three months ended March 31, 2018 and 2017, and selected explanatory notes. Management is responsible for the preparation and fair presentation of these condensed consolidated interim financial statements in accordance with Philippine Accounting Standards (PAS) 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on these condensed consolidated interim financial statements based on our review.

*Scope of Review*

We conducted our review in accordance with Philippine Standards on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Philippine Standards on Auditing and consequently does not enable us to obtain assurance that we become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

KPMG

*Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements is not prepared, in all material respects, in accordance with PAS 34, *Interim Financial Reporting*.

*Other Matter*

We audited the consolidated financial statements of the Group as at and for year ended December 31, 2017 and expressed an unqualified opinion thereon dated March 9, 2018.

**R.G. MANABAT & CO.**

DARWIN P. VIROCEL
Partner
CPA License No. 0094495
SEC Accreditation No. 1386-AR, Group A, valid until June 14, 2020
Tax Identification No. 912-535-864
BIR Accreditation No. 08-001987-31-2016
Issued October 18, 2016; valid until October 17, 2019
PTR No. 6615157MD
Issued January 3, 2018 at Makati City

July 5, 2018
Makati City, Metro Manila

## SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
## (A Wholly-owned Subsidiary of San Miguel Corporation)

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
## MARCH 31, 2018 AND DECEMBER 31, 2017
(In Thousands)

| | *Note* | **2018 (Unaudited)** | 2017 (Audited) |
|---|---|---|---|
| **ASSETS** | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | *8, 22, 23* | **P32,465,709** | P28,655,359 |
| Trade and other receivables - net | *9, 16, 22, 23* | **26,906,275** | 20,435,068 |
| Inventories | *10, 16* | **5,383,442** | 3,147,668 |
| Prepaid expenses and other current assets | *11, 22, 23* | **20,377,297** | 17,791,915 |
| **Total Current Assets** | | **85,132,723** | 70,030,010 |
| **Noncurrent Assets** | | | |
| Investments and advances - net | | **16,884,200** | 16,621,131 |
| Property, plant and equipment - net | *7, 12* | **312,707,221** | 250,961,307 |
| Deferred exploration and development costs | | **700,047** | 699,001 |
| Intangible assets and goodwill - net | *7* | **72,587,086** | 2,594,136 |
| Deferred tax assets | | **1,633,774** | 1,316,926 |
| Other noncurrent assets - net | *16, 22, 23* | **10,277,008** | 7,950,484 |
| **Total Noncurrent Assets** | | **414,789,336** | 280,142,985 |
| | | **P499,922,059** | P350,172,995 |
| **LIABILITIES AND EQUITY** | | | |
| **Current Liabilities** | | | |
| Loans payable | *13, 22, 23* | **P8,277,200** | P5,930,000 |
| Accounts payable and accrued expenses | *7, 14, 15, 16, 22, 23* | **41,192,366** | 31,074,714 |
| Finance lease liabilities - current portion | *7, 22, 23* | **17,824,445** | 16,844,431 |
| Income tax payable | | **525,411** | 151,906 |
| Current maturities of long-term debt - net of debt issue costs | *15, 22, 23* | **3,121,695** | 1,139,631 |
| **Total Current Liabilities** | | **70,941,117** | 55,140,682 |
| **Noncurrent Liabilities** | | | |
| Long-term debt - net of current maturities and debt issue costs | *15, 22, 23* | **182,851,211** | 89,589,070 |
| Deferred tax liabilities | | **7,468,574** | 7,324,111 |
| Finance lease liabilities - net of current portion | *7, 22, 23* | **136,568,772** | 137,949,259 |
| Other noncurrent liabilities | *22, 23* | **8,451,150** | 404,361 |
| **Total Noncurrent Liabilities** | | **335,339,707** | 235,266,801 |
| **Total Liabilities** | | **406,280,824** | 290,407,483 |

*Forward*

| | *Note* | **2018 (Unaudited)** | 2017 (Audited) |
|---|---|---|---|
| **Equity** | | | |
| **Equity Attributable to Equity Holders of the Parent Company:** | | | |
| Capital stock | | **P1,062,504** | P1,062,504 |
| Additional paid-in capital | | **2,490,000** | 2,490,000 |
| Redeemable perpetual securities | *5, 24* | **33,127,662** | - |
| Undated subordinated capital securities | *17* | **26,933,565** | 26,933,565 |
| Equity reserves | | **796,143** | 761,647 |
| Retained earnings | | **29,032,997** | 28,517,796 |
| | | **93,442,871** | 59,765,512 |
| **Non-controlling Interest** | | **198,364** | - |
| **Total Equity** | | **93,641,235** | 59,765,512 |
| | | **P499,922,059** | P350,172,995 |

*See Notes to the Condensed Consolidated Interim Financial Statements.*

## SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
## (A Wholly-owned Subsidiary of San Miguel Corporation)
## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF INCOME
## FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(In Thousands, Except Per Share Data)

| | *Note* | **2018 (Unaudited)** | 2017 (Unaudited) |
|---|---|---|---|
| **REVENUES** | *7, 16, 18* | **P24,660,512** | P19,353,204 |
| **COST OF POWER SOLD** | *7, 12, 16, 19* | **15,462,524** | 12,148,816 |
| **GROSS PROFIT** | | **9,197,988** | 7,204,388 |
| **SELLING AND ADMINISTRATIVE EXPENSES** | | **1,206,855** | 1,164,104 |
| **INCOME FROM OPERATIONS** | | **7,991,133** | 6,040,284 |
| **INTEREST INCOME** | *8* | **155,482** | 53,656 |
| **INTEREST EXPENSE AND OTHER FINANCING CHARGES** | *7, 13, 14, 15* | **(3,414,970)** | (2,906,036) |
| **EQUITY IN NET EARNINGS (LOSSES) OF ASSOCIATES AND JOINT VENTURES** - Net | | **(17,586)** | 28,428 |
| **OTHER INCOME (CHARGES)** - Net | *7, 16, 20, 22* | **(3,002,143)** | (1,215,118) |
| **INCOME BEFORE INCOME TAX** | | **1,711,916** | 2,001,214 |
| **INCOME TAX EXPENSE** - Net | | **365,046** | 874,565 |
| **NET INCOME** | | **P1,346,870** | P1,126,649 |
| **Attributable to:** | | | |
| Equity holders of the Parent Company | | **P1,346,583** | P1,126,649 |
| Non-controlling interest | | **287** | - |
| | | **P1,346,870** | P1,126,649 |
| **Earnings Per Common Share Attributable to Equity Holders of the Parent Company** | | | |
| Basic/Diluted | *21* | **P0.37** | P0.29 |

*See Notes to the Condensed Consolidated Interim Financial Statements.*

## SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE INCOME
## FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(In Thousands)

| | **2018 (Unaudited)** | 2017 (Unaudited) |
|---|---|---|
| **NET INCOME** | **P1,346,870** | P1,126,649 |
| **OTHER COMPREHENSIVE INCOME** | | |
| **Item that may be reclassified to profit or loss** | | |
| Gain on exchange differences on translation of foreign operations | **34,496** | - |
| **TOTAL COMPREHENSIVE INCOME** | **P1,381,366** | P1,126,649 |
| **Attributable to:** | | |
| Equity holders of the Parent Company | **P1,381,079** | P1,126,649 |
| Non-controlling interest | **287** | - |
| | **P1,381,366** | P1,126,649 |

*See Notes to the Condensed Consolidated Interim Financial Statements.*

# SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
## (A Wholly-owned Subsidiary of San Miguel Corporation)

## CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY
## FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017

(In Thousands)

| | | Equity Attributable to Equity Holders of Parent Company | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Equity Reserves | | | | | | |
| | **Note** | **Capital Stock** | **Additional Paid-in Capital** | **Redeemable Perpetual Securities** | **Undated Subordinated Capital Securities** | **Equity Reserves** | **Translation Reserves** | **Reserve for Retirement Plan** | **Retained Earnings** | **Total** | **Non-controlling Interest** | **Total Equity** |
| **Balance as of January 1, 2018, As previously reported (Audited)** | | **P1,062,504** | **P2,490,000** | **P -** | **P26,933,565** | **P785,279** | **P -** | **(P23,632)** | **P28,517,796** | **P59,765,512** | **P -** | **P59,765,512** |
| **Adjustment due to PFRS 15** | | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **(85,314)** | **(85,314)** | **-** | **(85,314)** |
| **As of January 1, 2018, As restated** | | **1,062,504** | **2,490,000** | **-** | **26,933,565** | **785,279** | **-** | **(23,632)** | **28,432,482** | **59,680,198** | **-** | **59,680,198** |
| Net income | | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **1,346,583** | **1,346,583** | **287** | **1,346,870** |
| Gain on exchange differences on translation of foreign operations | | **-** | **-** | **-** | **-** | **-** | **34,496** | **-** | **-** | **34,496** | **-** | **34,496** |
| Total comprehensive income for the period | | **-** | **-** | **-** | **-** | **-** | **34,496** | **-** | **1,346,583** | **1,381,079** | **287** | **1,381,366** |
| Issuance of redeemable perpetual securities | *24* | **-** | **-** | **33,127,662** | **-** | **-** | **-** | **-** | **-** | **33,127,662** | **-** | **33,127,662** |
| Non-controlling interest from acquisition of subsidiaries | *5* | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **198,077** | **198,077** |
| Distributions paid | *17* | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **(746,068)** | **(746,068)** | **-** | **(746,068)** |
| **Balance as of March 31, 2018 (Unaudited)** | | **P1,062,504** | **P2,490,000** | **P33,127,662** | **P26,933,565** | **P785,279** | **P34,496** | **(P23,632)** | **P29,032,997** | **P93,442,871** | **P198,364** | **P93,641,235** |
| Balance as of January 1, 2017 (Audited) | | P1,062,504 | P2,490,000 | P - | P26,933,565 | P785,279 | P - | (P26,371) | P23,425,647 | P54,670,624 | P - | P54,670,624 |
| Net income/total comprehensive income for the period | | - | - | - | - | - | - | - | 1,126,649 | 1,126,649 | - | 1,126,649 |
| Distributions paid | *17* | - | - | - | - | - | - | - | (720,611) | (720,611) | - | (720,611) |
| Balance as of March 31, 2017 (Unaudited) | | P1,062,504 | P2,490,000 | P - | P26,933,565 | P785,279 | P - | (P26,371) | P23,831,685 | P55,076,662 | P - | P55,076,662 |

*See Notes to the Condensed consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS**
**FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND 2017**
(In Thousands)

| | *Note* | **2018 (Unaudited)** | 2017 (Unaudited) |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Income before income tax | | **P1,711,916** | P2,001,214 |
| Adjustments for: | | | |
| Interest expense and other financing charges | *7, 13, 14, 15* | **3,414,970** | 2,906,036 |
| Depreciation and amortization | *7, 12* | **1,822,931** | 1,477,522 |
| Unrealized foreign exchange losses (gains) - net | | **1,610,949** | (30,530) |
| Equity in net losses (earnings) of associates and joint ventures - net | | **17,586** | (28,428) |
| Unrealized marked-to-market loss on derivatives | | **12,265** | - |
| Retirement benefit expense | | **7,783** | 7,060 |
| Impairment losses on trade and other receivables | | **-** | 69,322 |
| Interest income | | **(155,482)** | (53,656) |
| Operating income before working capital changes | | **8,442,918** | 6,348,540 |
| Decrease (increase) in: | | | |
| Trade and other receivables - net | | **(3,827,813)** | (3,110,976) |
| Inventories | | **138,348** | (4,767) |
| Prepaid expenses and other current assets | | **(1,358,283)** | 459,757 |
| Increase (decrease) in: | | | |
| Accounts payable and accrued expenses | | **2,097,371** | (1,568,008) |
| Other noncurrent liabilities | | **7,789,503** | 3,077 |
| Cash generated from operations | | **13,282,044** | 2,127,623 |
| Interest income received | | **140,341** | 37,987 |
| Income taxes paid | | **(203,474)** | (209,050) |
| Finance cost paid | | **(2,624,283)** | (476,701) |
| Net cash flows provided by operating activities | | **10,594,628** | 1,479,859 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Additions to investments and advances | | **(280,655)** | (162,242) |
| Additions to property, plant and equipment | *12* | **(751,425)** | (2,949,400) |
| Additions to deferred exploration and development costs | | **(1,046)** | (772) |
| Additions to intangible assets | | **(21,897)** | (37,092) |
| Acquisition of subsidiaries | | **(97,333,757)** | - |
| Decrease (increase) in other noncurrent assets | | **1,045,706** | (18,366) |
| Net cash flows used in investing activities | | **(97,343,074)** | (3,167,872) |

*Forward*

| | Note | 2018 (Unaudited) | 2017 (Unaudited) |
|---|---|---|---|
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from long-term borrowings | *15* | **P64,316,000** | P - |
| Proceeds from issuance of redeemable perpetual securities | | **33,127,662** | - |
| Proceeds from short-term borrowings | | **11,860,000** | 10,040,000 |
| Payments of long-term borrowings | *15* | **(262,500)** | (10,043,000) |
| Distributions to undated subordinated capital securities holders | | **(746,068)** | (720,611) |
| Payments of finance lease liabilities | *7* | **(6,319,017)** | (6,163,340) |
| Payments of short-term borrowings | | **(11,860,000)** | - |
| Net cash flows provided by (used in) financing activities | | **90,116,077** | (6,886,951) |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | | **442,719** | 7,945 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | | **3,810,350** | (8,567,019) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | | **28,655,359** | 21,491,385 |
| **CASH AND CASH EQUIVALENTS AT END OF THE PERIOD** | | **P32,465,709** | P12,924,366 |

*See Notes to the Condensed Consolidated Interim Financial Statements.*

# NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Amounts in Thousands, Except Per Share Data and Number of Shares)

## 1. Reporting Entity

SMC Global Power Holdings Corp. (SMC Global Power or Parent Company) was incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on January 23, 2008, and its primary purpose of business is to purchase, sell, lease, develop and dispose of all properties of every kind and description, and shares of stocks or other securities or obligations, created or issued by any corporation or other entity. The Parent Company's registered office address is located at 155 EDSA, Brgy. Wack-Wack, Mandaluyong City, Metro Manila.

The accompanying condensed consolidated interim financial statements comprise the financial statements of the Parent Company and its Subsidiaries (collectively referred to as the Group) and the Group's interests in associates and joint ventures.

The Parent Company is a wholly-owned subsidiary of San Miguel Corporation (SMC). The ultimate parent company of the Group is Top Frontier Investment Holdings, Inc. (Top Frontier). SMC and Top Frontier are public companies under Section 17.2 of the Securities Regulation Code and whose shares are listed on The Philippine Stock Exchange, Inc.

## 2. Basis of Preparation

Statement of Compliance

The accompanying condensed consolidated interim financial statements have been prepared in accordance with Philippine Accounting Standards (PAS) 34, *Interim Financial Reporting,* and should be read in conjunction with the Group's last annual audited consolidated financial statements as at and for the year ended December 31, 2017. They do not include all the information required for a complete set of Philippine Financial Reporting Standards (PFRS) financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the last annual audited consolidated financial statements.

The condensed consolidated interim financial statements were approved and authorized for issue by the Parent Company's Board of Directors (BOD) on May 7, 2018.

Basis of Measurement

The condensed consolidated interim financial statements of the Group have been prepared on the historical cost basis except for the following items which are measured on an alternative basis on each reporting date:

| Items | Measurement Basis |
|---|---|
| Derivative financial instruments | Fair value |
| Defined benefit retirement liability | Present value of the defined benefit retirement obligation |

Functional and Presentation Currency

The condensed consolidated interim financial statements are presented in Philippine peso, which is the functional currency of the Parent Company. All financial information are rounded off to the nearest thousand (P000), except when otherwise indicated.

Basis of Consolidation

The Parent Company's subsidiaries, primarily engaged in power generation, retail and other power-related services and coal mining are incorporated in the Philippines and registered with the Philippine SEC. The condensed consolidated interim financial statements include the accounts of the Parent Company and its subsidiaries as follows:

| | Percentage of Ownership | |
|---|---|---|
| | **2018** | 2017 |
| *Power Generation* | | |
| San Miguel Energy Corporation (SMEC) | **100** | 100 |
| South Premiere Power Corp. (SPPC) | **100** | 100 |
| Strategic Power Devt. Corp. (SPDC) | **100** | 100 |
| SMC PowerGen Inc. (SPI) | **100** | 100 |
| Limay Power Generation Corporation [(a)] | **100** | 100 |
| SMC Consolidated Power Corporation (SCPC) [(b) (c)] | **100** | 100 |
| San Miguel Consolidated Power Corporation (SMCPC) [(d)] | **100** | 100 |
| Central Luzon Premiere Power Corp. (CLPPC) [(e)] | **100** | 100 |
| Limay Premiere Power Corp. (LPPC) [(c) (e)] | **100** | 100 |
| PowerOne Ventures Energy Inc. (PVEI) [(f)] | **100** | 100 |
| Prime Electric Generation Corporation [(g)] | **100** | 100 |
| Oceantech Power Generation Corporation [(g)] | **100** | 100 |
| Masin-AES Pte. Ltd. (MAPL) [(h) (i)] | **100** | - |
| *Retail and Other Power-related Services* | | |
| San Miguel Electric Corp. (SMELC) | **100** | 100 |
| Albay Power and Energy Corp. (APEC) | **100** | 100 |
| SMC Power Generation Corp. (SPGC) [(j)] | **100** | 100 |
| *Coal Mining* | | |
| Daguma Agro-Minerals, Inc. (DAMI) [(k)] | **100** | 100 |
| Sultan Energy Phils. Corp. (SEPC) [(k)] | **100** | 100 |
| Bonanza Energy Resources, Inc. (BERI) [(k)] | **100** | 100 |
| *Others* | | |
| Mantech Power Dynamics Services Inc. (MPDSI) | **100** | 100 |
| Safetech Power Services Corp. (SPSC) | **100** | 100 |
| Ondarre Holding Corporation (OHC) [(l)] | **100** | 100 |
| Golden Quest Equity Holdings Inc. (GQEHI) [(k)] | **100** | 100 |
| Grand Planters International, Inc. (GPII) [(m)] | **100** | 100 |
| AES Transpower Private Ltd. (ATPL) [(h)] | **100** | - |
| AES Philippines Inc. (API)[(h)] | **100** | - |

(a) *Indirectly owned by the Parent Company through SPI and has not yet started commercial operations as of March 31, 2018.*

(b) *In May 2017, September 2017 and March 2018, SCPC started commercial operations of Units 1, 2 and 3, respectively, of its 4 x 150 MW (Phases I and II) coal-fired power plant in Limay, Bataan.*

(c) *On June 22, 2017, LPPC sold its 2 x 150 MW (Phase II) coal-fired power plant under construction to SCPC.*

(d) *In July 2017 and February 2018, SMCPC started commercial operations for Units 1 and 2, respectively, of its 2 x 150 megawatts (MW) coal-fired power plant in Malita, Davao.*

(e) *Incorporated in 2015 and has not yet started commercial operations as of March 31, 2018.*

(f) *PVEI owns 60% of the outstanding capital stock of Angat Hydropower Corporation (AHC) and KWPP Holdings Corporation as joint ventures.*

(g) *Incorporated in 2017 and has not started commercial operations as of March 31, 2018.*

(h) *Acquired in March 2018 (Note 5).*

(i) *Indirectly owns, through its subsidiaries (including Masinloc Power Partners Co. Ltd. (MPPCL), the 2 x 315 MW coal-fired power plant (Units 1 and 2), the under-construction project expansion of the 335 MW unit known as Unit 3, and the 10 MW battery energy storage project, all located in Masinloc, Zambales and the 2 x 20 MW battery energy storage facility in Kabankalan, Negros Occidental, which is still at the pre-development stage.*

(j) *SPGC owns 35% of the outstanding capital stock of Olongapo Electricity Distribution Company, Inc., (OEDC) as an associate.*

(k) *Indirectly owned by the Parent Company through SMEC and has not yet started commercial operations as of March 31, 2018.*

(l) *Acquired in February 2015 and has not yet started commercial operations as of March 31, 2018.*

(m) *Acquired in September 2015.*

A subsidiary is an entity controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

When the Group has less than majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including the contractual arrangement with the other vote holders of the investee, rights arising from other contractual arrangements and the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are included in the condensed consolidated interim financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The financial statements of the subsidiaries are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the condensed consolidated interim financial statements.

Non-controlling interests represent the portion of profit or loss and net assets not attributable to the Parent Company and are presented in the condensed consolidated interim statements of income, condensed consolidated interim statements of comprehensive income and within equity in the condensed consolidated interim statements of financial position, separately from the equity attributable to equity holders of the Parent Company.

Non-controlling interest pertain to the interest not held by the Parent Company in Alpha Water and Realty Services Corp., which is indirectly owned by MAPL through its subsidiary, MPPCL.

A change in the ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, the Group: (i) derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests and the cumulative transaction differences recorded in equity; (ii) recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in the condensed consolidated interim statements of income; and (iii) reclassify the Parent Company's share of components previously recognized in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

## 3. Significant Accounting Policies

Except as described below, the accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended December 31, 2017. The following changes in accounting policies are also expected to be reflected in the Group's consolidated financial statements as at and for the year ended December 31, 2018.

*New and Amended Standards and Interpretation Adopted in 2018*

The Group has adopted the following PFRS effective January 1, 2018 and accordingly, changed its accounting policies in the following areas:

- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which only the *Amendments to PAS 28, Investments in Associates*, on measuring an associate or joint venture at fair value is applicable to the Group. The amendments provide that a venture capital organization, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss (FVPL). This election can be made on an investment-by-investment basis. The amendments also provide that a non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture.

- PFRS 9 (2014), *Financial Instruments* replaces PAS 39, *Financial Instruments: Recognition and Measurement*, and supersedes the previously published versions of PFRS 9 that introduced new classifications and measurement requirements (in 2009 and 2010) and a new hedge accounting model (in 2013). PFRS 9 includes revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment, guidance on own credit risk on financial liabilities measured at fair value and supplements the new general hedge accounting requirements. PFRS 9 incorporates new hedge accounting requirements that represent a major overhaul of hedge accounting and introduces significant improvements by aligning the accounting more closely with risk management.

  The Group has adopted PFRS 9. The adoption of PFRS has no significant effect on the classification and measurement of financial assets and financial liabilities of the Group. The amount of expected credit losses as of January 1, 2018 does not materially differ from the recognized allowance for impairment of receivables of the Group.

  The following table shows the original classification categories under PAS 39 and the new classification categories under PFRS 9 for each class of the Group's financial assets as of January 1, 2018.

| | Classification under PAS 39 | Classification under PFRS 9 | Carrying Amount under PAS 39 | Carrying Amount under PFRS 9 |
|---|---|---|---|---|
| Cash and cash equivalents | Loans and receivables | Financial assets at amortized cost | P32,465,709 | P32,465,709 |
| Trade and other receivables - net | Loans and receivables | Financial assets at amortized cost | 26,814,354 | 26,814,354 |
| Investments in debt instruments | AFS financial assets | Financial assets at FVOCI | 54,717 | 54,717 |
| Derivative asset | Financial assets at FVPL | Financial assets at FVPL | 49,637 | 49,637 |
| Noncurrent receivables and restricted cash | Loans and receivables | Financial assets at amortized cost | 8,228,015 | 8,228,015 |

- PFRS 15, *Revenue from Contracts with Customers*, replaces PAS 11, *Construction Contracts*, PAS 18, *Revenue*, International Financial Reporting Interpretations Committee (IFRIC) 13, *Customer Loyalty Programmes*, IFRIC 18, *Transfer of Assets from Customers* and Standard Interpretation Committee - 31, *Revenue - Barter Transactions Involving Advertising Services*. The new standard introduces a new revenue recognition model for contracts with customers which specifies that revenue should be recognized when (or as) the Group transfers control of goods or services to a customer at the amount to which the Group expects to be entitled. Depending on whether certain criteria are met, revenue is recognized over time, in a manner that best reflects the Group's performance, or at a point in time, when control of the goods or services is transferred to the customer. The standard does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other PFRS. It also does not apply if two companies in the same line of business exchange nonmonetary assets to facilitate sales to other parties. Furthermore, if a contract with a customer is partly in the scope of another PFRS, then the guidance on separation and measurement contained in the other PFRS takes precedence.

  The Group has adopted PFRS 15 using the cumulative effect method. The cumulative effect of applying the new standard is recognized at the beginning of the year of initial application, with no restatement of comparative period. The impact of the adoption decreased retained earnings as of January 1, 2018 by P85,314.

  The following tables summarize the impact of adopting PFRS 15 on the condensed consolidated interim financial statements as of and for the period ended March 31, 2018.

Condensed Consolidated Statement of Financial Position

| | As Reported | Adjustments | Amounts Without Adoption of PFRS 15 |
|---|---|---|---|
| **Assets** | | | |
| Trade and other receivables - net | P26,906,275 | P54,877 | P26,961,152 |
| Deferred tax assets | 1,633,774 | (9,870) | 1,623,904 |
| **Current Assets** | 85,132,723 | 45,007 | 85,087,716 |
| **Noncurrent Assets** | 414,789,336 | - | 414,789,336 |
| **Total Assets** | P499,922,059 | P45,007 | P499,877,052 |
| **Liabilities** | | | |
| **Current Liabilities** | P70,941,117 | P - | P70,941,117 |
| **Noncurrent Liabilities** | 335,339,707 | - | 335,339,707 |
| **Total Liabilities** | 406,280,824 | - | 406,280,824 |
| **Equity** | | | |
| Retained earnings | 29,032,997 | 45,007 | 28,987,990 |
| **Equity Attributable to Equity Holders of the Parent Company** | 93,442,871 | 45,007 | 93,397,864 |
| **Non-controlling interest** | 198,364 | - | 198,364 |
| **Total Equity** | 93,641,235 | 45,007 | 93,596,228 |
| **Total Liabilities and Equity** | P499,922,059 | P45,007 | P499,877,052 |

Condensed Consolidated Statement of Comprehensive Income

| | As Reported | Adjustments | Amounts without Adoption of PFRS 15 |
|---|---|---|---|
| **Revenues** | P24,660,512 | P48,901 | P24,611,611 |
| **Cost of Power Sold** | 15,462,524 | - | 15,462,524 |
| **Gross Profit** | 9,197,988 | 48,901 | 9,149,087 |
| **Income Before Income Tax** | 1,711,916 | 48,901 | 1,663,015 |
| **Income Tax Expense** | 365,046 | (8,594) | 356,452 |
| **Net Income** | 1,346,870 | 40,307 | 1,306,563 |
| **Total Comprehensive Income -** Net of tax | P1,381,366 | P40,307 | P1,341,059 |

The adjustments are due to the effect of variable consideration in the determination of transaction price and the change in the recognition of revenue from sale of power. Prior to the adoption of PFRS 15, the Group recognized revenue upon supply of power to customers based on invoiced amounts, net of value-added tax, and separately recorded a reduction in revenue for discounts availed by qualified customers. Under PFRS 15, the Group recognizes a reduction in its revenue from sale of power for the amount of expected discounts to be given to customers on the same reporting period the revenue was earned. The discounts are estimated based on the historical data of customer's payment patterns and in accordance with the specific terms and conditions provided in the Group's power supply contract with the customer.

- Philippine Interpretation IFRIC 22, *Foreign Currency Transactions and Advance Consideration*. The amendments clarify that the transaction date to be used for translation of foreign currency transactions involving an advance payment or receipt is the date on which the entity initially recognizes the prepayment or deferred income arising from the advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date. The interpretation applies when an entity pays or receives consideration in a foreign currency and recognizes a non-monetary asset or liability before recognizing the related item.

Except as otherwise indicated, the adoption of these foregoing new and amended standards and interpretation did not have a material effect on the condensed consolidated interim financial statements.

*New and Amended Standards and Interpretation Not Yet Adopted*

A number of new and amended standards and interpretations are effective for annual periods beginning after January 1, 2018 and have not been applied in preparing the condensed consolidated interim financial statements. Unless otherwise indicated, none of these is expected to have a significant effect on the condensed consolidated interim financial statements.

The Group will adopt the following new and amended standards and interpretations on the respective effective dates:

- PFRS 16, *Leases*, supersedes PAS 17, *Leases*, and the related Philippine Interpretations. The new standard introduces a single lease accounting model for lessees under which all major leases are recognized on-balance sheet, removing the lease classification test. Lease accounting for lessors essentially remains unchanged except for a number of details including the application of the new lease definition, new sale-and-leaseback guidance, new sub-lease guidance and new disclosure requirements. Practical expedients and targeted reliefs were introduced including an optional lessee exemption for short-term leases (leases with a term of 12 months or less) and low-value items, as well as the permission of portfolio-level accounting instead of applying the requirements to individual leases. New estimates and judgmental thresholds that affect the identification, classification and measurement of lease transactions, as well as requirements to reassess certain key estimates and judgments at each reporting date were introduced.

  PFRS 16 is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply PFRS 15 at or before the date of initial application of PFRS 16. The Group is currently assessing the potential impact of the new standard.

- Philippine Interpretation IFRIC 23, *Uncertainty over Income Tax Treatments*, clarifies how to apply the recognition and measurement requirements in PAS 12, *Income Taxes*, when there is uncertainty over income tax treatments. Under the interpretation, whether the amounts recorded in the financial statements will differ to that in the tax return, and whether the uncertainty is disclosed or reflected in the measurement, depends on whether it is probable that the tax authority will accept the Group's chosen tax treatment. If it is not probable that the tax authority will accept the Group's chosen tax treatment, the uncertainty is reflected using the measure that provides the better prediction of the resolution of the uncertainty - either the most likely amount or the expected value. The interpretation also requires the reassessment of judgments and estimates applied if facts and circumstances change - e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority's right to challenge a treatment expires.

  The interpretation is effective for annual periods beginning on or after January 1, 2019 with earlier application permitted.

  The interpretation was approved by the Philippine Financial Reporting Standards Council (FRSC) on July 12, 2017 but is still subject to the approval by the Board of Accountancy (BOA).

  ▪

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture *(Amendments to PFRS 10, Consolidated Financial Statements, and PAS 28)*. The amendments address an inconsistency in the requirements in PFRS 10 and PAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require that a full gain or loss is recognized when a transaction involves a business whether it is housed in a subsidiary or not. A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

Originally, the amendments apply prospectively for annual periods beginning on or after January 1, 2016, with early adoption permitted. However on January 13, 2016, the FRSC decided to postpone the effective date until the International Accounting Standards Board has completed its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

- Prepayment Features with Negative Compensation *(Amendments to PFRS 9)*. The amendments cover the following areas: (a) Prepayment features with negative compensation. The amendment clarifies that a financial asset with a prepayment feature could be eligible for measurement at amortized cost or fair value through other comprehensive income (FVOCI) irrespective of the event or circumstance that causes the early termination of the contract, which may be within or beyond the control of the parties, and a party may either pay or receive reasonable compensation for that early termination. The amendment is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. Retrospective application is required, subject to relevant transitional reliefs; and (b) Modification of financial liabilities. The amendment to the Basis for Conclusions on PFRS 9 clarifies that the standard provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition and the treatment is consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset - i.e. the amortized cost of the modified financial liability is recalculated by discounting the modified contractual cash flows using the original effective interest rate and any adjustment is recognized in profit or loss. If the initial application of PFRS 9 results in a change in accounting policy for these modifications or exchanges, then retrospective application is required, subject to relevant transition reliefs.

  The amendments were approved by the FRSC on November 8, 2017 but is still subject to the approval by the BOA.

- Long-term Interests (LTI) in Associates and Joint Ventures *(Amendments to PAS 28)*. The amendment requires the application of PFRS 9 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests that, in substance, form part of the entity's net investment in an associate or joint venture. The amendment explains the annual sequence in which PFRS 9 and PFRS 28 are to be applied. In effect, PFRS 9 is first applied ignoring any PAS 28 loss absorption in prior years. If necessary, prior years' PAS 28 loss allocation is adjusted in the current year which may involve recognizing more prior years' losses, reversing these losses or re-allocating them between different LTI instruments. Any current year PAS 28 losses are allocated to the extent that the remaining LTI balance allows and any current year PAS 28 profits reverse any unrecognized prior years' losses and then allocations against LTI. The amendment is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. Retrospective application is required, subject to relevant transitional reliefs.

  The amendments were approved by the FRSC on November 8, 2017 but is still subject to the approval by the BOA.

- Plan Amendment, Curtailment or Settlement *(Amendments to PAS 19, Employee Benefits)*. The amendments clarify that: (a) current service cost and net interest for the period are determined using the actuarial assumptions when amendment, curtailment or settlement occurs; and (b) the effect of the asset ceiling is disregarded when calculating the gain or loss on any settlement of the plan and is dealt with separately in other comprehensive income.

  The amendments apply for plan amendments, curtailments or settlements that occur on or after January 1, 2019, or the date on which the amendments are first applied, with earlier application permitted.

  The amendments were approved by the FRSC on March 14, 2018 but is still subject to the approval by the BOA.

- Annual Improvements to PFRS Cycles 2015 - 2017 contain changes to three standards:

  - Previously Held Interest in a Joint Operation *(Amendments to PFRS 3, Business Combinations and PFRS 11, Joint Arrangements). The amendments* clarify how an entity accounts for increasing its interest in a joint operation that meets the definition of a business. If an entity maintains (or obtains) joint control, the previously held interest is not remeasured. If an entity obtains control, the transaction is a business combination achieved in stages and the acquiring entity remeasures the previously held interest at fair value.

    The amendments are effective for annual periods beginning on or after January 1, 2019, with early adoption permitted.

  - Income Tax Consequences of Payments on Financial Instrument Classified as Equity (Amendments to *PAS 12, Income Taxes).* The amendments clarify that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognized consistently with the transactions that generated the distributable profits - i.e., in profit or loss, other comprehensive income or equity.

    The amendments are effective for annual periods beginning on or after January 1, 2019, with early adoption permitted.

  - Borrowing Costs Eligible for Capitalization *(Amendments to PAS 23, Borrowing Costs)*. The amendments clarify that the general borrowings pool used to calculate eligible borrowing costs excludes borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale, or any non-qualifying assets, are included in that general pool.

    The amendments are effective for annual periods beginning on or after January 1, 2019, with early adoption permitted.

    The amendments were approved by the FRSC on March 14, 2018 but is still subject to the approval by the BOA.

- *Amendments to References to the Conceptual Framework in IFRS Standards.* The amendments introduce the following main improvements: (a) concept on measurement, including factors to be considered when selecting a measurement basis; (b) concept on presentation and disclosure, including when to classify income and expenses in other comprehensive income; (c) guidance on the recognition and derecognition of assets and liabilities in the financial statements; (d) improved definitions of an asset and a liability; and (e) clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

  The amendments are effective for annual periods beginning on or after January 1, 2020.

<u>Financial Assets at FVOCI.</u>
Investment in debt instruments is measured at FVOCI if it meets both of the following conditions and is not designated as at FVPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets; and

- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

At initial recognition of an investment in equity instrument that is not held for trading, the Group may irrevocably elect to present subsequent changes in the fair value in other comprehensive income. This election is made on an instrument-by-instrument basis.

After initial measurement, financial assets at FVOCI are subsequently measured at fair value. Changes in fair value are recognized in other comprehensive income.

Interest income calculated using the effective interest method, foreign exchange gains and losses and impairment on investment in debt instruments are recognized in the condensed consolidated interim statements of income. When investment in debt instruments at FVOCI is derecognized the related accumulated gains or losses previously reported in the condensed consolidated interim statements of changes in equity are transferred to and recognized in the condensed consolidated interim statements of income.

Dividends earned on holding an investment in equity instrument are recognized as dividend income when the right to receive the payment has been established. When investment in equity instruments at FVOCI is derecognized the related accumulated gains or losses previously reported in the condensed consolidated interim statements of changes in equity are never reclassified to the condensed consolidated interim statements of income.

The Group’s investments in debt instruments and investments in equity instruments at FVOCI are classified under this category.

<u>Financial Assets at FVPL.</u>
A financial asset is classified as at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated as at FVPL if the Group manages such investments and makes purchase and sale decisions based on their fair values in accordance with the documented risk management or investment strategy of the Group. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

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

Financial assets may be designated by management at initial recognition as at FVPL, when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis;

- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group carries financial assets at FVPL using their fair values. Attributable transaction costs are recognized in the condensed consolidated interim statements of income as incurred. Fair value changes and realized gains or losses are recognized in the condensed consolidated interim statements of income. Fair value changes from derivatives accounted for as part of an effective cash flow hedge are recognized in other comprehensive income and presented in the condensed consolidated interim statements of changes in equity. Any interest earned is recognized as part of "Interest income" account in the condensed consolidated interim statements of income. Any dividend income from equity securities classified as at FVPL is recognized in the condensed consolidated interim statements of income when the right to receive payment has been established.

The Group's derivative assets and financial assets at FVPL are classified under this category.

Business Combination

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included as part of "Selling and administrative expenses" account in the condensed consolidated interim statements of income.

When the Group acquires a business, it assesses the financial assets and financial liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured at the acquisition date fair value and any resulting gain or loss is recognized in the condensed consolidated interim statements of income.

The Group measures goodwill at the acquisition date as: a) the fair value of the consideration transferred; plus b) the recognized amount of any non-controlling interests in the acquiree; plus c) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less d) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. When the excess is negative, a bargain purchase gain is recognized immediately in the condensed consolidated interim statements of income. Subsequently, goodwill is measured at cost less any accumulated impairment in value. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognized in the condensed consolidated interim statements of income. Costs related to the acquisition, other than those associated with the issuance of debt or equity securities that the Group incurs in connection with a business combination, are expensed as incurred. Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in the condensed consolidated interim statements of income.

- *Goodwill in a Business Combination*
  Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

  - represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

  - is not larger than an operating segment determined in accordance with PFRS 8, *Operating Segments.*

  Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss with respect to goodwill is not reversed.

- *Intangible Assets Acquired in a Business Combination*
  The cost of an intangible asset acquired in a business combination is the fair value as at the date of acquisition, determined using discounted cash flows as a result of the asset being owned.

  Following initial recognition, intangible asset is carried at cost less any accumulated amortization and impairment losses, if any. The useful life of an intangible asset is assessed to be either finite or indefinite.

An intangible asset with finite life is amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each reporting date. A change in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for as a change in accounting estimate. The amortization expense on intangible asset with finite life is recognized in the condensed consolidated interim statements of income.

Transactions under Common Control

Transactions under common control entered into in contemplation of each other and business combination under common control designed to achieve an overall commercial effect are treated as a single transaction.

Transfers of assets between commonly controlled entities are accounted for using book value accounting.

Non-controlling Interests

The acquisitions of non-controlling interests are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognized as a result of such transactions. Any difference between the purchase price and the net assets of the acquired entity is recognized in equity. The adjustments to non-controlling interests are based on a proportionate amount of the identifiable net assets of the subsidiary.

Foreign Currency

*Foreign Currency Translations*

Transactions in foreign currencies are translated to the respective functional currencies of the Group entities at exchange rates at the dates of the transactions. Monetary assets and monetary liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the reporting date.

Nonmonetary assets and nonmonetary liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date the fair value was determined. Nonmonetary items in foreign currencies that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on translation are recognized in the condensed consolidated interim statements of income, except for differences arising on the translation of AFS financial assets, a financial liability designated as an effective hedge of the net investment in a foreign operation or qualifying cash flow hedges, which are recognized in other comprehensive income.

*Foreign Operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to Philippine peso at exchange rates at the reporting date. The income and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated to Philippine peso at average exchange rates for the period.

Foreign currency differences are recognized in other comprehensive income and presented in the "Translation reserve" account in the condensed consolidated interim statements of changes in equity. However, if the operation is not a wholly-owned subsidiary, then the relevant proportionate share of the translation difference is allocated to the non-controlling interests. When a foreign operation is disposed of such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to the profit or loss as part of the gain or loss on disposal.

When the Group disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, the relevant proportion of the cumulative amount is reattributed to non-controlling interests. When the Group disposes of only part of its investment in shares of stock of an associate or joint venture that includes a foreign operation while retaining significant influence or joint control, the relevant proportion of the cumulative amount is reclassified to profit or loss.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely to occur in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income and presented in the "Translation reserve" account in the condensed consolidated interim statements of changes in equity.

## 4. Use of Judgments, Estimates and Assumptions

In preparing these condensed consolidated interim financial statements, management has made judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, and income and expense. Actual results may differ from these estimates.

The significant judgments made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those applied in the consolidated financial statements as at and for the year ended December 31, 2017.

## 5. Business Combination

On March 20, 2018, SMC Global Power acquired 51% and 49% equity interests in MAPL from AES Phil Investment Pte. Ltd. and Gen Plus B.V., respectively. MAPL indirectly owns, through its subsidiaries [including MPPCL], the 2 x 315 MW coal-fired power plant (Units 1 and 2), the under-construction project expansion of the 335 MW unit known as Unit 3, and the 10 MW battery energy storage project, all located in Masinloc, Zambales, Philippines (collectively, the "MPPCL Assets") and the 2 x 20 MW battery energy storage facility in Kabankalan, Negros Occidental, which is still at the pre-development stage (Note 12).

As part of the acquisition, SMC Global Power also acquired 100% equity interests in ATPL and API. ATPL has a Philippine Regional Office and Headquarters which provides corporate support services to MPPCL, while API provides energy marketing services to MPPCL.

With the acquisition by SMC Global Power of MAPL, ATPL and API (the "Transaction"), the Group aims to improve its existing baseload capacity to further ensure its ability to provide affordable and reliable supply of power to its customers. The additional power assets provide an opportunity for the Group to increase its footprint in clean coal technology that provides reliable and affordable power, particularly in Luzon. The Transaction will result in the production of electricity in an environmentally responsible way.

The total consideration for the Transaction is US$1,900,000, subject to a post-closing purchase price adjustment. The total consideration was paid in cash by SMC Global Power using the proceeds of (a) US dollar-denominated long-term borrowings obtained from various financial institutions totaling to US$1,200,000 and (b) the issuance of Redeemable Perpetual Securities (RPS) to, and obtaining advances from, SMC amounting to US$650,000 and US$150,000, respectively (Note 24).

The MAPL, ATPL and API are consolidated by SMC Global Power effective on March 20, 2018.

From the date of acquisition, the MAPL, ATPL and API have contributed P542,298 of revenues to the Group's results.

For the period ended March 31, 2018, the consolidated revenues of the Group would have been P30,051,491 had the Transaction been completed at the beginning of the reporting period.

SMC Global has elected to measure non-controlling interest at proportionate interest in identifiable net assets.

The following summarizes the recognized provisionary amounts of assets acquired and liabilities assumed at the acquisition date:

| | **2018** |
|---|---|
| **Assets** | |
| Cash and cash equivalents | **P1,656,243** |
| Trade and other receivables - net | **2,438,955** |
| Inventories | **2,378,065** |
| Prepaid expenses and other current assets | **1,691,735** |
| Property, plant and equipment - net | **62,274,180** |
| Intangible assets and goodwill - net | **79,553** |
| Other noncurrent assets | **3,039,797** |
| **Liabilities** | |
| Loans payable | **(2,343,600)** |
| Accounts payable and accrued expenses | **(9,590,653)** |
| Finance lease liabilities (including current portion) | **(30,775)** |
| Income tax payable | **(139,445)** |
| Long-term debt - net (including current maturities) | **(31,951,895)** |
| Deferred tax liabilities | **(54,520)** |
| Other noncurrent liabilities | **(203,919)** |
| **Total identifiable net assets** | **P29,243,721** |

Provisional goodwill recognized as a result of acquisition follows:

| | 2018 |
|---|---|
| Consideration transferred | **P98,990,000** |
| Non-controlling interest measured at proportionate interest in identifiable net assets | **198,077** |
| Total identifiable net assets | **(29,243,721)** |
| **Provisional Goodwill** | **P69,944,356** |

*Trade and Other Receivables.* The fair value of the trade and other receivables amounts to P2,438,955. The gross amount of trade and other receivables is P2,504,704, of which P65,749 is expected to be uncollectible at the acquisition date.

*Acquisition-related Costs*
The Parent Company incurred acquisition-related costs of P52,191 and P194,688 for the period ended March 31, 2018 and for the year ended December 31, 2017, respectively, which have been included in the "Selling and administrative expenses" account in the condensed consolidated interim statements of income.

Goodwill arising from the Transaction is attributable to the benefit of expected synergies, revenue growth, future development and the assembled workforce. These benefits are not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets.

The Group is currently completing the purchase price allocation exercise on the acquisition. The identifiable net assets at fair value are based on provisionary amounts as at the acquisition date, which is allowed under PFRS 3, within 12 months from the completion of the Transaction.

## 6. Segment Information

Operating Segments
The Group's operations are segmented into four businesses: a) power generation, b) retail and other power-related services, c) coal mining and d) others, consistent with the reports prepared internally for use by the Group's Chief Operating Decision Maker in reviewing the business performance of the operating segments. The differing economic characteristics and activities of these power plants make it more useful to users of the condensed consolidated interim financial statements to have information about each component of the Group's profit or loss, assets and liabilities.

The coal mining companies, which were acquired in 2010, have not yet started commercial operations and are in the preparatory stage of mining activities. The mining companies' total assets do not exceed 10% of the combined assets of all operating segments. Accordingly, management believes that as of March 31, 2018 and December 31, 2017, the information about this component of the Group would not be useful to the users of the condensed consolidated interim financial statements.

Segment Assets and Liabilities
Segment assets include all operating assets used by a segment except investments and advances, intangible assets and goodwill and deferred tax assets. Segment liabilities include all operating liabilities except long-term debt, deferred tax liabilities and income tax payable. Capital expenditures consist of additions to property, plant and equipment of each reportable segment.

Inter-segment Transactions
The Group's inter-segment sales are accounted for based on contracts entered into by the parties and are eliminated in the consolidation. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transactions are eliminated in consolidation.

*Major Customers*
The Group sells, retails and distributes power, through power supply agreements, retail supply agreements, concession agreement and other power-related service agreements (Note 7), either directly to customers (other generators, distribution utilities, electric cooperatives and industrial customers) or through the Philippine Wholesale Electricity Spot Market (WESM). Sale, retail and/or distribution of power to individual external customers that represents 10% or more of the Group's total revenues is as follows:

| | **March 31** | |
|---|---|---|
| | **2018 (Unaudited)** | 2017 (Unaudited) |
| Manila Electric Company (Meralco) | **P11,692,435** | P10,985,948 |
| WESM | **1,751,392** | 987,710 |

For management reporting purposes, the Group’s operating segments are organized and managed separately as follows:

## Operating Segments

Financial information about reportable segments follows:

| | For the Three Months Ended March 31 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Power Generation** | | **Retail and Other Power-related Services** | | **Coal Mining** | | **Others** | | **Eliminations** | | **Consolidated** | |
| | **2018 (Unaudited)** | 2017 (Unaudited) | **2018 (Unaudited)** | 2017 (Unaudited) | **2018 (Unaudited)** | 2017 (Unaudited) | **2018 (Unaudited)** | 2017 (Unaudited) | **2018 (Unaudited)** | 2017 (Unaudited) | **2018 (Unaudited)** | 2017 (Unaudited) |
| **Revenues** | | | | | | | | | | | | |
| External | **P20,344,124** | P17,376,858 | **P4,316,388** | P1,976,346 | **P -** | P - | **P -** | P - | **P -** | P - | **P24,660,512** | P19,353,204 |
| Inter-segment | **4,022,470** | 2,409,423 | **42,595** | 9,463 | **-** | - | **140,008** | 9,500 | **(4,205,073)** | (2,428,386) | **-** | - |
| | **24,366,594** | 19,786,281 | **4,358,983** | 1,985,809 | **-** | - | **140,008** | 9,500 | **(4,205,073)** | (2,428,386) | **24,660,512** | 19,353,204 |
| **Cost and Expenses** | | | | | | | | | | | | |
| Cost of power sold | **15,903,985** | 12,693,179 | **4,003,909** | 1,903,146 | **-** | - | **1,132** | - | **(4,446,502)** | (2,447,509) | **15,462,524** | 12,148,816 |
| Selling and administrative expenses | **1,054,978** | 1,007,624 | **64,796** | 96,155 | **4,858** | 5,902 | **507,965** | 387,378 | **(425,742)** | (332,955) | **1,206,855** | 1,164,104 |
| | **16,958,963** | 13,700,803 | **4,068,705** | 1,999,301 | **4,858** | 5,902 | **509,097** | 387,378 | **(4,872,244)** | (2,780,464) | **16,669,379** | 13,312,920 |
| **Segment Result** | **P7,407,631** | P6,085,478 | **P290,278** | (P13,492) | **(P4,858)** | (P5,902) | **(P369,089)** | (P377,878) | **P667,171** | P352,078 | **P7,991,133** | P6,040,284 |
| Interest income | | | | | | | | | | | **155,482** | 53,656 |
| Interest expense and other financing charges | | | | | | | | | | | **(3,414,970)** | (2,906,036) |
| Equity in net earnings (losses) of associates and joint ventures - net | | | | | | | | | | | **(17,586)** | 28,428 |
| Other income (charges) - net | | | | | | | | | | | **(3,002,143)** | (1,215,118) |
| Income tax expense - net | | | | | | | | | | | **(365,046)** | (874,565) |
| **Consolidated Net Income** | | | | | | | | | | | **P1,346,870** | P1,126,649 |

| | For the Periods Ended | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Power Generation** | | **Retail and Other Power-related Services** | | **Coal Mining** | | **Others** | | **Eliminations** | | **Consolidated** | |
| | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
| **Other Information** | | | | | | | | | | | | |
| Segment assets | **P385,664,219** | P317,738,519 | **P5,203,360** | P4,791,648 | **P719,694** | P723,848 | **P45,925,892** | P36,352,591 | **(P28,696,166)** | (P29,965,804) | **P408,816,999** | P329,640,802 |
| Investments and advances - net | **9,974,624** | 9,836,060 | **177,508** | 177,219 | **-** | - | **202,462,382** | 53,297,475 | **(195,730,314)** | (46,689,623) | **16,884,200** | 16,621,131 |
| Intangible assets and goodwill - net | | | | | | | | | | | **72,587,086** | 2,594,136 |
| Deferred tax assets | | | | | | | | | | | **1,633,774** | 1,316,926 |
| **Consolidated Total Assets** | | | | | | | | | | | **P499,922,059** | P350,172,995 |
| Segment liabilities | **P229,379,904** | P219,179,600 | **P6,008,855** | P5,262,850 | **P789,406** | P788,714 | **P16,241,587** | P1,460,026 | **(P40,105,819)** | (P34,488,425) | **P212,313,933** | P192,202,765 |
| Long-term debt - net | | | | | | | | | | | **185,972,906** | 90,728,701 |
| Income tax payable | | | | | | | | | | | **525,411** | 151,906 |
| Deferred tax liabilities | | | | | | | | | | | **7,468,574** | 7,324,111 |
| **Consolidated Total Liabilities** | | | | | | | | | | | **P406,280,824** | P290,407,483 |
| Capital expenditures | **P748,206** | P8,870,396 | **P -** | P - | **P -** | P - | **P3,219** | P41,135 | **P -** | P - | **P751,425** | P8,911,531 |
| Depreciation and amortization of property, plant and equipment and intangible assets | **1,793,027** | 5,911,084 | **8,718** | 31,005 | **2,353** | 10,760 | **18,833** | 112,082 | **-** | - | **1,822,931** | 6,064,931 |
| Noncash items other than depreciation and amortization | **(1,818,528)** | 693,563 | **309** | (19,846) | **6** | 1 | **189,678** | 72,807 | **-** | - | **(1,628,535)** | 746,525 |

## 7. Significant Agreements and Lease Commitments

a. Independent Power Producer (IPP) Administration (IPPA) Agreements

As a result of the biddings conducted by PSALM for the Appointment of the IPP Administrator for the capacity of the following power plants, the Group was declared the winning bidder to act as IPP Administrator through the following appointed subsidiaries:

| Subsidiary | Power Plant | Location |
|---|---|---|
| SMEC | Sual Coal - Fired Power Station (Sual Power Plant) | Sual, Pangasinan Province |
| SPDC | San Roque Hydroelectric Multi-purpose Power Plant (San Roque Power Plant) | San Roque, Pangasinan Province |
| SPPC | Ilijan Natural Gas - Fired Combined Cycle Power Plant (Ilijan Power Plant) | Ilijan, Batangas Province |

The IPPA Agreements are with the conformity of the National Power Corporation (NPC), a government-owned and controlled corporation created by virtue of Republic Act (RA) No. 6395, as amended, whereby NPC confirms, acknowledges, approves and agrees to the terms of the IPPA Agreements and further confirms that for so long as it remains the counterparty of the IPP, it will comply with its obligations and exercise its rights and remedies under the original agreement with the IPP at the request and instruction of PSALM.

The IPPA Agreements include, among others, the following common salient rights and obligations:

i. the right and obligation to manage and control the capacity of the power plant for its own account and at its own cost and risks;

ii. the right to trade, sell or otherwise deal with the capacity (whether pursuant to the spot market, bilateral contracts with third parties or otherwise) and contract for or offer related ancillary services, in all cases for its own account and at its own cost and risks. Such rights shall carry the rights to receive revenues arising from such activities without obligation to account therefore to PSALM or any third party;

iii. the right to receive a transfer of the power plant upon termination of the IPPA Agreement at the end of the cooperation period or in case of buy-out;

iv. for SMEC and SPPC, the right to receive an assignment of NPC's interest in existing short-term bilateral power supply contracts;

v. the obligation to supply and deliver, at its own cost, fuel required by the IPP and necessary for the Sual Power Plant to generate the electricity required to be produced by the IPP;

vi. maintain the performance bond in full force and effect with a qualified bank; and

vii. the obligation to pay PSALM the monthly payments and energy fees in respect of all electricity generated from the capacity, net of outages.

Relative to the IPPA Agreements, SMEC, SPDC and SPPC have to pay PSALM monthly payments for 15 years until October 1, 2024, 18 years until April 26, 2028 and 12 years until June 26, 2022, respectively. Energy fees amounted to P5,562,766 and P5,407,968 for the three months ended March 31, 2018 and 2017, respectively (Note 19). SMEC and SPDC renewed their performance bonds in United States dollar (US$) amounting to US$58,187 and US$20,305 which will expire on November 3, 2018 and January 25, 2018, respectively. Subsequently, the performance bond of SPDC was renewed up to January 25, 2019.

On June 16, 2015, SPPC renewed its performance bond amounting to US$60,000 with a validity period of one year. This performance bond was subsequently drawn by PSALM on September 4, 2015 which is subject to an ongoing case (Note 24).

The finance lease liabilities are carried at amortized cost using the US dollar and Philippine peso discount rates as follows:

| | US Dollar | Philippine Peso |
|---|---|---|
| SMEC | 3.89% | 8.16% |
| SPPC | 3.85% | 8.05% |
| SPDC | 3.30% | 7.90% |

The discount determined at inception of the agreement is amortized over the period of the IPPA Agreement and recognized as part of "Interest expense and other financing charges" account in the condensed consolidated interim statements of income. Interest expense amounted to P2,145,097 and P2,339,130 for the three months ended March 31, 2018 and 2017, respectively.

The future minimum lease payments for each of the following periods are as follows:

| **March 31, 2018 (Unaudited)** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$258,838** | **P13,500,975** | **P12,395,420** | **P25,896,395** |
| More than 1 year and not later than 5 years | **1,099,136** | **57,330,943** | **52,648,256** | **109,979,199** |
| Later than 5 years | **515,984** | **26,913,722** | **24,745,690** | **51,659,412** |
| | **1,873,958** | **97,745,640** | **89,789,366** | **187,535,006** |
| Less: Future finance charges on finance lease liabilities | **228,563** | **11,921,822** | **21,250,193** | **33,172,015** |
| Present values of finance lease liabilities | **US$1,645,395** | **P85,823,818** | **P68,539,173** | **P154,362,991** |

| December 31, 2017 (Audited) | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$255,784 | P12,771,279 | P12,249,270 | P25,020,549 |
| More than 1 year and not later than 5 years | 1,114,370 | 55,640,495 | 53,374,792 | 109,015,287 |
| Later than 5 years | 567,483 | 28,334,431 | 27,214,567 | 55,548,998 |
| | 1,937,637 | 96,746,205 | 92,838,629 | 189,584,834 |
| Less: Future finance charges on finance lease liabilities | 244,014 | 12,183,624 | 22,607,520 | 34,791,144 |
| Present values of finance lease liabilities | US$1,693,623 | P84,562,581 | P70,231,109 | P154,793,690 |

The present values of minimum lease payments for each of the following periods are as follows:

| **March 31, 2018 (Unaudited)** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$201,610** | **P10,516,010** | **P7,307,667** | **P17,823,677** |
| More than 1 year and not later than 5 years | **957,733** | **49,955,353** | **39,538,306** | **89,493,659** |
| Later than 5 years | **486,052** | **25,352,455** | **21,693,200** | **47,045,655** |
| | **US$1,645,395** | **P85,823,818** | **P68,539,173** | **P154,362,991** |

| December 31, 2017 (Audited) | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$196,709 | P9,821,652 | P7,022,779 | P16,844,431 |
| More than 1 year and not later than 5 years | 963,978 | 48,131,431 | 39,493,581 | 87,625,012 |
| Later than 5 years | 532,936 | 26,609,498 | 23,714,749 | 50,324,247 |
| | US$1,693,623 | P84,562,581 | P70,231,109 | P154,793,690 |

b. Market Participation Agreements (MPA)

SMEC, SPDC, SPPC, SCPC and MPPCL entered into a MPA with the Philippine Electricity Market Corporation (PEMC) to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. Under the WESM Rules, the cost of administering and operating the WESM shall be recovered through a charge imposed on all WESM members or transactions, as approved by the ERC. PEMC's market fees charged to SMEC, SPDC, SPPC, SCPC and MPPCL recognized in the condensed consolidated interim statements of income amounted to P40,783 and P38,487 for the three months ended March 31, 2018 and 2017, respectively.

In March 2013, SMELC entered into a MPA for Supplier as Direct WESM Member - Customer Trading Participant Category with the PEMC to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. SMELC has a standby letter of credit, expiring on December 26, 2018, to secure the full and prompt performance of obligations for its transactions as a Direct Member and trading participant in the WESM.

c. Power Supply Agreements (PSA)

SMEC, SPPC, SPDC, SMCPC, SCPC and MPPCL have PSA with various counterparties, including related parties, to sell electricity produced by the power plants. Most of the agreements provide for renewals or extensions subject to mutually agreed terms and conditions by the parties and applicable rules and regulations.

Certain customers, particularly electric cooperatives and industrial customers are billed using energy-based pricing, such as time-of-use, flat generation rate or fixed energy rate, while others are billed at capacity-based rate. As stipulated in the contracts, each energy-based customer has to pay based on actual energy consumption using the basic energy charge and/or adjustments. For capacity-based contracts, the customers are charged with the capacity fees based on the contracted capacity plus the energy fees for the associated energy taken during the month.

SMEC, SPPC, SPDC, SMCPC, SCPC and MPPCL can also purchase power from WESM and other power generation companies during periods when the power generated from the power plants is not sufficient to meet customers' power requirements. Power purchases amounted to P2,579,097 and P1,473,398 for the three months ended March 31, 2018 and 2017, respectively (Note 19).

d. Concession Agreement

The Parent Company entered into a 25-year Concession Agreement with ALECO on October 29, 2013. It became effective upon confirmation of the National Electrification Administration on November 7, 2013.

On January 24, 2014, the Parent Company and APEC entered into an Assignment Agreement whereby APEC assumed all the rights, interests and obligations of the Parent Company under the Concession Agreement effective January 2, 2014.

The Concession Agreement include, among others, the following rights and obligations:

i. as Concession Fee, APEC shall pay to ALECO: (1) separation pay of ALECO employees in accordance with the Concession Agreement and (2) the amount of P2,100 every quarter for the upkeep of residual ALECO (fixed concession fee);

ii. if the net cash flow of APEC is positive within 5 years or earlier from date of signing of the Concession Agreement, 50% of the Net Cash Flow each month shall be deposited in an escrow account until the cumulative nominal sum reaches P4,048,529;

iii. on the 20$^{th}$ anniversary of the Concession Agreement, the concession period may be extended by mutual agreement between ALECO and APEC; and

iv. at the end of the concession period, all assets and system, as defined in the Concession Agreement, shall be returned by APEC to ALECO in good and usable condition. Additions and improvements to the system shall likewise be transferred to ALECO.

In this regard, APEC shall provide services within the franchise area and shall be allowed to collect fees and charges, as approved by the ERC. APEC formally assumed operations as concessionaire on February 26, 2014.

The Group recognized as intangible assets all costs directly related to the Concession Agreement. The intangible assets consist of: a) concession rights, which include fixed concession fees and separation pay of ALECO employees amounting to P384,317. Fixed concession fees are recognized at present value using the discount rate at the inception date with a corresponding concession payable recognized; and b) infrastructure, which includes the costs of structures and improvements, distribution system and equipment. Cost of infrastructure amounted to P533,020 and P509,419 as of March 31, 2018 and December 31, 2017, respectively. Interest expense on concession payable, included as part of "Interest expense and other financing charges" account in the condensed consolidated interim statements of income, amounted to P1,476 and P1,511 for the three months ended March 31, 2018 and 2017, respectively. Amortization of concession assets recognized in the "Depreciation and amortization" account in the condensed consolidated interim statements of income amounted to P8,573 and P7,008 for the three months ended March 31, 2018 and 2017, respectively.

Maturities of the carrying amount of concession payable are as follows:

| | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|
| Not later than 1 year | **P2,586** | P2,549 |
| More than 1 year and not later than 5 years | **11,964** | 11,794 |
| Later than 5 years | **87,045** | 87,876 |
| | **P101,595** | P102,219 |

Power concession assets consist of:

| | **Concession Rights** | **Completed Projects/Others** | **Asset Under Construction** | **Total** |
|---|---|---|---|---|
| **Cost** | | | | |
| January 1, 2017 (Audited) | P384,317 | P231,910 | P154,173 | P770,400 |
| Additions | - | 115,055 | 8,281 | 123,336 |
| December 31, 2017 (Audited) | 384,317 | 346,965 | 162,454 | 893,736 |
| Additions | - | 16,701 | 6,900 | 23,601 |
| **March 31, 2018 (Unaudited)** | **384,317** | **363,666** | **169,354** | **917,337** |
| **Accumulated Depreciation and Amortization** | | | | |
| January 1, 2017 (Audited) | 43,557 | 37,869 | - | 81,426 |
| Additions | 15,373 | 15,053 | - | 30,426 |
| December 31, 2017 (Audited) | 58,930 | 52,922 | - | 111,852 |
| Additions | 3,843 | 4,730 | - | 8,573 |
| **March 31, 2018 (Unaudited)** | **62,773** | **57,652** | **-** | **120,425** |
| **Carrying Amount** | | | | |
| December 31, 2017 (Audited) | P325,387 | P294,043 | P162,454 | P781,884 |
| **March 31, 2018 (Unaudited)** | **P321,544** | **P306,014** | **P169,354** | **P796,912** |

The Group accounted for revenue and costs relating to construction or upgrade services in accordance with PFRS 15 based on the stage of completion of work performed. The fair value of the construction and upgrade services provided is equal to the recorded cost of the intangible asset built up from day one until the construction activity ceases. Construction revenue and construction cost amounted to P23,601 and P39,706 for the three months ended March 31, 2018 and 2017, respectively (Note 20).

## 8. Cash and Cash Equivalents

Cash and cash equivalents consist of:

| | Note | March 31 2018 (Unaudited) | December 31 2017 (Audited) |
|---|---|---|---|
| Cash in banks and on hand | | **P12,965,429** | P3,557,558 |
| Short-term investments | | **19,500,280** | 25,097,801 |
| | *22, 23* | **P32,465,709** | P28,655,359 |

Cash in banks earn interest at bank deposit rates. Short-term investments include demand deposits which can be withdrawn at anytime depending on the immediate cash requirements of the Group and earn interest at short-term investment rates.

Interest income from cash and cash equivalents amounted to P145,206 and P30,936 for the three months ended March 31, 2018 and 2017, respectively.

## 9. Trade and Other Receivables

Trade and other receivables consist of:

| | Note | March 31 2018 (Unaudited) | December 31 2017 (Audited) |
|---|---|---|---|
| Trade | | **P20,728,639** | P14,332,102 |
| Non-trade | | **6,927,858** | 6,674,594 |
| Amounts owed by related parties | *7, 16* | **1,765,289** | 1,880,190 |
| | | **29,421,786** | 22,886,886 |
| Less allowance for impairment losses | | **2,515,511** | 2,451,818 |
| | *22, 23* | **P26,906,275** | P20,435,068 |

Trade and other receivables are non-interest bearing, unsecured and are generally on a 30-day term or an agreed collection period. The balance of trade receivables is inclusive of VAT on the sale of power collectible from customers.

The movements in the allowance for impairment losses are as follows:

| | March 31 2018 (Unaudited) | December 31 2017 (Audited) |
|---|---|---|
| Balance at beginning of period | **P2,451,818** | P2,451,818 |
| Acquisition of subsidiaries | **63,693** | - |
| Balance at end of period | **P2,515,511** | P2,451,818 |

The aging of trade and other receivables as of December 31 are as follows:

| | **March 31, 2018 (Unaudited)** | | | | December 31, 2017 (Audited) | | | |
|---|---|---|---|---|---|---|---|---|
| | **Trade** | **Non-trade** | **Amounts Owed by Related Parties** | **Total** | Trade | Non-trade | Amounts Owed by Related Parties | Total |
| Current | **P11,026,345** | **P996,535** | **P1,343,735** | **P13,366,615** | P6,824,541 | P647,896 | P1,106,847 | P8,579,284 |
| Past due: | | | | | | | | |
| 1-30 days | **1,005,167** | **124,739** | **203,218** | **1,333,124** | 934,933 | 68,034 | 161,730 | 1,164,697 |
| 31-60 days | **682,015** | **5,070** | **34,104** | **721,189** | 410,187 | 71,377 | 6,362 | 487,926 |
| 61-90 days | **1,813,302** | **96,130** | **13,294** | **1,922,726** | 184,690 | 1,001 | 2,414 | 188,105 |
| Over 90 days | **6,201,810** | **5,705,384** | **170,938** | **12,078,132** | 5,977,751 | 5,886,286 | 602,837 | 12,466,874 |
| | **P20,728,639** | **P6,927,858** | **P1,765,289** | **P 29,421,786** | P14,332,102 | P6,674,594 | P1,880,190 | P22,886,886 |

Past due trade receivables more than 30 days pertain mainly to output VAT. The Group believes that the unimpaired amounts that are past due and those that are neither past due nor impaired are still collectible based on historical payment behavior and analyses of the underlying customer credit ratings. There are no significant changes in their credit quality.

## 10. Inventories

Inventories at cost consist of:

| | *Note* | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|---|
| Coal | | **P4,645,245** | P2,910,853 |
| Fuel oil | *16* | **75,951** | 110,858 |
| Materials and supplies | | **624,244** | 96,793 |
| Other consumables | | **38,002** | 29,164 |
| | | **P5,383,442** | P3,147,668 |

There were no inventory write-downs to net realizable value for the three months ended March 31, 2018 and for the year ended December 31, 2017. Inventories charged to cost of power sold amounted to P5,256,573 and P3,828,309 for the three months ended March 31, 2018 and 2017, respectively (Note 19).

## 11. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of:

| | *Note* | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|---|
| Input VAT | | **P13,179,111** | P11,792,871 |
| Prepaid tax | | **5,430,281** | 4,883,278 |
| Prepaid rent and others | *16* | **1,767,905** | 1,115,766 |
| | | **P20,377,297** | P17,791,915 |

Input VAT consists of input VAT on purchases of goods and services which can be offset against the output VAT payable (Note 14).

Prepaid tax consists of creditable withholding taxes and excess tax credits which can be used as a deduction against future income tax payable.

## 12. Property, Plant and Equipment

Property, plant and equipment consist of:

| | Power Plants | Land and Leasehold Improvements | Other Equipment | Building | Capital Projects in Progress | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| January 1, 2017 (Audited) | P224,974,260 | P3,718,583 | P1,068,112 | P41,657 | P53,507,853 | P283,310,465 |
| Additions | 112,263 | 715 | 60,252 | - | 8,738,301 | 8,911,531 |
| Reclassifications | 25,458,414 | 234,580 | (446,381) | - | (23,730,390) | 1,516,223 |
| December 31, 2017 (Audited) | 250,544,937 | 3,953,878 | 681,983 | 41,657 | 38,515,764 | 293,738,219 |
| Acquisition of subsidiaries | 53,382,578 | 910,347 | 2,330,710 | 974,510 | 23,483,409 | 81,081,554 |
| Additions | - | - | 25,008 | - | 726,417 | 751,425 |
| Reclassifications | 11,612,762 | 1,067,205 | 111,407 | 364,973 | (12,764,924) | 391,423 |
| Currency translation adjustments | 71,694 | 1,396 | 3,577 | 1,497 | 36,073 | 114,237 |
| **March 31, 2018 (Unaudited)** | **315,611,971** | **5,932,826** | **3,152,685** | **1,382,637** | **49,996,739** | **376,076,858** |
| **Accumulated Depreciation and Amortization** | | | | | | |
| January 1, 2017 (Audited) | 36,566,871 | 42,462 | 206,885 | 6,220 | - | 36,822,438 |
| Additions | 5,811,940 | 43,863 | 95,238 | 3,433 | - | 5,954,474 |
| December 31, 2017 (Audited) | 42,378,811 | 86,325 | 302,123 | 9,653 | - | 42,776,912 |
| Acquisition of subsidiaries | 18,004,069 | 32,202 | 696,136 | 74,967 | - | 18,807,374 |
| Additions | 1,751,461 | 17,296 | 21,879 | 2,453 | - | 1,793,089 |
| Reclassifications | (37,267) | - | (86) | 687 | - | (36,666) |
| Currency translation adjustment | 27,692 | 50 | 1,070 | 116 | - | 28,928 |
| **March 31, 2018 (Unaudited)** | **62,124,766** | **135,873** | **1,021,122** | **87,876** | **-** | **63,369,637** |
| **Carrying Amount** | | | | | | |
| December 31, 2017 (Audited) | P208,166,126 | P3,867,553 | P379,860 | P32,004 | P38,515,764 | P250,961,307 |
| **March 31, 2018 (Unaudited)** | **P253,487,205** | **P5,796,953** | **P2,131,563** | **P1,294,761** | **P49,996,739** | **P312,707,221** |

| | Power Plants | Land and Leasehold Improvements | Other Equipment | Building | Capital Projects in Progress | Total |
|---|---|---|---|---|---|---|
| Cost | | | | | | |
| January 1, 2017 (Audited) | P224,974,260 | P3,718,583 | P1,068,112 | P41,657 | P53,507,853 | P283,310,465 |
| Additions | - | - | 20,346 | - | 2,929,054 | 2,949,400 |
| Reclassifications | - | - | - | - | 63,742 | 63,742 |
| March 31, 2017 (Unaudited) | 224,974,260 | 3,718,583 | 1,088,458 | 41,657 | 56,500,649 | 286,323,607 |
| Accumulated Depreciation and Amortization | | | | | | |
| January 1, 2017 (Audited) | 36,566,871 | 42,462 | 206,885 | 6,220 | - | 36,822,438 |
| Additions | 1,403,146 | 16,882 | 30,033 | 1,464 | - | 1,451,525 |
| March 31, 2017 (Unaudited) | 37,970,017 | 59,344 | 236,918 | 7,684 | - | 38,273,963 |
| Carrying Amount | | | | | | |
| March 31, 2017 (Unaudited) | P187,004,243 | P3,659,239 | P851,540 | P33,973 | P56,500,649 | P248,049,644 |

a. The combined carrying amounts of power plants under finance lease amounted to P171,276,891 and P172,573,492 as of March 31, 2018 and December 31, 2017, respectively (Note 7).

b. The carrying amount of land under finance lease amounted to P872,552 as of March 31, 2018.

c. The capitalized asset retirement costs, net of accumulated depreciation, amounted to P150,047 and P151,306 as of March 31, 2018 and December 31, 2017, respectively.

d. Other equipment includes machinery and equipment, transportation equipment, mining equipment, office equipment and furniture and fixtures.

e. Capital projects in progress pertains to the following:

   i. Project of SMCPC for the construction of 2 x 150 MW (Units 1 and 2) Malita Power Plant.

      Following the completion of Units 1 and 2, and the ERC grant of the Provisional Authority to Operate in favor of SMCPC, all CPIP costs were reclassified to the appropriate property, plant and equipment account.

   ii. Projects of SCPC for the construction of 4 x 150MW (Phase I and II) Limay Power Plant.

      Following the completion of Units 1 and 2, and the ERC grant of a Provisional Authority to Operate in favor of SCPC in 2017 for both Units, all related CPIP costs were reclassified to the appropriate property, plant and equipment account.

      As of March 31, 2018, CPIP pertains to costs of Unit 3, which started its testing and commissioning phase in November 2017, and the costs of Unit 4 under construction.

   iii. Plant optimization and pumped-storage hydropower projects of SPDC.

   iv. Expenditures for the 500 kilovolts connection facilities in relation to the 600 MW Pagbilao power plant project of CLPPC.

   v. Ongoing construction of the 335 MW (Unit 3) Masinloc Power Plant of MPPCL.

f. Depreciation and amortization related to property, plant and equipment are recognized in profit or loss as follows:

| | March 31 | |
|---|---|---|
| | **2018 (Unaudited)** | 2017 (Unaudited) |
| Cost of power sold | **P1,756,826** | P1,403,145 |
| Selling and administrative expenses | **36,263** | 48,380 |
| | **P1,793,089** | P1,451,525 |

The Group has borrowing costs amounting to P391,487 and P1,362,871 which were capitalized for the three months ended March 31, 2018 and for the year ended December 31, 2017, respectively. The capitalization rates used to determine the amount of interest eligible for capitalization range from 3.50% to 7.39% and 2.75% to 6.54% as of March 31, 2018 and December 31, 2017, respectively. The unamortized capitalized borrowing costs amounted to P2,347,684 and P1,968,151 as of March 31, 2018 and December 31, 2017 respectively (Note 15).

## 13. Loans Payable

| | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|
| **SMCPC** | | |
| Philippine peso-denominated | **P5,930,000** | P5,930,000 |
| **MPPCL** | | |
| Foreign currency-denominated | **2,347,200** | - |
| | **P8,277,200** | P5,930,000 |

This account pertains to unsecured Philippine peso and US dollar-denominated loans obtained from various local financial institutions. Interest rate for Philippine peso-denominated and US dollar-denominated loans is 3.75% and 4.13%, respectively.

Interest expense on loans payable amounted to P55,831 (inclusive of P15,957 capitalized in CPIP) and P3,498 for the three months ended March 31, 2018 and 2017, respectively.

## 14. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of:

| | *Note* | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|---|
| Trade | *7* | **P13,461,767** | P14,994,454 |
| Non-trade | | **19,473,597** | 9,693,202 |
| Output VAT | | **6,295,971** | 5,140,417 |
| Accrued interest | *7, 13, 15* | **1,148,845** | 427,469 |
| Amounts owed to related parties | *16* | **622,120** | 541,428 |
| Withholding taxes | | **190,066** | 277,744 |
| | *22, 23* | **P41,192,366** | P31,074,714 |

Trade payables consist of payable related to energy fees, inventories and power purchases. These are generally on a 30-day term and are non-interest bearing.

Non-trade payables include liability relating to power rate adjustments, payables to contractors and other payables to the Government except output VAT and withholding taxes.

Output VAT consists of current and deferred output VAT payable. Deferred output VAT represents the VAT on sale of power which will be remitted to the Government only upon collection from the customers (Note 9).

## 15. Long-term Debt

Long-term debt consists of:

| | Note | March 31 2018 (Unaudited) | December 31 2017 (Audited) |
|---|---|---|---|
| **Bonds** | | | |
| Parent Company | | | |
| Peso-denominated | | | |
| Fixed interest rate of 5.3750%, 6.2500% and 6.6250% maturing in 2022, 2024 and 2027, respectively (a) | | **P19,791,316** | P19,784,249 |
| Fixed interest rate of 4.3458%, 4.7575% and 5.1792% maturing in 2021, 2023 and 2026, respectively (b) | | **14,871,115** | 14,865,330 |
| | | **34,662,431** | 34,649,579 |
| **Term Loans** | | | |
| Parent Company | | | |
| Peso-denominated | | | |
| Fixed interest rate of 6.9265%, with maturities up to 2024 (c) | | **14,861,495** | 14,856,835 |
| Foreign currency-denominated | | | |
| Fixed interest rate of 3.25%, maturing in 2023 (d) | | **25,818,382** | - |
| Floating interest rate based on London Interbank Offered Rate (LIBOR) plus margin, maturing in 2021 and 2023 (e) | | **35,650,222** | - |
| Subsidiaries | | | |
| Peso-denominated | | | |
| Fixed interest rate of 6.2836%, 6.5362% and 7.3889% with maturities up to 2029 (f) | | **42,978,133** | 41,222,287 |
| Foreign currency-denominated | | | |
| Fixed interest rate of 5.3084% and 6.2177%, with maturities up to 2023 and 2030, respectively (g) (h) | | **24,029,694** | - |
| Floating interest rate based on LIBOR plus margin, with maturities up to 2023 and 2030 (g) (h) | | **7,972,549** | - |
| | | **151,310,475** | 56,079,122 |
| | *22, 23* | **185,972,906** | 90,728,701 |
| Less current maturities | | **3,121,695** | 1,139,631 |
| | | **P182,851,211** | P89,589,070 |

a. The amount represents the first tranche of the Parent Company's P35,000,000 fixed rate bonds shelf registration. The first tranche, with an aggregate principal amount of P20,000,000, were issued and listed in the Philippine Dealing and Exchange Corp. (PDEx) for trading on December 22, 2017 at the issue price of 100% of face value. It comes in three series, with terms and interest rates as follows:

| | Term | Interest Rate Per Annum |
|---|---|---|
| Series D Bonds | 5 years, due 2022 | 5.3750% |
| Series E Bonds | 7 years, due 2024 | 6.2500% |
| Series F Bonds | 10 years, due 2027 | 6.6250% |

Interest on the Bonds shall be payable quarterly in arrears starting on March 22, 2018, for the first interest payment date, and June 22, September 22, December 22 and March 22 of each year thereafter.

Proceeds from the issuance were used by the Parent Company to refinance its P20,000,000 short-term loans obtained from local banks.

b. The amount represents issuance of the Parent Company of the fixed rate Philippine peso-denominated bonds with an aggregate principal amount of P15,000,000. The Bonds were issued and listed in the PDEx on July 11, 2016 at the issue price of 100% of face value in three series with terms and interest rates as follows:

| | Term | Interest Rate Per Annum |
|---|---|---|
| Series A Bonds | 5 years, due 2021 | 4.3458% |
| Series B Bonds | 7 years, due 2023 | 4.7575% |
| Series C Bonds | 10 years, due 2026 | 5.1792% |

Interest is payable quarterly in arrears starting on October 11, 2016, for the first interest payment date, and January 11, April 11, July 11 and October 11 of each year thereafter.

The net proceeds were used on July 25, 2016 to refinance the US$300,000 short-term loan provided by a local bank of which the proceeds were used for the redemption of the US$300,000 bond in January 2016.

c. The amount represents the availment by the Parent Company of P15,000,000 fixed rate 7-year Term Loan Facility on April 26, 2017 from a local bank. Interest is payable quarterly in arrears on the last day of the agreed interest period. Principal repayment shall be in 13 semi-annual installments starting at the end of the first year from drawdown date. The proceeds were used to fund the payment of the remaining US$300,000 out of the US$700,000 term loan.

d. The amount represents the availment by the Parent Company of US$500,000, 5-year credit facility agreement with a foreign financial institution on March 15, 2018. The proceeds were used by the Parent Company to partially finance the acquisition of the MAPL, ATPL and API (Note 5).

e. The amount represents the US$700,000 floating interest term loan availed by the Parent Company from a syndicate of foreign banks on March 16, 2018. The US$700,000 is divided into Facility A Loan amounting to US$200,000 maturing on March 12, 2021 and Facility B Loan amounting to US$500,000 maturing on March 13, 2023. The proceeds were used by the Parent Company to partially finance the acquisition of the MAPL, ATPL and API (Note 5).

f. The amount represents the P42,000,000 and P2,000,000 drawn by SCPC on June 28, 2017 and Janury 31, 2018, respectively, from a P44,000,000 12-year Omnibus Loan and Security Agreement with a syndicate of banks that was signed on June 22, 2017. The proceeds were used by SCPC for the following purposes:

   i the settlement of the US$360,000 short-term loan availed on May 8, 2017 from a local bank;

   ii to fund the acquisition of the Phase II Limay Power Plant, under construction, from LPPC, and

   iii the repayment of advances from the Parent Company.

g. The amount represents the US$337,500 total outstanding loan drawn in various tranches by MPPCL from its Omnibus Refinancing Agreement (ORA), with various local banks, which refinanced its debt obligations previously obtained to partially finance the acquisition, operation, maintenance and repair of the power plant facilities purchased from PSALM by MPPCL. The loan is divided into fixed interest tranche and floating interest tranche based on a 6-month LIBOR plus margin.

h. The amount represents the US$287,000 total outstanding loan drawn in various tranches by MPPCL from its Omnibus Expansion Financing Agreement (OEFA), with various local banks, to finance the construction of the additional 300 MW (net) coal-fired plant within MPPCL existing facilities. The loan is divided into fixed interest tranche and floating interest tranche based on a 6-month LIBOR plus margin.

*Valuation Technique for peso-denominated Bonds*
The market value was determined using the market comparison technique. The fair values are based on PDEx. The Bonds are traded in an active market and the quotes reflect the actual transactions in identical instruments.

The fair value of the Bonds, amounting to P34,543,099 and P35,651,237 as of March 31, 2018 and December 31, 2017, respectively, has been categorized as Level 1 in the fair value hierarchy based on the inputs used in the valuation techniques.

The debt agreements of the Parent Company, SCPC and MPPCL impose a number of covenants including, but not limited to, maintenance of certain financial ratios throughout the duration of the term of the debt agreements. The terms and conditions of the debt agreements also contain negative pledge provision with certain limitations on the ability of the Parent Company and its material subsidiaries and SCPC to create or have outstanding any security interest upon or with respect to any of the present or future business, undertaking, assets or revenue (including any uncalled capital) of the Parent Company or any of its material subsidiaries and SCPC to secure any indebtedness, subject to certain exceptions.

The loan of SCPC is secured by real estate and chattel mortgages on all present and future assets and reserves of SCPC as well as a pledge by the Parent Company of all its outstanding shares of stock in SCPC. The loans of MPPCL obtained from its ORA and OEFA are secured by real estate and chattel mortgages on all assets (purchased under its asset purchase agreement, and all its rights in a land lease agreement, with PSALM) and all future assets.

As of March 31, 2018 and December 31, 2017, the Group is in compliance with the covenants of the debt agreements.

The movements in debt issue costs are as follows:

| | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|
| Balance at beginning of period | **P1,271,299** | P1,346,578 |
| Additions | **1,133,424** | 1,297,703 |
| Acquisition of subsidiaries | **572,065** | - |
| Currency translation adjustments | **876** | - |
| Capitalized amount | **(7,829)** | (80,480) |
| Amortization | **(39,321)** | (1,292,502) |
| Balance at end of period | **P2,930,514** | P1,271,299 |

<u>Repayment Schedule</u>
The annual maturities of the long-term debt are as follows:

| | Gross Amount | | | | |
|---|---|---|---|---|---|
| Year | US Dollar | Peso Equivalent of US Dollar | Peso | Debt Issue Costs | Net |
| April 1, 2018 to March 31, 2019 | US$38,100 | P1,987,296 | P1,200,000 | P65,601 | P3,121,695 |
| April 1, 2019 to March 31, 2020 | 40,487 | 2,111,802 | 1,200,000 | 100,287 | 3,211,515 |
| April 1, 2020 to March 31, 2021 | 255,774 | 13,341,182 | 1,942,500 | 442,058 | 14,841,624 |
| April 1, 2021 to March 31, 2022 | 59,395 | 3,098,012 | 8,655,750 | 205,608 | 11,548,154 |
| April 1, 2022 to March 31, 2023 | 1,039,134 | 54,201,235 | 12,645,460 | 1,148,578 | 65,698,117 |
| April 1, 2023 and thereafter | 391,610 | 20,426,393 | 68,093,790 | 968,382 | 87,551,801 |
| | US$1,824,500 | P95,165,920 | P93,737,500 | P2,930,514 | P185,972,906 |

Contractual terms of the Group's interest bearing loans and borrowings and exposure to interest rate, foreign currency and liquidity risks are discussed in Note 22.

## 16. Related Party Disclosures

The Group, in the normal course of business, purchases products and renders services to related parties. Transactions with related parties are made at normal market prices and terms. Amounts owed by/owed to related parties are collectible/will be settled in cash. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

The following are the transactions with related parties and the outstanding balances as of March 31, 2018 and December 31, 2017:

| | Year | Revenues from Related Parties | Purchases from Related Parties | Amounts Owed by Related Parties | Amounts Owed to Related Parties | Terms | Conditions |
|---|---|---|---|---|---|---|---|
| SMC | **2018** | **P112,040** | **P186,007** | **P78,657** | **P381,008** | On demand or | Unsecured; |
| | 2017 | 215,004 | 664,262 | 87,697 | 9,273 | 30 days; non-interest bearing | no impairment |
| | **2018** | **-** | **-** | **49,637** | **-** | More than 1 year; | Unsecured; |
| | 2017 | - | - | 61,903 | - | non-interest bearing | no impairment |
| | **2018** | **-** | **-** | **-** | **7,824,000** | More than 1 year; | Unsecured |
| | 2017 | - | - | - | - | interest bearing | |
| Entities Under Common Control | **2018** | **660,882** | **97,338** | **752,005** | **211,606** | On demand or | Unsecured; |
| | 2017 | 2,365,748 | 1,134,950 | 741,814 | 484,482 | 30 days; non-interest bearing | no impairment |
| | **2018** | **-** | **-** | **-** | **493** | More than 1 year; | Unsecured |
| | 2017 | - | - | - | - | non-interest bearing | |
| Associates | **2018** | **219,857** | **4,167** | **63,158** | **29,506** | On demand or | Unsecured; |
| | 2017 | 902,864 | - | 98,556 | 29,643 | 30 days; non-interest bearing | no impairment |
| | **2018** | **3,271** | **-** | **251,505** | **-** | 9 years; | Unsecured; |
| | 2017 | 13,458 | - | 250,603 | - | interest bearing | no impairment |
| Joint Venture | **2018** | **6,222** | **86,700** | **2,024** | **-** | 30 days; | Unsecured; |
| | 2017 | 24,183 | 416,058 | 1,937 | 18,522 | non-interest bearing | no impairment |
| | **2018** | **5,890** | **-** | **351,104** | **-** | 92 days; | Unsecured; |
| | 2017 | 64,797 | - | 635,163 | - | interest bearing | no impairment |
| Associates of Entities Under Common Control | **2018** | **229,313** | **-** | **224,181** | **-** | 30 days; | Unsecured; |
| | 2017 | 850,515 | 23,880 | 133,236 | - | non-interest bearing | no impairment |
| Others | **2018** | **333,049** | **-** | **235,098** | **-** | On demand or 30 days; | Unsecured; |
| | 2017 | 45,161 | - | 130,794 | - | non-interest bearing | no impairment |
| | **2018** | **P1,570,524** | **P374,212** | **P2,007,369** | **P8,446,613** | | |
| | 2017 | P4,481,730 | P2,239,150 | P2,141,703 | P541,920 | | |

a. Amounts owed by related parties consist of trade and other receivables, derivative asset and security deposits (Note 9).

b. Amounts owed by associates mainly consist of interest bearing loan granted to OEDC, included as part of “Trade and other receivables” and “Other noncurrent assets” accounts in the condensed consolidated interim statements of financial position (Note 9).

c. Amounts owed by a joint venture consists of interest bearing loan granted and management fees charged to AHC by PVEI, included as part of “Trade and other receivables” account in the condensed consolidated interim statements of financial position (Notes 9 and 20).

d. Amounts owed to related parties consist of trade and non-trade payables pertaining to management fees, purchases of fuel, reimbursement of expenses, rent, insurance and services rendered by related parties, and shareholder advances (Notes 10 and 14).

e. The compensation of key management personnel of the Group, by benefit type, follows:

| | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|
| Short-term employee benefits | **P18,487** | P81,537 |
| Retirement cost | **-** | 1,398 |
| | **P18,487** | P82,935 |

## 17. Dividends and Distributions

Cash Dividends

There were no cash dividend declarations during the three months ended March 31, 2017 and 2018, respectively.

Distributions to USCS Holders

The Parent Company issued and listed on the Singapore Stock Exchange the following USCS at an issue price of 100%:

| Date of Issuance | Distribution Payment Date | Initial Rate of Distribution | Step-Up Date | Amount of USCS Issued | Amount in Philippine Peso |
|---|---|---|---|---|---|
| August 26, 2015 | August 26 and February 26 of each year | 6.75% per annum | February 26, 2021 | US$300,000 | P13,823,499 |
| May 7, 2014 | May 7 and November 7 of each year | 7.5% per annum | November 7, 2019 | 300,000 | 13,110,066 |
| | | | | **US$600,000** | **P26,933,565** |

The holders of the USCS have conferred a right to receive distributions on a semi-annual basis from their issuance dates at the initial rate of distribution, subject to the step-up rate. The Parent Company has a right to defer this distribution under certain conditions.

The USCS have no fixed redemption date and are redeemable in whole, but not in part, at the Parent Company's option on step-up date, or any distribution payment date thereafter or upon the occurrence of certain other events at the principal amounts of the USCS plus any accrued, unpaid or deferred distribution.

The proceeds were used by the Parent Company to finance investments in power-related assets and other general corporate purposes.

For the three months ended March 31, 2018 and 2017 and for the year ended December 31, 2017, the Group made cash distributions amounting to P746,068, P720,611 and P3,074,204, respectively, to holders of USCS.

## 18. Revenues

Revenues consist of:

| | | March 31 | |
|---|---|---|---|
| | ***Note*** | **2018 (Unaudited)** | 2017 (Unaudited) |
| Sale of power | | **P20,344,124** | P17,376,858 |
| Retail and other power-related services | | **4,316,388** | 1,976,346 |
| | *7, 16* | **P24,660,512** | P19,353,204 |

## 19. Cost of Power Sold

Cost of power sold consist of:

| | Note | March 31 2018 (Unaudited) | March 31 2017 (Unaudited) |
|---|---|---|---|
| Energy fees | *7* | **P5,562,766** | P5,407,968 |
| Coal, fuel oil and other consumables | *10, 16* | **5,256,573** | 3,828,309 |
| Power purchases | *7* | **2,579,097** | 1,473,398 |
| Depreciation and amortization | *7, 12* | **1,765,399** | 1,410,154 |
| Plant operations and maintenance fees | | **298,689** | 28,987 |
| | | **P15,462,524** | P12,148,816 |

## 20. Other Income (Charges)

Other income (charges) consist of:

| | Note | March 31 2018 (Unaudited) | March 31 2017 (Unaudited) |
|---|---|---|---|
| PSALM monthly fees reduction | *7* | **P359,114** | P103,450 |
| Construction revenue | *7* | **23,601** | 39,706 |
| Surcharges and late payment of customers | | **15,449** | 8,420 |
| Construction cost | *7* | **(23,601)** | (39,706) |
| Foreign exchange losses - net | *22* | **(3,436,922)** | (1,336,227) |
| Miscellaneous income - net | *16* | **60,216** | 9,239 |
| | | **(P3,002,143)** | (P1,215,118) |

PSALM monthly fees reduction pertain to the approved reduction in monthly fees payable to PSALM resulting from the outages of the Sual Power Plant in 2018 and 2017.

Construction revenue is recognized by reference to the stage of completion of the construction activity at the reporting date. When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately.

Construction costs pass through the profit or loss before it is capitalized as concession assets.

Miscellaneous income mostly pertain to sale of fly ash to a related party, insurance claims, rental income, and sale of scrap materials to a third party.

## 21. Basic and Diluted Earnings Per Share

Basic and diluted EPS is computed as follows:

| | March 31 | |
|---|---|---|
| | **2018 (Unaudited)** | 2017 (Unaudited) |
| Net income attributable to equity holders of the Parent Company | **P1,346,583** | P1,126,649 |
| Distributions to USCS holders for the period | **(793,575)** | (764,196) |
| Distributions to RPS holders for the period | **(88,292)** | - |
| Net income attributable to common shareholders of the Parent Company (a) | **464,716** | 362,453 |
| Weighted average number of common shares outstanding (in thousands) (b) | **1,250,004** | 1,250,004 |
| Basic/Diluted Earnings Per Share (a/b) | **P0.37** | P0.29 |

As of March 31, 2018 and 2017, the Group has no dilutive debt or equity instruments.

## 22. Financial Risk and Capital Management Objectives and Policies

Objectives and Policies

The Group has significant exposure to the following financial risks primarily from its use of financial instruments:

- Interest Rate Risk
- Foreign Currency Risk
- Commodity Price Risk
- Liquidity Risk
- Credit Risk

This note presents information about the exposure to each of the foregoing risks, the objectives, policies and processes for measuring and managing these risks, and for management of capital.

The principal non-trade related financial instruments of the Group include cash and cash equivalents, financial assets at FVOCI, restricted cash, noncurrent receivables, loans payable, long-term debt and derivative instruments. These financial instruments, except financial assets at FVOCI and derivative instruments, are used mainly for working capital management purposes. The trade-related financial assets and financial liabilities of the Group such as trade and other receivables, accounts payable and accrued expenses, finance lease liabilities and other noncurrent liabilities arise directly from, and are used to facilitate, its daily operations.

The outstanding derivative instruments of the Group which is fixed swaps are intended mainly for risk management purposes. The Group uses derivatives to manage its exposures to foreign currency and commodity price risks arising from the operating and financing activities.

The Parent Company's BOD has the overall responsibility for the establishment and oversight of the risk management framework of the Group.

The risk management policies of the Group are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The BOD constituted the Audit and Risk Oversight Committee to assist the BOD in fulfilling its oversight responsibility of the Group's corporate governance process relating to the: (a) quality and integrity of the consolidated financial statements and financial reporting process and the systems of internal accounting and financial controls; (b) performance of the internal auditors; (c) annual independent audit of the consolidated financial statements, the engagement of the independent auditors and the evaluation of the independent auditors' qualifications, independence and performance; (d) compliance with tax, legal and regulatory requirements; (e) evaluation of management's process to assess and manage the enterprise risk issues; and (f) fulfillment of the other responsibilities set out by the BOD. The Audit and Risk Oversight Committee shall prepare such reports as may be necessary to document the activities of the committee in the performance of its functions and duties. Such reports shall be included in the annual report of the Group and other corporate disclosures as may be required by the SEC and/or the PDEx.

The Audit and Risk Oversight Committee also oversees how management monitors compliance with the risk management policies and procedures of the Group and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. Internal Audit assists the Audit and Risk Oversight Committee in monitoring and evaluating the effectiveness of the risk management and governance processes of the Group. Internal Audit undertakes both regular and special reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Oversight Committee.

The accounting policies in relation to derivatives are set out in Note 23 to the selected notes to the condensed consolidated interim financial statements.

Interest Rate Risk

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group’s exposure to changes in interest rates relates primarily to the long-term borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest cost by using an optimal combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rate and ensures that the mark-up rates charged on its borrowings are optimal and benchmarked against the rates charged by other creditor banks.

On the other hand, the investment policy of the Group is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the operations and working capital management. However, the Group invests only in high-quality short-term investments while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term fluctuations on the earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P60,527 for the period ended March 31, 2018. A 1% decrease in the interest rate would have had the equal but opposite effect. These changes are considered to be reasonably possible given the observation of prevailing market conditions in those periods. There is no impact on the Group's other comprehensive income.

Interest Rate Risk Table

The terms and maturity profile of the interest bearing financial instruments, together with its gross amounts, are shown in the following tables:

| **March 31, 2018 (Unaudited)** | **1 Year or Less** | **>1-2 Years** | **>2-3 Years** | **>3-4 Years** | **>4-5 Years** | **>5 Years** | **Total** |
|---|---|---|---|---|---|---|---|
| **Fixed Rate** | | | | | | | |
| Philippine peso-denominated | **P1,200,000** | **P1,200,000** | **P1,942,500** | **P8,655,750** | **P12,645,460** | **P68,093,790** | **P93,737,500** |
| Interest rate | **6.2836% to 7.3889%** | **6.2836% to 7.3889%** | **6.2836% to 7.3889%** | **4.3458% to 7.3889%** | **6.2836% to 7.3889%** | **4.7575% to 7.3889%** | |
| Foreign currency-denominated (expressed in Philippine peso) | **1,490,472** | **1,583,880** | **2,183,217** | **2,324,970** | **27,612,476** | **15,343,970** | **50,538,985** |
| Interest rate | **5.3084%** | **5.3084% to 6.2177%** | **5.3084% to 6.2177%** | **5.3084% to 6.2177%** | **3.2500% to 6.2177%** | **6.2177%** | |
| **Floating Rate** | | | | | | | |
| Foreign currency-denominated (expressed in Philippine peso) | **496,824** | **527,922** | **11,157,965** | **773,042** | **26,588,759** | **5,082,423** | **44,626,935** |
| Interest rate | **LIBOR + Margin** | **LIBOR + Margin** | **LIBOR + Margin** | **LIBOR + Margin** | **LIBOR + Margin** | **LIBOR + Margin** | |
| | **P3,187,296** | **P3,311,802** | **P15,283,682** | **P11,753,762** | **P66,846,695** | **P88,520,183** | **P188,903,420** |

| December 31, 2017 (Audited) | 1 Year or Less | >1-2 Years | >2-3 Years | >3-4 Years | >4-5 Years | >5 Years | Total |
|---|---|---|---|---|---|---|---|
| Fixed Rate | | | | | | | |
| Philippine peso-denominated | P1,200,000 | P1,200,000 | P1,620,000 | P8,508,250 | P12,477,960 | P66,993,790 | P92,000,000 |
| Interest rate | 6.2836% to 6.9265% | 6.2836% to 6.9265% | 6.2836% to 6.9265% | 4.3458% to 6.9265% | 5.3750% to 6.9265% | 4.7575% to 6.9265% | |
| | P1,200,000 | P1,200,000 | P1,620,000 | P8,508,250 | P12,477,960 | P66,993,790 | P92,000,000 |

Foreign Currency Risk

The functional currency is the Philippine peso, which is the denomination of the bulk of the Group's revenues. The exposure to foreign currency risk results from significant movements in foreign exchange rates that adversely affect the foreign currency-denominated transactions of the Group. The risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity. The Group enters into foreign currency hedges using derivative instruments such as foreign currency forwards to manage its foreign currency risk exposure.

Short-term currency forward contracts (non-deliverable) are entered into to manage foreign currency risks arising from foreign currency-denominated obligations.

Information on the Group's foreign currency-denominated monetary assets and monetary liabilities and their Philippine peso equivalents are as follows:

| | **March 31, 2018 (Unaudited)** | | December 31, 2017 (Audited) | |
|---|---|---|---|---|
| | **US Dollar** | **Peso Equivalent** | US Dollar | Peso Equivalent |
| **Assets** | | | | |
| Cash and cash equivalents | **US$266,408** | **P13,895,833** | US$102,067 | P5,096,218 |
| Trade and other receivables | **207,387** | **10,817,310** | 85,664 | 4,277,192 |
| Prepaid expenses and other current assets | **1,082** | **56,419** | - | - |
| Noncurrent receivables | **101,232** | **5,280,275** | - | - |
| | **576,109** | **30,049,837** | 187,731 | 9,373,410 |
| **Liabilities** | | | | |
| Loans payable | **45,000** | **2,347,200** | - | - |
| Accounts payable and accrued expenses | **399,412** | **20,833,349** | 122,259 | 6,104,423 |
| Long-term debt (including current maturities) | **1,824,500** | **95,165,920** | - | - |
| Finance lease liabilities (including current portion) | **1,645,975** | **85,854,044** | 1,693,623 | 84,562,581 |
| Other noncurrent liabilities | **252,103** | **13,149,710** | - | - |
| | **4,166,990** | **217,350,223** | 1,815,882 | 90,667,004 |
| **Net foreign currency-denominated monetary liabilities** | **US$3,590,881** | **P187,300,386** | US$1,628,151 | P81,293,594 |

The Group reported net losses on foreign exchange amounting to P3,436,922 and P1,336,227 for the three months ended March 31, 2018 and 2017, respectively, with the translation of its foreign currency-denominated assets and liabilities (Note 20). These mainly resulted from the movements of the Philippine peso against US dollar as shown in the following table:

| | **US Dollar to Philippine Peso** |
|---|---|
| **March 31, 2018** | **52.16** |
| December 31, 2017 | 49.93 |
| March 31, 2017 | 50.16 |
| December 31, 2016 | 49.72 |

The management of foreign currency risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various foreign currency exchange rate scenarios.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities):

| | **March 31, 2018 (Unaudited)** | | December 31, 2017 (Audited) | |
|---|---|---|---|---|
| | **P1 Decrease in the US Dollar Exchange Rate** | **P1 Increase in the US Dollar Exchange Rate** | P1 Decrease in the US Dollar Exchange Rate | P1 Increase in the US Dollar Exchange Rate |
| Cash and cash equivalents | **(P266,408)** | **P266,408** | (P102,067) | P102,067 |
| Trade and other receivables | **(207,387)** | **207,387** | (85,664) | 85,664 |
| Prepaid expenses and other current assets | **(1,082)** | **1,082** | - | - |
| Noncurrent receivables | **(101,232)** | **101,232** | - | - |
| | **(576,109)** | **576,109** | (187,731) | 187,731 |
| Loans payable | **45,000** | **(45,000)** | - | - |
| Accounts payable and accrued expenses | **399,412** | **(399,412)** | 122,259 | (122,259) |
| Long-term debt (including current maturities) | **1,824,500** | **(1,824,500)** | - | - |
| Finance lease liabilities (including current portion) | **1,645,975** | **(1,645,975)** | 1,693,623 | (1,693,623) |
| Other noncurrent liabilities | **252,103** | **(252,103)** | - | - |
| | **4,166,990** | **(4,166,990)** | 1,815,882 | (1,815,882) |
| | **P3,590,881** | **(P3,590,881)** | P1,628,151 | (P1,628,151) |

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

<u>Commodity Price Risk</u>
Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in commodity prices.

The Group, through SMC, enters into commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show marked-to-market losses; however, any loss in the marked-to-market position is offset by the resulting lower physical raw material cost.

*Commodity Swaps.* Commodity swaps are used to manage the Group's exposures to volatility in prices of coal.

<u>Liquidity Risk</u>
Liquidity risk pertains to the risk that the Group will encounter difficulty to meet payment obligations when they fall under normal and stress circumstances.

The Group's objectives to manage its liquidity risk are as follows: (a) to ensure that adequate funding is available at all times; (b) to meet commitments as they arise without incurring unnecessary costs; (c) to be able to access funding when needed at the least possible cost; and (d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps and surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted receipts and payments used for liquidity management.

| **March 31, 2018 (Unaudited)** | **Carrying Amount** | **Contractual Cash Flow** | **1 Year or Less** | **>1 Year - 2 Years** | **>2 Years - 5 Years** | **Over 5 Years** |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | **P32,465,709** | **P32,465,709** | **P32,465,709** | **P -** | **P -** | **P -** |
| Trade and other receivables - net* | **26,814,354** | **26,814,354** | **26,814,354** | **-** | **-** | **-** |
| Financial assets at FVOCI (included under "Prepaid expenses and other current assets" account) | **54,717** | **54,717** | **54,717** | **-** | **-** | **-** |
| Derivative asset (included under "Other noncurrent assets - net" account) | **49,637** | **49,637** | **-** | **49,637** | **-** | **-** |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | **328,020** | **367,403** | **69,561** | **42,134** | **118,204** | **137,504** |
| Restricted cash (included under "Other noncurrent assets - net" account) | **7,899,995** | **7,899,995** | **-** | **7,899,995** | **-** | **-** |
| **Financial Liabilities** | | | | | | |
| Loans payable | **8,277,200** | **8,277,200** | **8,277,200** | **-** | **-** | **-** |
| Accounts payable and accrued expenses* | **33,794,594** | **33,794,594** | **33,794,594** | **-** | **-** | **-** |
| Long-term debt - net (including current maturities) | **185,972,906** | **252,726,534** | **11,376,244** | **12,676,349** | **121,175,409** | **107,498,532** |
| Finance lease liabilities (including current portion) | **154,393,217** | **187,565,233** | **25,896,395** | **27,495,415** | **82,483,785** | **51,689,638** |
| Other noncurrent liabilities (including current portion of concession liability) | **7,998,941** | **8,072,554** | **8,400** | **81,254** | **25,200** | **7,957,700** |

**Excluding statutory receivables and payables*

| December 31, 2017 (Audited) | Carrying Amount | Contractual Cash Flow | 1 Year or Less | >1 Year - 2 Years | >2 Years - 5 Years | Over 5 Years |
|---|---|---|---|---|---|---|
| Financial Assets | | | | | | |
| Cash and cash equivalents | P28,655,359 | P28,655,369 | P28,655,369 | P - | P - | P - |
| Trade and other receivables - net* | 20,384,934 | 20,384,934 | 20,384,934 | - | - | - |
| Derivative asset (included under "Other noncurrent assets - net" account) | 61,903 | 61,903 | - | 61,903 | - | - |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | 278,965 | 322,012 | 60,773 | 39,371 | 115,904 | 105,964 |
| Restricted cash (included under "Other noncurrent assets - net" account) | 4,805,175 | 4,805,175 | - | 4,805,175 | - | - |
| Financial Liabilities | | | | | | |
| Loans payable | 5,930,000 | 5,938,566 | 5,938,566 | - | - | - |
| Accounts payable and accrued expenses* | 24,818,444 | 24,818,444 | 24,818,444 | - | - | - |
| Long-term debt - net (including current maturities) | 90,728,701 | 133,277,391 | 6,837,616 | 6,760,234 | 38,229,217 | 81,450,324 |
| Finance lease liabilities (including current portion) | 154,793,690 | 189,584,834 | 25,020,549 | 26,220,439 | 82,794,848 | 55,548,998 |
| Other noncurrent liabilities (including current portion of concession liability) | 171,174 | 246,756 | 8,400 | 74,118 | 25,200 | 139,038 |

**Excluding statutory receivables and payables*

Credit Risk
Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from trade and other receivables. The Group manages its credit risk mainly through the application of transaction limits and close risk monitoring. It is the Group's policy to enter into transactions with a wide diversity of creditworthy counterparties to mitigate any significant concentration of credit risk.

The Group has regular internal control reviews to monitor the granting of credit and management of credit exposures.

*Trade and Other Receivables*
The exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry in which customers operate, as these factors may have an influence on the credit risk.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the standard payment and delivery terms and conditions are offered. The Group ensures that sales on account are made to customers with appropriate credit history. The Group has detailed credit criteria and several layers of credit approval requirements before engaging a particular customer or counterparty. The review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer and are reviewed on a regular basis. Customers that fail to meet the benchmark creditworthiness may transact with the Group only on a prepayment basis.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance include a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

The Group recognizes impairment losses based on specific and collective impairment tests, when objective evidence of impairment has been identified either on an individual account or on a portfolio level.

Financial information on the Group's maximum exposure to credit risk, without considering the effects of collaterals and other risk mitigation techniques, is presented below:

| | ***Note*** | **March 31 2018 (Unaudited)** | December 31 2017 (Audited) |
|---|---|---|---|
| Cash and cash equivalents (excluding cash on hand) | *8* | **P32,463,945** | P28,653,631 |
| Trade and other receivables - net* | *9* | **26,814,354** | 20,384,934 |
| Financial assets at FVOCI | | **54,717** | - |
| Derivative asset | | **49,637** | 61,903 |
| Noncurrent receivables | | **328,020** | 278,965 |
| Restricted cash | | **7,899,995** | 4,805,175 |
| | | **P67,610,668** | P54,184,608 |

**Excluding statutory receivables*

The credit risk for cash and cash equivalents, financial assets at FVOCI, derivative asset and restricted cash are considered negligible, since the counterparties are reputable entities with high quality external credit ratings.

The Group's exposure to credit risk arises from default of counterparty. Generally, the maximum credit risk exposure of trade and other receivables and noncurrent receivables is its carrying amount without considering collaterals or credit enhancements, if any. The Group has significant concentration of credit risk. Sale of power to Meralco accounts for 47% and 57% of the Group's total revenues for the three months ended March 31, 2018 and 2017, respectively. The Group does not execute any credit guarantee in favor of any counterparty.

Other Market Price Risk

The Group's market price risk arises from its investments carried at fair value (financial assets at FVOCI). The Group manages its risk arising from changes in market price by monitoring the changes in the market price of the investments.

Capital Management

The Group maintains a sound capital base to ensure its ability to continue as a going concern, thereby continue to provide returns to stockholders and benefits to other stakeholders and to maintain an optimal capital structure to reduce cost of capital.

The Group manages its capital structure and makes adjustments in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, distribution payment, pay-off existing debts, return capital to shareholders or issue new shares, subject to compliance with certain covenants of its long-term debts, USCS and RPS.

The Group defines capital as capital stock, additional paid-in capital, USCS, RPS and retained earnings, both appropriated and unappropriated. Other components of equity such as equity reserves and reserve for retirement plan are excluded from capital for purpose of capital management.

The Group monitors capital on the basis of debt-to-equity ratio, which is calculated as total debt divided by total equity. Total debt is defined as total current liabilities and total noncurrent liabilities, while equity is total equity as shown in the consolidated statements of financial position.

The BOD has overall responsibility for monitoring capital in proportion to risk. Profiles for capital ratios are set in the light of changes in the external environment and the risks underlying the Group's business, operation and industry.

There were no changes in the Group's approach to capital management during the period.

## 23. Financial Assets and Financial Liabilities

The table below presents a comparison by category of the carrying amounts and fair values of the Group's financial instruments:

| | **March 31, 2018 (Unaudited)** | | December 31, 2017 (Audited) | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value |
| **Financial Assets** | | | | |
| Cash and cash equivalents | **P32,465,709** | **P32,465,709** | P28,655,359 | P28,655,359 |
| Trade and other receivables - net* | **26,814,354** | **26,814,354** | 20,384,934 | 20,384,934 |
| Financial assets at FVOCI (included under "Prepaid expenses and other current assets" account) | **54,717** | **54,717** | - | - |
| Derivative asset (included under "Other noncurrent assets - net" account) | **49,637** | **49,637** | 61,903 | 61,903 |
| Noncurrent receivables (included under "Other noncurrent assets - net" account) | **328,020** | **328,020** | 278,965 | 278,965 |
| Restricted cash (included under "Other noncurrent assets - net" account) | **7,899,995** | **7,899,995** | 4,805,175 | 4,805,175 |
| | **P67,612,432** | **P67,612,432** | P54,186,336 | P54,186,336 |
| **Financial Liabilities** | | | | |
| Loans Payable | **P8,277,200** | **P8,277,200** | P5,930,000 | P5,930,000 |
| Accounts payable and accrued expenses* | **33,794,594** | **33,794,594** | 24,818,444 | 24,818,444 |
| Long-term debt - net (including current maturities) | **185,972,906** | **193,096,040** | 90,728,701 | 96,948,336 |
| Finance lease liabilities (including current portion) | **154,393,217** | **154,393,217** | 154,793,690 | 154,793,690 |
| Other noncurrent liabilities (including current portion of concession liability) | **7,998,941** | **8,006,957** | 171,174 | 171,174 |
| | **P390,436,858** | **P397,568,008** | P276,442,009 | P282,661,644 |

**Excluding statutory receivables and payables*

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

*Cash and Cash Equivalents, Trade and Other Receivables (excluding statutory receivables), Noncurrent Receivables, and Restricted Cash.* The carrying amount of cash and cash equivalents, and trade and other receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of noncurrent receivables and restricted cash, the carrying amounts approximate their fair values, since the effect of discounting is not considered material.

*Financial assets at FVOCI.* The fair values of publicly traded instruments and similar investments are based on quoted market prices in an active market. For debt instruments with no quoted market prices, a reasonable estimate of their fair values is calculated based on the expected cash flows from the instruments discounted using the applicable discount rates of comparable instruments quoted in active markets. The fair values of the financial assets at FVOCI have been categorized as Level 1 in the fair value hierarchy.

*Derivatives.* The fair values of freestanding currency and commodity derivatives are determined based on quoted prices obtained from their respective active markets. The fair values of the derivatives have been categorized as Level 2 in the fair value hierarchy.

*Loans Payable and Accounts Payable and Accrued Expenses (excluding statutory payables).* The carrying amount of loans payable and accounts payable and accrued expenses approximates fair value due to the relatively short-term maturities of these financial instruments.

*Long-term Debt, Finance Lease Liabilities and Other Noncurrent Liabilities*. The fair value of interest-bearing fixed-rate loans is based on the discounted value of expected future cash flows using the applicable market rates for similar types of instruments as of reporting date. Discount rates used for Philippine peso-denominated loans range from 3.08% to 6.72% and 2.47% to 5.70% as of March 31, 2018 and December 31, 2017, respectively. Discount rates used for foreign currency-denominated loans range from 1.70% to 2.7% as of March 31, 2018. The carrying amounts of floating rate loans with quarterly interest rate repricing approximate their fair values.

The fair value of peso-denominated bonds has been categorized as Level 1 and interest-bearing fixed-rate loans, finance lease liabilities and other noncurrent liabilities have been categorized as Level 2 in the fair value hierarchy.

Derivative Financial Instruments

The Group's derivative financial instruments according to the type of financial risk being managed and the details of freestanding derivative financial instruments are discussed below.

The Group entered into currency and commodity derivative contracts to manage its exposure on foreign currency and commodity price risk. The portfolio is a mixture of instruments including forwards and swaps.

*Freestanding Derivatives*

For the purpose of hedge accounting, hedges are classified as either:

(a) fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk);

(b) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment; or

(c) hedges of a net investment in foreign operations.

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

*Fair Value Hedge.* Derivatives classified as fair value hedges are carried at fair value with corresponding change in fair value recognized in the consolidated statements of income. The carrying amount of the hedged asset or liability is also adjusted for changes in fair value attributable to the hedged item and the gain or loss associated with that remeasurement is also recognized in the condensed consolidated interim statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued and the adjustment to the carrying amount of a hedged financial instrument is amortized immediately.

The Group discontinues fair value hedge accounting if:

(a) the hedging instrument expires, is sold, is terminated or is exercised;

(b) the hedge no longer meets the criteria for hedge accounting; or

(c) the Group revokes the designation.

The Group has no outstanding derivatives accounted for as a fair value hedge as of March 31, 2018 and December 31, 2017.

*Cash Flow Hedge.* Changes in the fair value of a hedging instrument that qualifies as a highly effective cash flow hedge are recognized in other comprehensive income and presented in the condensed consolidated interim statements of changes in equity. The ineffective portion is immediately recognized in the condensed consolidated interim statements of income.

If the hedged cash flow results in the recognition of an asset or a liability, all gains or losses previously recognized directly in the condensed consolidated interim statements of changes in equity are transferred and included in the initial measurement of the cost or carrying amount of the asset or liability. Otherwise, for all other cash flow hedges, gains or losses initially recognized in the condensed consolidated interim statements of changes in equity are transferred to the condensed consolidated interim statements of income in the same period or periods during which the hedged forecasted transaction or recognized asset or liability affects the condensed consolidated interim statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been reported directly in the condensed consolidated interim statements of changes in equity is retained until the forecasted transaction occurs. When the forecasted transaction is no longer expected to occur, any net cumulative gain or loss previously reported in the condensed consolidated interim statements of changes in equity is recognized in the condensed consolidated interim statements of income.

The Group has no outstanding derivatives accounted for as a cash flow hedge as of March 31, 2018 and December 31, 2017.

*Net Investment Hedge.* Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, are accounted for in a way similar to cash flow hedges. Gains or losses on the hedging instrument relating to the effective portion of the hedge are recognized in other comprehensive income while any gains or losses relating to the ineffective portion are recognized in the consolidated statements of income. On disposal of a foreign operation, the cumulative value of any such gains and losses recorded in the condensed consolidated interim statements of changes in equity is transferred to and recognized in the condensed consolidated interim statements of income.

The Group has no hedge of a net investment in a foreign operation as of March 31, 2018 and December 31, 2017.

Changes in fair values of derivatives that do not qualify for hedge accounting are recognized directly in the condensed consolidated interim statements of income.

*Embedded Derivatives*
The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid or combined instrument is not recognized as at FVPL.

Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Embedded derivatives that are bifurcated from the host contracts are accounted for either as financial assets or financial liabilities at FVPL.

Derivative Instruments not Designated as Hedges
The Group enters into certain derivatives as economic hedges of certain underlying exposures. These include freestanding derivatives which are not designated as accounting hedges. Changes in fair value of these instruments are accounted for directly in the condensed consolidated interim statements of comprehensive income. Details are as follows:

Freestanding Derivatives
Freestanding derivatives consist of currency and commodity derivatives entered into by the Group.

*Currency Forwards*
As of March 31, 2018 and December 31, 2017, the Group has no outstanding currency forwards.

*Commodity Swap*
The Group has an outstanding fixed swap agreement covering its purchase of coal for calendar year 2019. Under the agreement, payment is made either by the Group or its counterparty for the difference between the hedged fixed price and the relevant monthly average index price. The outstanding equivalent notional quantity covered by the commodity swap is 60,000 metric tons as of March 31, 2018 and December 31, 2017. The positive fair value of these swap amounted to P49,637 and P61,903 as of March 31, 2018 and December 31, 2017, respectively.

Fair Value Measurements
The Group measures a number of financial and non-financial assets and liabilities at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either: (a) in the principal market for the asset or liability, or (b) in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or most advantageous market must be accessible to the Group.

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

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

- Level 3: inputs for the asset or liability that are not based on observable market data.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing the categorization at the end of each reporting period.

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

Fair Value Hierarchy

Financial assets and financial liabilities measured at fair value in the condensed consolidated interim statements of financial position are categorized in accordance with the fair value hierarchy. This hierarchy groups financial assets and financial liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and financial liabilities.

The Group has no financial instruments valued based on Level 3 as of March 31, 2018 and December 31, 2017. For the period ended March 31, 2018 and for the year ended December 31, 2017, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurement.

## 24. Other Matters

a. Contingencies

The Group is a party to certain cases or claims which are either pending decision by the court/regulators or are subject to settlement agreements. The outcome of these cases or claims cannot be presently determined.

i. *Generation Payments to PSALM*

SPPC and PSALM are parties to the Ilijan IPPA Agreement covering the appointment of SPPC as the IPP Administrator of the Ilijan Power Plant.

SPPC and PSALM have an ongoing dispute arising from differing interpretations of certain provisions related to generation payments under the Ilijan IPPA Agreement. As a result of such dispute, the parties have arrived at different computations regarding the subject payments. In a letter dated August 6, 2015, PSALM has demanded payment of the difference between the generation payments calculated based on its interpretation and the amount which has already been paid by SPPC, plus interest, covering the period December 26, 2012 to April 25, 2015.

On August 12, 2015, SPPC initiated a dispute resolution process with PSALM as provided under the terms of the Ilijan IPPA Agreement, while continuing to maintain that it has fully paid all of its obligations to PSALM. Notwithstanding the bona fide dispute, PSALM issued a notice terminating the Ilijan IPPA Agreement on September 4, 2015. On the same day, PSALM also called on the Performance Bond posted by SPPC pursuant the Ilijan IPPA Agreement.

On September 8, 2015, SPPC filed a Complaint with the RTC of Mandaluyong City. In its Complaint, SPPC requested the RTC that its interpretation of the relevant provisions of the Ilijan IPPA Agreement be upheld. The Complaint also asked that a 72-hour Temporary Restraining Order (TRO) be issued against PSALM for illegally terminating the Ilijan IPPA Agreement and drawing on the Performance Bond. On even date, the RTC issued a 72-hour TRO which prohibited PSALM from treating SPPC as being in Administrator Default and from performing other acts that would change the status quo ante between the parties before PSALM issued the termination notice and drew on the Performance Bond. The TRO was extended for until September 28, 2015.

On September 28, 2015, the RTC issued an Order granting a Preliminary Injunction enjoining PSALM from proceeding with the termination of the Ilijan IPPA Agreement while the main case is pending.

On October 22, 2015, the RTC also issued an Order granting the Motion for Intervention and Motion to Admit Complaint-in-intervention by Meralco.

In an Order dated June 27, 2016, the RTC denied PSALM's: (1) Motion for Reconsideration of the Order dated September 28, 2015, which issued a writ of preliminary injunction enjoining PSALM from further proceedings with the termination of the IPPA Agreement while the case is pending; (2) Motion for Reconsideration of the Order, which allowed Meralco to intervene in the case; and (3) Motion to Dismiss. In response to this Order, PSALM filed a petition for certiorari with the Court of Appeals (CA) seeking to annul the RTC's Orders granting the writ of preliminary injunction, allowing Meralco's intervention, and the Orders denying PSALM's motions for reconsideration of said injunction and intervention orders. PSALM also prayed for the issuance of a TRO and/or writ of preliminary injunction "against public respondent RTC and its assailed Orders." The CA, however, denied the petition filed by PSALM in its Decision dated December 19, 2017. PSALM filed its Motion for Reconsideration dated January 19, 2018 to the December 19, 2017 CA Decision. On March 9, 2018, SPPC filed its Opposition to the aforesaid Motion for Reconsideration filed by PSALM.

The preliminary conference on the RTC case was suspended to pave way for mediation between the parties. During the last mediation conference on January 6, 2017, mediation between the parties was terminated. Thereafter, the case was referred to judicial dispute resolution. During the dispute conference between the parties on September 28, 2017, the judicial dispute process was terminated. The parties were required to submit their respective position papers on whether or not the case should be re-raffled. In compliance with the Order of the RTC dated October 24, 2017, on December 8, 2017 SPPC filed its Comment and Opposition to the Motion for Inhibition filed by PSALM. On December 18, 2017, the presiding judge of the RTC who conducted the judicial dispute resolution issued an Order inhibiting himself in the instant case. The case was then re-raffled to another RTC judge in Mandaluyong City which scheduled the Pre-Trial Conference on May 11, 2018. SPPC filed a Request for Motion for Production of Documents on February 28, 2018, while PSALM filed its Manifestation with Motion to Hear Affirmative Defenses and Objections Ad Cautelam. Both motions are now submitted for resolution.

Meanwhile, there are no restrictions or limitations on the ability of SPPC to supply power from the Ilijan Power Plant to Meralco under its PSA with the latter.

By virtue of the Preliminary Injunction issued by the RTC, SPPC continues to be the IPP Administrator for the Ilijan Power Plant.

*ii. Criminal Cases*

SPPC

On September 29, 2015, SPPC filed a criminal complaint for estafa and for violation of Section 3(e) of RA No. 3019, otherwise known as the Anti-Graft and Corrupt Practices Act, before the Department of Justice (DOJ), against certain officers of PSALM, in connection with the termination of SPPC's IPPA Agreement, which was made by PSALM with manifest partiality and evident bad faith. Further, it was alleged that PSALM fraudulently misrepresented its entitlement to draw on the Performance Bond posted by SPPC, resulting in actual injury to SPPC in the amount of US$60,000. The case is still pending with the DOJ as of March 31, 2018.

SMEC

On October 21, 2015, SMEC filed a criminal complaint for Plunder and violation of Section 3(e) and 3(f) of RA 3019, before the DOJ against a certain officer of PSALM, and certain officers of Team Philippines Energy Corp. (TPEC) and TSC, relating to the illegal grant of the so-called "excess capacity" of the Sual Power Plant in favor of TPEC which enabled it to receive a certain amount at the expense of the Government and SMEC.

In a Resolution dated July 29, 2016, the DOJ found probable cause to file Information against the respondents for (a) Plunder; (b) Violation of Sec. 3(e) of the Anti-Graft and Corrupt Practices Act; and (c) Violation of Sec. 3(f) of the Anti-Graft and Corrupt Practices Act. The DOJ further resolved to forward the entire records of the case to the Office of the Ombudsman for their proper action. Respondents have respectively appealed said DOJ's Resolution of July 29, 2016 with the Secretary of Justice. On October 25, 2017, the DOJ issued a Resolution partially granting the Petition for Review by reversing the July 29, 2016 DOJ Resolution insofar as the conduct of the preliminary investigation. On November 17, 2017, SMEC filed a motion for partial reconsideration of said October 25, 2017 DOJ Resolution.

On June 17, 2016, SMEC filed with the RTC Pasig a civil complaint for consignation against PSALM arising from PSALM's refusal to accept SMEC's remittances corresponding to the proceeds of the sale on the WESM of electricity generated from capacity in excess of the 1000 MW of the Sual Power Plant ("Sale of the Excess Capacity"). With the filing of the complaint, SMEC also consigned with the RTC Pasig, the amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods December 26, 2015 to April 25, 2016.

On October 3, 2016, SMEC filed an Omnibus Motion (To Admit Supplemental Complaint and To Allow Future Consignation without Tender). Together with this Omnibus Motion, SMEC consigned with the RTC Pasig an additional amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods from April 26, 2016 to July 25, 2016.

Pending for resolution are (a) PSALM's Motion for Preliminary Hearing and Special and Affirmative Defenses and (b) SMEC's Omnibus Motion (to Admit Supplemental Complaint and to Allow Future Consignations without Tender).

On December 1, 2016, SMEC received a copy of a Complaint filed by TPEC and TSC with the ERC against SMEC and PSALM in relation to the Excess Capacity issues, which issues have already been raised in the abovementioned cases. SMEC filed a Motion to Dismiss and Motion to Suspend Proceeding of the instant case.

On July 5, 2017, SMEC consigned with the RTC Pasig the amount representing additional proceeds of Sale of the Excess Capacity for the billing period July 26, 2016 to August 25, 2016. SMEC also filed a Motion to Admit Second Supplemental Complaint in relation to said consignation. With the submission of manifestation from PSALM, the Motion to Admit Second Supplemental Complaint is submitted for resolution.

As of March 31, 2018 and December 31, 2017, the total amount consigned with the RTC Pasig is P491,242, included under "Other noncurrent assets", particularly "Restricted cash" account, in the condensed consolidated interim statements of financial position.

iii. *TRO Issued to Meralco*

On December 23, 2013, the Supreme Court (SC) issued a TRO, effective immediately, preventing Meralco from collecting from its customers the power rate increase pertaining to November 2013 billing. As a result, Meralco was constrained to fix its generation rate to its October 2013 level of P5.67/kWh. Claiming that since the power supplied by generators, including SMEC and SPPC is billed to Meralco's customers on a pass-through basis, Meralco deferred a portion of its payment on the ground that it was not able to collect the full amount of its generation cost. Further, on December 27, 2013, the DOE, the ERC and PEMC, acting as a tripartite committee, issued a joint resolution setting a reduced price cap on the WESM of P32/kWh. The price will be effective for 90 days until a new cap is decided upon.

On January 16, 2014, the SC granted Meralco's plea to include other power supplier and generation companies, including SMEC and SPPC, as respondents to an inquiry. On February 18, 2014, the SC extended the period of the TRO until April 22, 2014 and enjoined the respondents (PEMC and the generators) from demanding and collecting the deferred amounts.

On March 3, 2014, the ERC issued an order declaring the November and December 2013 Luzon WESM prices void and imposed the application of regulated prices. Accordingly, SMEC, SPPC and SPDC recognized a reduction in the sale of power while SMELC recognized a reduction in its power purchases. Consequently, a payable and receivable were also recognized for the portion of over-collection or over-payment, the settlement of which have been covered by a 24-month Special Payment Arrangement with PEMC which was already completed on May 25, 2016. On June 26, 2014, SMEC, SPPC, SPDC and SPI filed with the CA a Petition for Review of these orders.

In a Decision dated November 7, 2017 ("Decision"), the CA granted the Petition for Review filed by SMEC, SPPC, SPDC and SPI, declaring the aforesaid ERC Order null and void and set aside the Orders of the ERC dated March 3, 2014, March 27, 2014, May 9, 2014 and October 15, 2014 and accordingly reinstated and declared as valid the WESM prices for Luzon for the supply of months of November to December 2013.

Upon finality of the Decision, a claim for refund may be made by the relevant subsidiaries with PEMC for an amount up to P2,625,585, plus interest.

b. Commitments

The outstanding purchase commitments of the Group amounted to P1,743,435 and P1,996,473 as of March 31, 2018 and December 31, 2017, respectively.

Amount authorized but not yet disbursed for capital projects as of March 31, 2018 and December 31, 2017 is approximately P10,252,519 and P12,861,746, respectively.

c. Significant Transaction

On March 16, 2018, the Parent Company issued the RPS at an issue price of 100% amounting to US$650,000 (equivalent to P33,127,662, net of issuance costs) in favor of SMC, the Security Holder.

The RPS are direct, unconditional, unsecured and subordinated capital securities with no fixed redemption date. The Security Holder will have the right to receive distribution at 6.25% per annum, payable quarterly in arrears every March 16, June 16, September 16 and December 16 of each year commencing on June 16, 2018. The Parent Company has a right to defer this distribution under certain conditions.

The proceeds were used to partially finance the acquisition of MAPL, ATPL and API by the Parent Company (Note 5).

Based on the pertinent conditions of the RPS, the Group classified the securities as equity. Distributions are treated as direct reduction to retained earnings.

d. Events After the Reporting Date

On May 7, 2018, the Parent Company's BOD approved the payment of distribution in the total amount of US$10,125, plus applicable taxes, on August 26, 2018 to the holders of the US$300,000 USCS issued in August 2015. On the same date, the BOD approved the payment of the distribution, amounting to US$10,156 on June 16, 2018, to the holder of the US$650,000 RPS.

# SMC GLOBAL POWER HOLDINGS CORP.
# AND SUBSIDIARIES

**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2017, 2016 and 2015**

R.G. Manabat & Co.
The KPMG Center, 9/F
6787 Ayala Avenue, Makati City
Philippines 1226
Telephone +63 (2) 885 7000
Fax +63 (2) 894 1985
Internet www.kpmg.com.ph
Email ph-inquiry@kpmg.com.ph

**REPORT OF INDEPENDENT AUDITORS**

The Board of Directors and Stockholders
**SMC Global Power Holdings Corp.**
155 EDSA, Brgy. Wack-Wack
Mandaluyong City, Metro Manila

*Opinion*

We have audited the consolidated financial statements of SMC Global Power Holdings Corp. and Subsidiaries (the "Group"), which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2017, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2017 and 2016, and its consolidated financial performance and its consolidated cash flows for each of the three years in the period ended December 31, 2017, in accordance with Philippine Financial Reporting Standards (PFRS).

*Basis for Opinion*

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

*Key Audit Matter*

Key audit matter is a matter that, in our professional judgment, is of most significance in our audit of the consolidated financial statements of the current period. This matter is addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on this matter.

*Valuation of Trade and Other Receivables*

*The risk -*
The Group's disclosures about the measurement and impairment assumptions to determine the recoverability and carrying amount of trade and other receivables are included in the significant accounting policies in Notes 3, 4 and 8 to the consolidated financial statements. As required by Philippine Accounting Standards No. 39, an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or a group of financial assets measured at amortized cost is impaired. The determination of the recoverable amounts is subject to significant management's judgment and estimation. As a result, we assessed that the impairment testing is a key audit matter. Given the significant management's judgment and estimation, there is a risk that potential impairment loss on trade and other receivables may not be adequately recognized resulting in over valuation of the Group's trade and other receivables.

*Our response -*
Our audit procedures included, among others, the identification of any events and objective evidence that impairment may exist individually for trade and other receivables that are individually significant and collectively for trade and other receivables that are not individually significant. We evaluated the possible impact that these indications might have on the recoverability of trade and other receivables.

We have:

- Discussed with management regarding the level and aging of trade and other receivables and recoverability of amounts due from customers.
- Assessed the recoverability of trade and other receivables with reference to the historical levels of bad debt expense and credit history of the counterparties.
- Evaluated the calculations of the impairment testing as well as the presentation and the relevant disclosures within the consolidated financial statements.
- Performed retrospective review of the impairment losses recognized and assumptions made by the management in previous years.
- Considered the consistency of judgments by the management regarding the recoverability of trade and other receivables to consider whether there is evidence of management bias through discussions with management on their rationale and obtaining evidence to support their judgments.

KPMG

*Other Information*

Management is responsible for the other information. The other information comprises the information included in the SEC Form 20-IS (Definitive Information Statement) and SEC Form 17-A as at and for the year ended December 31, 2017, but does not include the consolidated financial statements and our auditors' report thereon. The SEC Form 20-IS (Definitive Information Statement) and SEC Form 17-A as at and for the year ended December 31, 2017 are expected to be made available to us after the date of this auditors' report.

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

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

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

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

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

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

*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements*

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine the matter that was of most significance in the audit of the consolidated financial statements of the current period and is therefore the key audit matter. We describe the matter in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Mr. Darwin P. Virocel.

**R.G. MANABAT & CO.**

DARWIN P. VIROCEL
Partner
CPA License No. 0094495
SEC Accreditation No. 1386-AR, Group A, valid until June 14, 2020
Tax Identification No. 912-535-864
BIR Accreditation No. 08-001987-31-2016
Issued October 18, 2016; valid until October 17, 2019
PTR No. 6615157MD
Issued January 3, 2018 at Makati City

March 9, 2018
Makati City, Metro Manila

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**
**DECEMBER 31, 2017 AND 2016**
(In Thousands)

| | *Note* | **2017** | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | *7, 30, 31* | **P28,655,359** | P21,491,385 |
| Trade and other receivables - net | *4, 6, 8, 20, 30, 31* | **20,435,068** | 22,342,846 |
| Inventories | *4, 6, 9, 20* | **3,147,668** | 2,272,289 |
| Prepaid expenses and other current assets | *6, 10* | **17,791,915** | 17,683,020 |
| | | **70,030,010** | 63,789,540 |
| Assets held for sale | *11, 13* | **-** | 184,324 |
| **Total Current Assets** | | **70,030,010** | 63,973,864 |
| **Noncurrent Assets** | | | |
| Investments and advances - net | *4, 12* | **16,621,131** | 16,245,454 |
| Property, plant and equipment - net | *4, 6, 13* | **250,961,307** | 246,488,027 |
| Deferred exploration and development costs | *4, 6, 14* | **699,001** | 693,379 |
| Intangible assets and goodwill - net | *4, 6, 14, 15* | **2,594,136** | 2,572,119 |
| Deferred tax assets | *4, 27* | **1,316,926** | 2,955,570 |
| Other noncurrent assets - net | *16, 20, 30, 31* | **7,950,484** | 1,020,771 |
| **Total Noncurrent Assets** | | **280,142,985** | 269,975,320 |
| | | **P350,172,995** | P333,949,184 |
| **LIABILITIES AND EQUITY** | | | |
| **Current Liabilities** | | | |
| Loans payable | *17, 30, 31* | **P5,930,000** | P - |
| Accounts payable and accrued expenses | *18, 20, 30, 31* | **31,074,714** | 37,729,415 |
| Finance lease liabilities - current portion | *4, 6, 30, 31* | **16,844,431** | 16,344,246 |
| Income tax payable | | **151,906** | 127,198 |
| Current maturities of long-term debt - net of debt issue costs | *19, 30, 31* | **1,139,631** | 1,040,690 |
| **Total Current Liabilities** | | **55,140,682** | 55,241,549 |
| **Noncurrent Liabilities** | | | |
| Long-term debt - net of current maturities and debt issue costs | *19, 30, 31* | **89,589,070** | 65,283,036 |
| Deferred tax liabilities | *27* | **7,324,111** | 4,785,217 |
| Finance lease liabilities - net of current portion | *4, 6, 30, 31* | **137,949,259** | 153,745,290 |
| Other noncurrent liabilities | *4, 6, 20, 21, 30, 31* | **404,361** | 223,468 |
| **Total Noncurrent Liabilities** | | **235,266,801** | 224,037,011 |
| **Total Liabilities** | | **290,407,483** | 279,278,560 |

*Forward*

| | *Note* | 2017 | 2016 |
|---|---|---|---|
| **Equity** | *22* | | |
| Capital stock | | **P1,062,504** | P1,062,504 |
| Additional paid-in capital | | **2,490,000** | 2,490,000 |
| Undated subordinated capital securities | | **26,933,565** | 26,933,565 |
| Equity reserves | | **785,279** | 785,279 |
| Equity reserve for retirement plan | *21* | **(23,632)** | (26,371) |
| Retained earnings | | **28,517,796** | 23,425,647 |
| **Total Equity** | | **59,765,512** | 54,670,624 |
| | | **P350,172,995** | P333,949,184 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**
(In Thousands, Except Per Share Data)

| | ***Note*** | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| **REVENUES** | *5, 20, 23, 33* | **P82,790,575** | P77,972,430 | P77,506,691 |
| **COST OF POWER SOLD** | *24* | **53,678,763** | 45,002,440 | 48,899,927 |
| **GROSS PROFIT** | | **29,111,812** | 32,969,990 | 28,606,764 |
| **SELLING AND ADMINISTRATIVE EXPENSES** | *25* | **4,835,532** | 6,239,650 | 4,904,135 |
| **INCOME FROM OPERATIONS** | | **24,276,280** | 26,730,340 | 23,702,629 |
| **INTEREST INCOME** | *7, 16* | **460,958** | 200,502 | 414,444 |
| **GAIN ON SALE OF PROPERTY, PLANT AND EQUIPMENT** | *13* | **-** | 116,357 | - |
| **EQUITY IN NET LOSSES OF ASSOCIATES AND JOINT VENTURES** | *12* | **(40,396)** | (294,795) | (528,445) |
| **INTEREST EXPENSE AND OTHER FINANCING CHARGES** | *6, 17, 19* | **(13,244,581)** | (12,354,229) | (13,130,252) |
| **OTHER INCOME (CHARGES)** - Net | *6, 26* | **2,944,165** | (6,881,754) | (5,926,050) |
| **INCOME BEFORE INCOME TAX** | | **14,396,426** | 7,516,421 | 4,532,326 |
| **INCOME TAX EXPENSE** | *27, 28* | **6,179,510** | 3,365,759 | 2,703,408 |
| **NET INCOME** | | **P8,216,916** | P4,150,662 | P1,828,918 |
| **Basic/Diluted Earnings (Loss) Per Share** | *29* | **P4.11** | P0.97 | (P0.07) |

*See Notes to the Consolidated Financial Statements.*

# SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
## (A Wholly-owned Subsidiary of San Miguel Corporation)

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
## FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015
(In Thousands)

| | *Note* | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| **NET INCOME** | | **P8,216,916** | P4,150,662 | P1,828,918 |
| **OTHER COMPREHENSIVE INCOME** | | | | |
| **Item that will not be reclassified to profit or loss** | | | | |
| Equity reserve for retirement plan | *21* | **3,913** | (15,319) | (22,354) |
| Income tax benefit (expense) | *27* | **(1,174)** | 4,596 | 6,706 |
| | | **2,739** | (10,723) | (15,648) |
| **TOTAL COMPREHENSIVE INCOME** | | **P8,219,655** | P4,139,939 | P1,813,270 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
# FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015
(In Thousands)

| | *Note* | **Capital Stock** | **Additional Paid-in Capital** | **Undated Subordinated Capital Securities** | **Equity Reserves** | **Equity Reserve for Retirement Plan** | **Retained Earnings** | **Total Equity** |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2017** | | **P1,062,504** | **P2,490,000** | **P26,933,565** | **P785,279** | **(P26,371)** | **P23,425,647** | **P54,670,624** |
| Net income for the year | | **-** | **-** | **-** | **-** | **-** | **8,216,916** | **8,216,916** |
| Equity reserve for retirement plan - net of tax | *21* | **-** | **-** | **-** | **-** | **2,739** | **-** | **2,739** |
| Total comprehensive income for the year | | **-** | **-** | **-** | **-** | **2,739** | **8,216,916** | **8,219,655** |
| Share issuance costs | | **-** | **-** | **-** | **-** | **-** | **(50,563)** | **(50,563)** |
| Distributions: | | | | | | | | |
| Undated subordinated capital securities | *22* | **-** | **-** | **-** | **-** | **-** | **(3,074,204)** | **(3,074,204)** |
| Transactions with owners | | **-** | **-** | **-** | **-** | **-** | **(3,124,767)** | **(3,124,767)** |
| **Balance as of December 31, 2017** | | **P1,062,504** | **P2,490,000** | **P26,933,565** | **P785,279** | **(P23,632)** | **P28,517,796** | **P59,765,512** |
| Balance as of January 1, 2016 | | P1,062,504 | P2,490,000 | P26,933,565 | P785,279 | (P15,648) | P25,179,558 | P56,435,258 |
| Net income for the year | | - | - | - | - | - | 4,150,662 | 4,150,662 |
| Equity reserve for retirement plan - net of tax | *21* | - | - | - | - | (10,723) | - | (10,723) |
| Total comprehensive income for the year | | - | - | - | - | (10,723) | 4,150,662 | 4,139,939 |
| Cash dividends and distributions: | | | | | | | | |
| Common | *22* | - | - | - | - | - | (3,000,000) | (3,000,000) |
| Undated subordinated capital securities | *22* | - | - | - | - | - | (2,904,573) | (2,904,573) |
| Transactions with owners | | - | - | - | - | - | (5,904,573) | (5,904,573) |
| Balance as of December 31, 2016 | | P1,062,504 | P2,490,000 | P26,933,565 | P785,279 | (P26,371) | P23,425,647 | P54,670,624 |
| Balance as of January 1, 2015 | | P1,062,504 | P2,490,000 | P13,110,066 | P785,279 | P - | P29,301,328 | P46,749,177 |
| Net income for the year | | - | - | - | - | - | 1,828,918 | 1,828,918 |
| Equity reserve for retirement plan - net of tax | *21* | - | - | - | - | (15,648) | - | (15,648) |
| Total comprehensive income for the year | | - | - | - | - | (15,648) | 1,828,918 | 1,813,270 |
| Issuance of undated subordinated capital securities | *22* | - | - | 13,823,499 | - | - | - | 13,823,499 |
| Cash dividends and distributions: | | | | | | | | |
| Common | *22* | - | - | - | - | - | (4,500,000) | (4,500,000) |
| Undated subordinated capital securities | *22* | - | - | - | - | - | (1,450,688) | (1,450,688) |
| Transactions with owners | | - | - | - | - | - | (5,950,688) | (5,950,688) |
| Balance as of December 31, 2015 | | P1,062,504 | P2,490,000 | P26,933,565 | P785,279 | (P15,648) | P25,179,558 | P56,435,258 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**
(In Thousands)

| | *Note* | 2017 | 2016 | 2015 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| Income before income tax | | **P14,396,426** | P7,516,421 | P4,532,326 |
| Adjustments for: | | | | |
| Interest expense and other financing charges | *6, 17, 19* | **13,244,581** | 12,354,229 | 13,130,252 |
| Depreciation and amortization | *6, 13, 15, 24, 25* | **6,064,931** | 6,341,931 | 6,539,813 |
| Equity in net losses of associates and joint venture | *12* | **40,396** | 294,795 | 528,445 |
| Retirement benefit expense | *21* | **12,653** | 8,388 | 6,611 |
| Unrealized marked - to - market gain on derivatives | | **(61,903)** | - | - |
| Interest income | *7, 16* | **(460,958)** | (200,502) | (414,444) |
| Unrealized foreign exchange (gains) losses - net | | **(786,921)** | 7,446,813 | 7,505,369 |
| Impairment losses on trade and other receivables | *8, 25, 26* | **-** | 1,210,451 | 374,801 |
| Impairment losses on property, plant and equipment | *13* | **-** | 323,788 | - |
| Impairment losses on concession assets | | **-** | 20,460 | - |
| Gain on sale of property, plant and equipment | *13* | **-** | (116,357) | - |
| Operating income before working capital changes | | **32,449,205** | 35,200,417 | 32,203,173 |
| Decrease (increase) in: | | | | |
| Trade and other receivables - net | *8* | **2,114,023** | (657,993) | (749,571) |
| Inventories | *9* | **(875,379)** | (1,009,071) | 101,815 |
| Prepaid expenses and other current assets | *10* | **(982,825)** | (2,614,273) | (6,647,768) |
| Increase (decrease) in: | | | | |
| Accounts payable and accrued expenses | *18* | **(4,864,843)** | 5,130,812 | 4,686,593 |
| Other noncurrent liabilities | | **14,521** | 49,479 | (565,860) |
| Cash generated from operations | | **27,854,702** | 36,099,371 | 29,028,382 |
| Interest income received | | **395,960** | 203,493 | 426,480 |
| Income taxes paid | | **(1,242,012)** | (2,640,580) | (1,517,632) |
| Finance cost paid | | **(5,163,304)** | (3,182,682) | (2,907,116) |
| Net cash flows provided by operating activities | | **21,845,346** | 30,479,602 | 25,030,114 |

*Forward*

| | *Note* | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| Proceeds from sale of property, plant and equipment | *13* | **P54,184** | P13,820,388 | P - |
| Additions to deferred exploration and development costs | *14* | **(5,622)** | (3,831) | (17,765) |
| Additions to intangible assets | *6, 15* | **(132,474)** | (271,991) | (117,735) |
| Net additions to investments and advances | *12* | **(416,073)** | (5,927,312) | (529,105) |
| Additions to other noncurrent assets | | **(6,867,810)** | 1,227,455 | (32,811) |
| Additions to property, plant and equipment | *13, 17, 19* | **(8,911,531)** | (14,862,133) | (33,832,759) |
| Net cash flows used in investing activities | | **(16,279,326)** | (6,017,424) | (34,530,175) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | |
| Proceeds from short-term borrowings | *17, 32* | **113,419,200** | 14,364,000 | - |
| Proceeds from long-term debt | *19, 32* | **77,000,000** | 30,684,375 | 8,825,000 |
| Proceeds from issuance of undated subordinated capital securities | *22* | **-** | - | 13,823,499 |
| Cash dividends paid | *22* | **-** | (3,000,000) | (4,500,000) |
| Payment of stock issuance costs | | **(50,563)** | - | - |
| Distributions to undated subordinated capital securities holders | *22* | **(3,074,204)** | (2,904,573) | (1,450,688) |
| Payments of finance lease liabilities | *6, 32* | **(24,874,993)** | (23,873,363) | (22,280,118) |
| Payments of long-term debt | *19, 32* | **(53,110,468)** | (26,348,700) | (1,373,100) |
| Payments of short-term borrowings | *17, 32* | **(107,782,255)** | (14,155,500) | - |
| Net cash flows provided by (used in) financing activities | | **1,526,717** | (25,233,761) | (6,955,407) |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | | **71,237** | 21,607 | 392,535 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | | **7,163,974** | (749,976) | (16,062,933) |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | | **21,491,385** | 22,241,361 | 38,304,294 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | *7* | **P28,655,359** | P21,491,385 | P22,241,361 |

*See Notes to the Consolidated Financial Statements.*

# SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Thousands, Except Per Share Data and Number of Shares)

### 1. Reporting Entity

SMC Global Power Holdings Corp. (the Parent Company) was incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on January 23, 2008, and its primary purpose of business is to purchase, sell, lease, develop and dispose of all properties of every kind and description, and shares of stocks or other securities or obligations, created or issued by any corporation or other entity. The Parent Company's registered office address is located at 155 EDSA, Brgy. Wack-Wack, Mandaluyong City, Metro Manila.

The accompanying consolidated financial statements comprise the financial statements of the Parent Company and its Subsidiaries (collectively referred to as the Group) and the Group's interests in associates and joint ventures.

The Parent Company is a wholly-owned subsidiary of San Miguel Corporation (SMC). The ultimate parent company of the Group is Top Frontier Investment Holdings, Inc. (Top Frontier). SMC and Top Frontier are public companies under Section 17.2 of the Securities Regulation Code and whose shares are listed on The Philippine Stock Exchange, Inc. (PSE).

### 2. Basis of Preparation

Statement of Compliance
The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards issued by the International Accounting Standards Board (IASB). PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations issued by the Philippine Financial Reporting Standards Council (FRSC).

The consolidated financial statements were approved and authorized for issue in accordance with a resolution by the Board of Directors (BOD) on March 9, 2018.

Basis of Measurement
The consolidated financial statements of the Group have been prepared on the historical cost basis except for the following items which are measured on an alternative basis on each reporting date:

| Items | Measurement Basis |
|---|---|
| Derivative financial instruments | Fair value |
| Defined benefit retirement liability | Present value of the defined benefit retirement obligation |

Functional and Presentation Currency

The consolidated financial statements are presented in Philippine peso, which is the functional currency of the Parent Company. All financial information are rounded off to the nearest thousand (P000), except when otherwise indicated.

Basis of Consolidation

The Parent Company's subsidiaries, primarily engaged in power generation, retail and other power-related services and coal mining are incorporated in the Philippines and registered with the Philippine SEC. The consolidated financial statements include the accounts of the Parent Company and its Subsidiaries as follows:

| | Percentage of Ownership | |
|---|---|---|
| | **2017** | 2016 |
| *Power Generation* | | |
| San Miguel Energy Corporation (SMEC) | **100** | 100 |
| South Premiere Power Corp. (SPPC) | **100** | 100 |
| Strategic Power Devt. Corp. (SPDC) | **100** | 100 |
| SMC PowerGen Inc. (SPI) | **100** | 100 |
| Limay Power Generation Corporation [c] | **100** | 100 |
| SMC Consolidated Power Corporation (SCPC) [g] [j] | **100** | 100 |
| San Miguel Consolidated Power Corporation (SMCPC) [b] | **100** | 100 |
| Central Luzon Premiere Power Corp. (CLPPC) [e] | **100** | 100 |
| Limay Premiere Power Corp. (LPPC) [e] [j] | **100** | 100 |
| PowerOne Ventures Energy Inc. (PVEI) [h] | **100** | 100 |
| Prime Electric Generation Corporation [k] | **100** | - |
| Oceantech Power Generation Corporation [k] | **100** | - |
| *Retail and Other Power-related Services* | | |
| San Miguel Electric Corp. (SMELC) | **100** | 100 |
| Albay Power and Energy Corp. (APEC) | **100** | 100 |
| SMC Power Generation Corp. (SPGC) [i] | **100** | 100 |
| *Coal Mining* | | |
| Daguma Agro-Minerals, Inc. (DAMI) [a] | **100** | 100 |
| Sultan Energy Phils. Corp. (SEPC) [a] | **100** | 100 |
| Bonanza Energy Resources, Inc. (BERI) [a] | **100** | 100 |
| *Others* | | |
| Mantech Power Dynamics Services Inc. | **100** | 100 |
| Safetech Power Services Corp. | **100** | 100 |
| Ondarre Holding Corporation (OHC) [d] | **100** | 100 |
| Golden Quest Equity Holdings Inc. [a] | **100** | 100 |
| Grand Planters International, Inc. (GPII) [f] | **100** | 100 |

*(a) Indirectly owned by the Parent Company through SMEC and has not yet started commercial operations as of December 31, 2017.*

*(b) In July 2017, SMCPC started commercial operations for Unit 1 of its 2 x 150 Mega Watt (MW) Coal-fired Power Plant in Malita, Davao.*

*(c) Indirectly owned by the Parent Company through SPI and has not yet started commercial operations as of December 31, 2017.*

*(d) Acquired in February 2015 and has not yet started commercial operations as of December 31, 2017.*

*(e) Incorporated in 2015 and has not yet started commercial operations as of December 31, 2017.*

*(f) Acquired in September 2015.*

*(g) In May and September 2017, SCPC started commercial operations of Unit 1 and Unit 2, respectively, of its initial 2 x 150 MW Coal-fired Power Plant in Limay, Bataan.*

*(h) PVEI owns 60% of the outstanding capital stock of Angat Hydropower Corporation and KWPP Holdings Corporation as joint ventures.*

*(i) SPGC owns 35% of the outstanding capital stock of Olongapo Electricity Distribution Company, Inc., as an associate.*

*(j) On June 22, 2017, LPPC sold its 2 x 150 MW Coal-fired Power Plant under construction to SCPC.*

*(k) Incorporated in 2017 and has not started commercial operations as of December 31, 2017.*

A subsidiary is an entity controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

When the Group has less than majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including the contractual arrangement with the other vote holders of the investee, rights arising from other contractual arrangements and the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are included in the consolidated financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The financial statements of the subsidiaries are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the consolidated financial statements.

A change in the ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, the Group: (i) derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests and the cumulative transaction differences recorded in equity; (ii) recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in the consolidated statements of income; and (iii) reclassify the Parent Company's share of components previously recognized in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

## 3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards and Interpretation
The FRSC approved the adoption of a number of new and amended standards and interpretation as part of PFRS.

*Amendments to Standards Adopted in 2017*

The Group has adopted the following amendments to PFRS starting January 1, 2017 and accordingly, changed its accounting policies in the following areas:

- Disclosure Initiative *(Amendments to PAS 7, Statement of Cash Flows*). The amendments resulted in improved disclosures about the net debt of an entity relevant to the understanding of its cash flows. The amendments require entities to provide disclosures that enable users of the financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g., by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities.

- Recognition of Deferred Tax Assets for Unrealized Losses *(Amendments to PAS 12, Income Taxes)*. The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.

- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which only the *Amendments to PFRS 12, Disclosure of Interests in Other Entities,* on clarification of the scope of the standard is applicable to the Group. The amendments clarify that the disclosure requirements for interests in other entities also apply to interests that are classified as held for sale or distribution.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the consolidated financial statements.

*New and Amended Standards and Interpretations Not Yet Adopted*

A number of new and amended standards and interpretations are effective for annual periods beginning after January 1, 2017 and have not been applied in preparing the consolidated financial statements. Unless otherwise indicated, none of these is expected to have a significant effect on the consolidated financial statements.

The Group will adopt the following new and amended standards and interpretations on the respective effective dates:

- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which only the *Amendments to PAS 28, Investments in Associates,* on measuring an associate or joint venture at fair value is applicable to the Group. The amendments provide that a venture capital organization, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss (FVPL). This election can be made on an investment-by-investment basis. The amendments also provide that a non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture.

  The amendments are to be applied retrospectively on or after January 1, 2018, with early application permitted.

- PFRS 9 (2014), *Financial Instruments,* replaces PAS 39, *Financial Instruments: Recognition and Measurement,* and supersedes the previously published versions of PFRS 9 that introduced new classifications and measurement requirements (in 2009 and 2010) and a new hedge accounting model (in 2013). PFRS 9 includes revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment, guidance on own credit risk on financial liabilities measured at fair value and supplements the new general hedge accounting requirements. PFRS 9 incorporates new hedge accounting requirements that represent a major overhaul of hedge accounting and introduces significant improvements by aligning the accounting more closely with risk management.

  The new standard is required to be applied retrospectively for annual periods beginning on or after January 1, 2018, with early adoption permitted.

  The Group will adopt the new standard on the effective date and will not restate comparative information. The Group has performed an assessment which is based on currently available information and may be subject to changes arising from further reasonable and supportable information being made available to the Group in 2018. The adoption of PFRS 9 will have no significant effect on the classification and measurement of financial assets and liabilities of the Group. The Group does not expect any impact on its consolidated statement of financial position except for the possible effect of applying the expected credit loss model in estimating impairment.

- PFRS 15, *Revenue from Contracts with Customers*, replaces PAS 11, *Construction Contracts*, PAS 18, *Revenue*, International Financial Reporting Interpretations Committee (IFRIC) 13, *Customer Loyalty Programmes*, IFRIC 18, *Transfer of Assets from Customers* and Standard Interpretation Committee - 31, *Revenue - Barter Transactions Involving Advertising Services*. The new standard introduces a new revenue recognition model for contracts with customers which specifies that revenue should be recognized when (or as) the Group transfers control of goods or services to a customer at the amount to which the Group expects to be entitled. Depending on whether certain criteria are met, revenue is recognized over time, in a manner that best reflects the Group's performance, or at a point in time, when control of the goods or services is transferred to the customer. The standard does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other PFRS. It also does not apply if two companies in the same line of business exchange nonmonetary assets to facilitate sales to other parties. Furthermore, if a contract with a customer is partly in the scope of another PFRS, then the guidance on separation and measurement contained in the other PFRS takes precedence.

  The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. An entity can apply the new standard using either the retrospective or the cumulative effect method. Under the retrospective method, each comparative period presented is retrospectively adjusted, with a choice of practical expedients. While under the cumulative effect method, the cumulative effect of applying the new standard is recognized at the beginning of the year of initial application, with no restatement of comparative periods, with a choice of practical expedients.

The Group will adopt the new standard on the effective date using the cumulative effect method. The cumulative impact of the adoption will be recognized in retained earnings as of January 1, 2018 and comparative information will not be restated. As of March 9, 2018, the Group is in the process of finalizing its assessment on the impact of adopting PFRS 15 on the Group's revenue recognition policies, but it does not expect any significant impact on its consolidated financial position and consolidated net income.

- Philippine Interpretation IFRIC 22, *Foreign Currency Transactions and Advance Consideration.* The amendments clarify that the transaction date to be used for translation of foreign currency transactions involving an advance payment or receipt is the date on which the entity initially recognizes the prepayment or deferred income arising from the advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date. The interpretation applies when an entity pays or receives consideration in a foreign currency and recognizes a non-monetary asset or liability before recognizing the related item.

  The interpretation is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

- PFRS 16, *Leases,* supersedes PAS 17, *Leases,* and the related Philippine Interpretations. The new standard introduces a single lease accounting model for lessees under which all major leases are recognized on-balance sheet, removing the lease classification test. Lease accounting for lessors essentially remains unchanged except for a number of details including the application of the new lease definition, new sale-and-leaseback guidance, new sub-lease guidance and new disclosure requirements. Practical expedients and targeted reliefs were introduced including an optional lessee exemption for short-term leases (leases with a term of 12 months or less) and low-value items, as well as the permission of portfolio-level accounting instead of applying the requirements to individual leases. New estimates and judgmental thresholds that affect the identification, classification and measurement of lease transactions, as well as requirements to reassess certain key estimates and judgments at each reporting date were introduced.

  PFRS 16 is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply PFRS 15 at or before the date of initial application of PFRS 16. The Group is currently assessing the potential impact of the new standard.

- Philippine Interpretation IFRIC 23, *Uncertainty over Income Tax Treatments,* clarifies how to apply the recognition and measurement requirements in PAS 12 when there is uncertainty over income tax treatments. Under the interpretation, whether the amounts recorded in the financial statements will differ to that in the tax return, and whether the uncertainty is disclosed or reflected in the measurement, depends on whether it is probable that the tax authority will accept the Group's chosen tax treatment. If it is not probable that the tax authority will accept the Group's chosen tax treatment, the uncertainty is reflected using the measure that provides the better prediction of the resolution of the uncertainty - either the most likely amount or the expected value. The interpretation also requires the reassessment of judgments and estimates applied if facts and circumstances change - e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority's right to challenge a treatment expires.

The interpretation is effective for annual periods beginning on or after January 1, 2019 with earlier application permitted.

- Long-term Interests in Associates and Joint Ventures *(Amendments to PAS 28)*. The amendment requires the application of PFRS 9 to other financial instruments in an associate or joint venture to which the equity method is not applied. These include long-term interests (LTIs) that, in substance, form part of the entity's net investment in an associate or joint venture. The amendment explains the annual sequence in which PFRS 9 and PFRS 28 are to be applied. In effect, PFRS 9 is first applied ignoring any prior years' PAS 28 loss absorption. If necessary, prior years' PAS 28 loss allocation is trued-up in the current year which may involve recognizing more prior years' losses, reversing these losses or re-allocating them between different LTI instruments. Any current year PAS 28 losses are allocated to the extent that the remaining LTI balance allows and any current year PAS 28 profits reverse any unrecognized prior years' losses and then allocations against LTI. The amendment is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. Retrospective application is required, subject to relevant transitional reliefs.

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture *(Amendments to PFRS 10, Consolidated Financial Statements, and PAS 28).* The amendments address an inconsistency in the requirements in PFRS 10 and PAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require that a full gain or loss is recognized when a transaction involves a business whether it is housed in a subsidiary or not. A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

  Originally, the amendments apply prospectively for annual periods beginning on or after January 1, 2016, with early adoption permitted. However, on January 13, 2016, the FRSC decided to postpone the effective date until the IASB has completed its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

<u>Current versus Noncurrent Classification</u>
The Group presents assets and liabilities in the consolidated statements of financial position based on current and noncurrent classification. An asset is current when it is: (a) expected to be realized or intended to be sold or consumed in the normal operating cycle; (b) held primarily for the purpose of trading; (c) expected to be realized within 12 months after the reporting period; or (d) cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

A liability is current when it is: (a) expected to be settled in the normal operating cycle; (b) held primarily for trading; (c) due to be settled within 12 months after the reporting period; or (d) there is no unconditional right to defer the settlement of the liability for at least 12 months after the reporting period.

The Group classifies all other assets and liabilities as noncurrent. Deferred tax assets and liabilities are classified as noncurrent.

Financial Assets and Financial Liabilities
*Date of Recognition.* The Group recognizes a financial asset or a financial liability in the consolidated statements of financial position when it becomes a party to the contractual provisions of a financial instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

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

*'Day 1' Difference.* Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and the fair value (a 'Day 1' difference) in the consolidated statements of income unless it qualifies for recognition as some other type of asset. In cases where data used is not observable, the difference between the transaction price and model value is only recognized in the consolidated statements of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' difference amount.

*Financial Assets*
The Group classifies its financial assets, at initial recognition, in the following categories: financial assets at FVPL, loans and receivables, available-for-sale (AFS) financial assets and held-to-maturity (HTM) investments. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. The Group determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

The Group has no AFS financial assets and HTM investments as of December 31, 2017 and 2016.

*Financial Assets at FVPL.* A financial asset is classified as at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated as at FVPL if the Group manages such investments and makes purchase and sale decisions based on their fair values in accordance with the documented risk management or investment strategy of the Group. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

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

Financial assets may be designated by management at initial recognition as at FVPL, when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis;

- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group carries financial assets at FVPL using their fair values. Attributable transaction costs are recognized in the consolidated statements of income as incurred. Fair value changes and realized gains or losses are recognized in the consolidated statements of income. Any interest earned is recognized as part of "Interest income" account in the consolidated statements of income. Any dividend income from equity securities classified as at FVPL is recognized in the consolidated statements of income when the right to receive payment has been established.

The Group's derivative assets and financial assets at FVPL are classified under this category (Notes 30 and 31).

*Loans and Receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables is recognized as part of "Interest income" account in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" account in the consolidated statements of income. Gains or losses are recognized in the consolidated statements of income when loans and receivables are derecognized or impaired.

Cash includes cash on hand and in banks which are stated at face value. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

The Group's cash and cash equivalents, trade and other receivables, noncurrent receivables and restricted cash are included under this category (Notes 7, 8, 16, 30 and 31).

<u>*Financial Liabilities*</u>
The Group classifies its financial liabilities, at initial recognition, in the following categories: financial liabilities at FVPL and other financial liabilities. The Group determines the classification of its financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date. All financial liabilities are recognized initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

*Financial Liabilities at FVPL.* Financial liabilities are classified under this category through the fair value option. Derivative instruments (including embedded derivatives) with negative fair values, except those covered by hedge accounting relationships, are also classified under this category.

The Group carries financial liabilities at FVPL using their fair values and reports fair value changes in profit or loss. Any interest expense incurred is recognized as part of "Interest expense and other financing charges" account in the consolidated statements of income.

The Group has no financial liabilities at FVPL as of December 31, 2017 and 2016.

*Other Financial Liabilities.* This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability. The effective interest rate amortization is included in "Interest expense and other financing charges" account in the consolidated statements of income. Gains and losses are recognized in the consolidated statements of income when the liabilities are derecognized as well as through the amortization process.

The Group's liabilities arising from its trade or borrowings such as loans payable, accounts payable and accrued expenses, long-term debt, finance lease liabilities and other noncurrent liabilities are included under this category (Notes 6, 17, 18, 19, 30 and 31).

<u>Derivative Financial Instruments and Hedging</u>
*Freestanding Derivatives*
For the purpose of hedge accounting, hedges are classified as either:

(a) fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk);

(b) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment; or

(c) hedges of a net investment in foreign operations.

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

*Fair Value Hedge.* Derivatives classified as fair value hedges are carried at fair value with corresponding change in fair value recognized in the consolidated statements of income. The carrying amount of the hedged asset or liability is also adjusted for changes in fair value attributable to the hedged item and the gain or loss associated with that remeasurement is also recognized in the consolidated statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued and the adjustment to the carrying amount of a hedged financial instrument is amortized immediately.

The Group discontinues fair value hedge accounting if:

(a) the hedging instrument expires, is sold, is terminated or is exercised;

(b) the hedge no longer meets the criteria for hedge accounting; or

(c) the Group revokes the designation.

The Group has no outstanding derivatives and financial instruments accounted for as a fair value hedge as of December 31, 2017 and 2016.

*Cash Flow Hedge.* Changes in the fair value of a hedging instrument that qualifies as a highly effective cash flow hedge are recognized in other comprehensive income and presented in the consolidated statements of changes in equity. The ineffective portion is immediately recognized in the consolidated statements of income.

If the hedged cash flow results in the recognition of an asset or a liability, all gains or losses previously recognized directly in the consolidated statements of changes in equity are transferred and included in the initial measurement of the cost or carrying amount of the asset or liability. Otherwise, for all other cash flow hedges, gains or losses initially recognized in the consolidated statements of changes in equity are transferred to the consolidated statements of income in the same period or periods during which the hedged forecasted transaction or recognized asset or liability affects the consolidated statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been reported directly in the consolidated statements of changes in equity is retained until the forecasted transaction occurs. When the forecasted transaction is no longer expected to occur, any net cumulative gain or loss previously reported in the consolidated statements of changes in equity is recognized in the consolidated statements of income.

The Group has no outstanding derivatives and financial instruments accounted for as a cash flow hedge as of December 31, 2017 and 2016.

*Net Investment Hedge.* Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment, are accounted for in a way similar to cash flow hedges. Gains or losses on the hedging instrument relating to the effective portion of the hedge are recognized in other comprehensive income while any gains or losses relating to the ineffective portion are recognized in the consolidated statements of income. On disposal of a foreign operation, the cumulative value of any such gains and losses recorded in the consolidated statements of changes in equity is transferred to and recognized in the consolidated statements of income.

The Group has no hedge of a net investment in a foreign operation as of December 31, 2017 and 2016.

Changes in fair values of derivatives that do not qualify for hedge accounting are recognized directly in the consolidated statements of income.

*Embedded Derivatives*
The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid or combined instrument is not recognized as at FVPL.

Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Embedded derivatives that are bifurcated from the host contracts are accounted for either as financial assets or financial liabilities at FVPL.

The Group has no embedded derivatives as of December 31, 2017 and 2016.

Derecognition of Financial Assets and Financial Liabilities
*Financial Assets.* A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognized when:

- the rights to receive cash flows from the asset have expired; or

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

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the Group continues to recognize the transferred asset to the extent of the Group's continuing involvement. In that case, the Group also recognizes the associated liability. The transferred asset and the associated liability are measured on the basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group is required to repay.

*Financial Liabilities.* A financial liability is derecognized when the obligation under the liability is discharged or cancelled, or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statements of income.

Impairment of Financial Assets

The Group assesses, at the reporting date, whether a financial asset or group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

*Assets Carried at Amortized Cost.* For financial assets carried at amortized cost such as loans and receivables, the Group first assesses whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets with similar credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

The carrying amount of the asset is reduced either directly or through the use of an allowance account. The impairment loss for the period is recognized in the consolidated statements of income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statements of income, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

Classification of Financial Instruments between Liability and Equity

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

A financial instrument is classified as liability if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity;

- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or

- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

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

Debt Issue Costs

Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest rate method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are recognized in the consolidated statements of income.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost is determined using specific identification method or weighted average method for coal inventories, weighted average method for fuel oil and other consumables and specific identification method for spare parts. Net realizable value is the current replacement cost.

Any write-down of inventories to net realizable value and all losses of inventories are recognized as expense in the year of write-down or loss occurrence. The amount of reversals, if any, of write-down of inventories arising from an increase in net realizable value are recognized as reduction in the amount of inventories recognized as expense in the year in which the reversal occurs.

Business Combination

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included as part of "Selling and administrative expenses" account in the consolidated statements of income.

When the Group acquires a business, it assesses the financial assets and financial liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured at the acquisition date fair value and any resulting gain or loss is recognized in the consolidated statements of income.

The Group measures goodwill at the acquisition date as: a) the fair value of the consideration transferred; plus b) the recognized amount of any non-controlling interests in the acquiree; plus c) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less d) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. When the excess is negative, a bargain purchase gain is recognized immediately in the consolidated statements of income. Subsequently, goodwill is measured at cost less any accumulated impairment in value. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognized in the consolidated statements of income. Costs related to the acquisition, other than those associated with the issuance of debt or equity securities that the Group incurs in connection with a business combination, are expensed as incurred. Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in the consolidated statements of income.

- *Goodwill in a Business Combination*

  Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is allocated:

  - represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

  - is not larger than an operating segment determined in accordance with PFRS 8, *Operating Segments*.

Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss with respect to goodwill is not reversed.

- *Intangible Assets Acquired in a Business Combination*
  The cost of an intangible asset acquired in a business combination is the fair value as at the date of acquisition, determined using discounted cash flows as a result of the asset being owned.

  Following initial recognition, intangible asset is carried at cost less any accumulated amortization and impairment losses, if any. The useful life of an intangible asset is assessed to be either finite or indefinite.

  An intangible asset with finite life is amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each reporting date. A change in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for as a change in accounting estimate. The amortization expense on intangible asset with finite life is recognized in the consolidated statements of income.

Transactions under Common Control
Transactions under common control entered into in contemplation of each other and business combination under common control designed to achieve an overall commercial effect are treated as a single transaction.

Transfers of assets between commonly controlled entities are accounted for using book value accounting.

Investments in Shares of Stock of Associates and Joint Ventures
An associate is an entity in which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The considerations made in determining significant influence or joint control is similar to those necessary to determine control over subsidiaries.

The Group's investments in shares of stock of associates and joint ventures are accounted for using the equity method.

Under the equity method, the investment in shares of stock of an associate or joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize the changes in the Group's share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortized nor individually tested for impairment.

The Group's share in profit or loss of an associate or joint venture is recognized as "Equity in net losses of associates and joint ventures" account in the consolidated statements of income. Adjustments to the carrying amount may also be necessary for changes in the Group's proportionate interest in the associate or joint venture arising from changes in the associate or joint venture's other comprehensive income. The Group's share on these changes is recognized in the consolidated statements of comprehensive income. Unrealized gains and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

After application of the equity method, the Group determines whether it is necessary to recognize an impairment loss on its investment in the shares of stock of an associate or joint venture. At each reporting date, the Group determines whether there is objective evidence that the investment in shares of stock of an associate or joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount and carrying amount of the investment in shares of stock of an associate or joint venture and then recognizes the loss as part of "Equity in net losses of associates and joint ventures" account in the consolidated statements of income.

Upon loss of significant influence over the associate or joint control over the joint venture, the Group measures and recognizes any retained investment at fair value. Any difference between the carrying amount of the investment in an associate or joint venture upon loss of significant influence or joint control, and the fair value of the retained investment and proceeds from disposal is recognized in the consolidated statements of income.

The financial statements of the associate or joint venture are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

Property, Plant and Equipment

Property, plant and equipment, except for land, are stated at cost less accumulated depreciation and amortization and any accumulated impairment in value. Such cost includes the cost of replacing part of the property, plant and equipment at the time the cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its construction cost or purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation (ARO). Expenditures incurred after the asset has been put into operation, such as repairs, maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. Major repairs are capitalized as part of property, plant and equipment only when it is probable that future economic benefits associated with the items will flow to the Group and the cost of the items can be measured reliably.

Capital projects in progress (CPIP) represents the amount of accumulated expenditures on unfinished and/or ongoing projects. This includes the costs of construction and other direct costs. Borrowing costs that are directly attributable to the construction of plant and equipment are capitalized during the construction period. CPIP is not depreciated until such time that the relevant assets are ready for use.

Depreciation and amortization, which commence when the assets are available for their intended use, are computed using the straight-line method over the following estimated useful lives of the assets:

| | Number of Years |
|---|---|
| Power plants | 10 - 43 |
| Leasehold improvements | 5 - 25 or term of the lease, whichever is shorter |
| Other equipment | 2 - 20 |
| Building | 10 - 25 |

The remaining useful lives, residual values, and depreciation and amortization methods are reviewed and adjusted periodically, if appropriate, to ensure that such periods and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Fully depreciated assets are retained in the accounts until they are no longer in use.

An item of property, plant and equipment is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its use or disposal. Any gain or loss arising from the retirement and disposal of an item of property, plant and equipment (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognized in the consolidated statements of income in the period of retirement and disposal.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of an intangible asset acquired in a business combination is its fair value at the date of acquisition. Subsequently, intangible assets are carried at cost less accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditures are recognized in the consolidated statements of income in the year in which the related expenditures are incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible assets may be impaired. The amortization period and the amortization method used for an intangible asset with a finite useful life are reviewed at least at each reporting date. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimate. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income consistent with the function of the intangible asset.

Amortization is computed using the straight-line method over the following estimated useful lives of intangible assets with finite lives:

| | Number of Years |
|---|---|
| Power concession right | 25 |
| Computer software and licenses | 3 |

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

*Power Concession Assets and Obligations*
Public-to-private service concession arrangements where: (a) the grantor controls or regulates what services the entity in the Group can provide with the infrastructure, to whom it can provide them, and at what price; and (b) the grantor controls (through ownership, beneficial entitlement or otherwise) any significant residual interest in the infrastructure at the end of the term of the arrangement are accounted for under Philippine Interpretation IFRIC 12, *Service Concession Arrangements.* Infrastructures used in a public-to-private service concession arrangement for its entire useful life (whole-of-life assets) are within the scope of the Interpretation if the conditions in (a) are met.

The Interpretation applies to both: (a) infrastructure that the entity in the Group construct or acquire from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the entity in the Group access for the purpose of the service arrangement.

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

The Group's power concession right pertains to the right granted by the Government to the Parent Company, through APEC, to operate and maintain the franchise of Albay Electric Cooperative, Inc. (ALECO). The Group's power concession right is carried at cost less accumulated amortization and any accumulated impairment losses.

The useful life of power concession right is assessed to be either finite or indefinite. Power concession right arising from a service concession arrangement is amortized using straight-line method over the concession period, which is 25 years from the first day of the commencement of operations, or the estimated useful lives of the infrastructure, whichever is shorter, and assessed for impairment whenever there is an indication that the asset may be impaired. The amortization period and method are reviewed at least at each reporting date. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense is recognized in the consolidated statements of income in the expense category consistent with the function of the concession assets.

The power concession right is derecognized on disposal or when no further economic benefits are expected from its use or disposal. Gain or loss from derecognition of the power concession right is measured as the difference between the net disposal proceeds and the carrying amount of the asset, and is recognized in the consolidated statements of income.

An entity recognizes and measures revenue in accordance with PAS 11 and PAS 18 for the services it performs. If an entity performs more than one service under a single contract or arrangement, consideration received or receivable is allocated by reference to the relative fair values of the services delivered when the amounts are separately identifiable.

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

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

When the applicable entity has contractual obligations to fulfill as a condition of its license: (i) to maintain the infrastructure to a specified level of serviceability; or (ii) 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 the contractual obligations in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, i.e., at the best estimate of the expenditure that would be required to settle the present obligation at the reporting date.

In accordance with PAS 23, *Borrowing Costs*, borrowing costs attributable to the arrangement are recognized as expenses in the period in which they are incurred unless the applicable entities have 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.

Concession payable is recognized at the date of inception of the concession agreement. Fixed concession fees are recognized at present value using the discount rate at the inception date. This account is debited upon payment of fixed fees and such payments are apportioned between interest payment and payment of the principal. Interest arising from the accretion of concession payable is presented under "Interest expense and other financing charges" account in the consolidated statements of income.

Concession payable that are expected to be settled within 12 months after the reporting date are classified as current liabilities. Otherwise, these are classified as noncurrent liabilities.

*Mining Rights*

The Group's mining rights have finite lives and are carried at cost less accumulated amortization and any accumulated impairment losses.

Subsequent expenditures are capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures are recognized in the consolidated statements of income as incurred.

Amortization of mining rights is recognized in the consolidated statements of income based on the units of production method utilizing only recoverable coal reserves as the depletion base. In applying the units of production method, amortization is normally calculated using the quantity of material extracted from the mine in the period as a percentage of the total quantity of material to be extracted in current and future periods based on proved and probable reserves. The amortization of mining rights will commence upon commercial operations.

Gain or loss from derecognition of mining rights is measured as the difference between the net disposal proceeds and the carrying amount of the asset, and is recognized in the consolidated statements of income.

<u>Deferred Exploration and Development Costs</u>

Deferred exploration and development costs comprise of expenditures which are directly attributable to:

- Researching and analyzing existing exploration data;
- Conducting geological studies, exploratory drilling and sampling;
- Examining and testing extraction and treatment methods; and
- Compiling pre-feasibility and feasibility studies.

Deferred exploration and development costs also include expenditures incurred in acquiring mining rights, entry premiums paid to gain access to areas of interest and amounts payable to third parties to acquire interests in existing projects.

Exploration assets are reassessed on a regular basis and tested for impairment provided that at least one of the following conditions is met:

- the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;

- such costs are expected to be recouped in full through successful development and exploration of the area of interest or alternatively, by its sale; or

- exploration and evaluation activities in the area of interest have not yet reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in relation to the area are continuing, or planned for the future.

If the project proceeds to development stage, the amounts included within deferred exploration and development costs are transferred to property, plant and equipment.

Impairment of Non-financial Assets

The carrying amounts of investments and advances, property, plant and equipment, deferred exploration and development costs and intangible assets with finite useful lives are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill are tested for impairment annually either individually or at the cash-generating unit level. If any such indication exists, and if the carrying amount exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of fair value less costs to sell and value in use. The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the consolidated statements of income in those expense categories consistent with the function of the impaired asset.

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

Fair Value Measurements

The Group measures a number of financial and non-financial assets and liabilities at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either: (a) in the principal market for the asset or liability; or (b) in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or most advantageous market must be accessible to the Group.

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

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

- Level 3: inputs for the asset or liability that are not based on observable market data.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing the categorization at the end of each reporting period.

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

Provisions

Provisions are recognized when: (a) the Group has a present obligation (legal or constructive) as a result of past events; (b) it is probable (i.e., more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate of the amount of the obligation can be made. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognized as a separate asset only when it is virtually certain that reimbursement will be received. The amount recognized for the reimbursement shall not exceed the amount of the provision. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

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 the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

*ARO*. The Company records a provision for asset retirement costs of its power plants. Asset retirement costs are provided at the present value of expected costs to settle the obligation using estimated cash flows and are recognized as part of property, plant and equipment. The cash flows are discounted at a current pre-tax rate that reflects the risks specific to the retirement liability. The unwinding of the discount is expensed as incurred and recognized in the consolidated statements of income as "Interest expense and other financing charges". The estimated future costs of asset retirement are reviewed annually and adjusted prospectively. Changes in the estimated future costs or in the discount rate applied are added to or deducted from the cost of the power plants. If the decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognized immediately in the statement of income.

Capital Stock and Additional Paid-in Capital

*Common Shares.* Common shares are measured at par and are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

*Additional Paid-in Capital.* When the shares are sold at premium, the difference between the proceeds and the par value is credited to the "Additional paid-in capital" account in the consolidated statements of financial position. When shares are issued for a consideration other than cash, the proceeds are measured by the fair value of the consideration received. In case the shares are issued to extinguish or settle the liability of the Parent Company, the shares are measured either at the fair value of the shares issued or fair value of the liability settled, whichever is more reliably determinable.

Undated Subordinated Capital Securities

Undated subordinated capital securities (USCS) are classified as equity when there is no contractual obligation to deliver cash or other financial assets to another person or entity or to exchange financial assets or financial liabilities with another person or entity that is potentially unfavorable to the issuer.

Incremental costs directly attributable to the issuance of USCS are recognized as a deduction from equity, net of tax. The proceeds received, net of any directly attributable transaction costs, are credited to USCS.

Retained Earnings

Retained earnings represent the accumulated net income or losses, net of any dividend, distributions and other capital adjustments. Appropriated retained earnings represent that portion which is restricted and therefore not available for any dividend declaration.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. Revenues are stated at amounts invoiced to customers, inclusive of pass-through charges, net of value-added tax (VAT) and other taxes.

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

*Sale of Power.* Revenue from power generation and trading is recognized in the period when actual power or capacity is generated, transmitted and/or made available to the customers, net of related discounts and adjustments.

*Retail and Other Power-related Services.* Revenues are recognized upon the supply of electricity to the customers. The Uniform Filing Requirements on the rate unbundling released by the Energy Regulatory Commission (ERC) on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) system loss charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) currency exchange rate adjustments, where applicable and (h) interclass and life subsidies. Feed-in tariffs allowance, VAT, local franchise tax and universal charges are billed and collected on behalf of the national and local government and do not form part of the Group's revenue. Generation, transmission and system loss charges, which are part of revenues, are pass-through charges.

*Others*

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

Management income is recognized when earned in accordance with the terms of the agreement.

Rent income from operating lease is recognized on a straight-line basis over the related lease terms. Lease incentives granted are recognized as an integral part of the total rent income over the term of the lease.

Construction revenue related to the Group's recognition of intangible asset on the right to operate and maintain the franchise of ALECO, which is the fair value of the intangible asset, is earned and recognized as the construction progresses. The Group recognizes the corresponding amount as intangible asset as it recognizes the construction revenue. The Group assumes no profit margin in earning the right to operate and maintain the franchise of ALECO.

The Group uses the cost to cost percentage-of-completion method to determine the appropriate amount of revenue to be recognized in a given period. The stage of completion is measured by reference to the costs incurred related to the construction of ALECO infrastructure up to the end of the reporting period as a percentage of total estimated cost of the construction.

Cost and Expense Recognition

*Costs and Expenses.* Costs and expenses are decreases in economic benefits during the reporting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. Cost of power sold is debited for the direct costs related to power generation, retail and distribution of electricity, and/or trading. Expenses are recognized when incurred.

*Interest Expense and Other Financing Charges.* Interest expense and other financing charges comprise finance charges on finance lease liabilities, loans, concession payable and other borrowings. Finance charges on finance lease liabilities, loans, and concession payable are recognized in consolidated statements of income using the effective interest rate method.

Leases

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

(a) there is a change in contractual terms, other than a renewal or extension of the arrangement;

(b) a renewal option is exercised or an extension is granted, unless the term of the renewal or extension was initially included in the lease term;

(c) there is a change in the determination of whether fulfillment is dependent on a specific asset; or

(d) there is a substantial change to the asset.

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

*Finance Lease*

Finance leases, which transfer to the Group substantially all the risks and rewards incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Obligations arising from plant assets under finance lease agreement are classified in the consolidated statements of financial position as finance lease liabilities.

Lease payments are apportioned between financing charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Financing charges are recognized in the consolidated statements of income.

Capitalized leased assets are depreciated over the estimated useful lives of the assets when there is reasonable certainty that the Group will obtain ownership by the end of the lease term.

*Operating Lease*

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

*Group as Lessor.* Leases where the Group does not transfer substantially all the risks and rewards of ownership of the assets are classified as operating leases. Rent income from operating leases is recognized as income on a straight-line basis over the lease term. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as rent income. Contingent rents are recognized as income in the period in which they are earned.

<u>Borrowing Costs</u>

Borrowing costs directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use.

<u>Employee Benefits</u>

*Short-term Employee Benefits.* Short-term employee benefits are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

*Retirement Costs.* The net defined benefit retirement liability or asset is the aggregate of the present value of the amount of future benefit that employees have earned in return for their service in the current and prior periods, reduced by the fair value of plan assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of economic benefits available in the form of reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit retirement obligation is actuarially determined using the projected unit credit method. Projected unit credit method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning projected salaries of employees. Actuarial gains and losses are recognized in full in the period in which they occur in other comprehensive income. Such actuarial gains and losses are also immediately recognized in equity and are not reclassified to profit or loss in subsequent period.

Defined benefit costs comprise the following:

- Service costs
- Net interest on the net defined benefit retirement liability or asset
- Remeasurements of net defined benefit retirement liability or asset

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in the consolidated statements of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuary.

Net interest on the net defined benefit retirement liability or asset is the change during the period as a result of contributions and benefit payments, which is determined by applying the discount rate based on the government bonds to the net defined benefit retirement liability or asset. Net interest on the net defined benefit retirement liability or asset is recognized as expense or income in the consolidated statements of income.

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

When the benefits of a plan are changed, or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in the consolidated statements of income. The Group recognizes gains and losses on the settlement of a defined benefit retirement plan when the settlement occurs.

Foreign Currency Translations

Transactions in foreign currencies are translated to the functional currency of the Group at exchange rates at the dates of the transactions. Monetary assets and monetary liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the reporting date.

Nonmonetary assets denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date the fair value was determined. Nonmonetary items in foreign currencies that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on translation are recognized in the consolidated statements of income.

Taxes

*Current Tax.* Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Group periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretations and establishes provisions where appropriate.

*Deferred Tax.* Deferred tax is recognized using the liability method in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

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

- with respect to taxable temporary differences associated with investments in shares of stock of subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits - Minimum Corporate Income Tax (MCIT) and unused tax losses - Net Operating Loss Carry Over (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except:

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

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

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

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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

Current and deferred tax are recognized in the consolidated statements of income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

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

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

- where the tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and

- receivables and payables that are stated with the amount of tax included.

The net amount of tax recoverable from, or payable to, the taxation authority is included as part of "Prepaid expenses and other current assets" or "Accounts payable and accrued expenses" accounts in the consolidated statements of financial position.

Assets Held for Sale
Noncurrent assets, or disposal groups comprising assets and liabilities, are classified as held for sale if their carrying amount will be recovered primarily through sale rather than through continuing use.

The assets or disposal groups are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a *pro rata* basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property or biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognized in the consolidated statements of income. Gains are not recognized in excess of any cumulative impairment losses.

The criteria for held for sale is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the sale will be made or that the sale will be withdrawn.

Property and equipment once classified as held for sale are not amortized or depreciated. In addition, equity accounting of equity accounted investees ceases once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately as current items in the consolidated statements of financial position.

Related Parties
Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control. Related parties may be individuals or corporate entities. Transactions between related parties are on an arm's length basis in a manner similar to transactions with non-related parties.

Basic and Diluted Earnings Per Common Share (EPS)
Basic EPS is computed by dividing the net income for the period attributable to equity holders of the Parent Company, net of distributions to the holders of USCS, by the weighted average number of issued and outstanding common shares during the period, with retroactive adjustment for any stock dividends declared.

Diluted EPS is computed in the same manner, adjusted for the effect of all potential dilutive debt or equity instruments.

As of December 31, 2017, 2016 and 2015, the Group has no dilutive equity instruments as disclosed in Note 29 to the consolidated financial statements.

Operating Segments
The Group's operating segments are organized and managed separately according to the services provided, with each segment representing a strategic business unit that offers different economic characteristic and activities. Financial Information on operating segments is presented in Note 5 to the consolidated financial statements. The Chief Executive Officer (the chief operating decision maker; CODM) reviews management reports on a regular basis.

The measurement policies the Group used for segment reporting under PFRS 8 are the same as those used in the consolidated financial statements. There have been no changes in the measurement methods used to determine reported segment profit or loss from prior periods. All inter-segment transfers are carried out at arm's length prices.

Segment revenues, expenses and performance include sales and purchases between business segments. Such sales and purchases are eliminated in consolidation.

Contingencies
Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to the consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements when an inflow of economic benefits is probable.

Events After the Reporting Date
Post year-end events that provide additional information about the Group's financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the consolidated financial statements when material.

## 4. Use of Judgments, Estimates and Assumptions

The preparation of the consolidated financial statements in accordance with PFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the amounts of assets, liabilities, income and expenses reported in the consolidated financial statements at the reporting date. However, uncertainty about these judgments, estimates and assumptions could result in an outcome that could require a material adjustment to the carrying amount of the affected asset or liability in the future.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions are recognized in the period in which the judgments and estimates are revised and in any future period affected.

Judgments

In the process of applying the accounting policies, the Group has made the following judgments, apart from those involving estimations, which have an effect on the amounts recognized in the consolidated financial statements:

*Finance Lease - Group as Lessee.* The Independent Power Producer Administration (IPPA) Agreements with the Power Sector Assets and Liabilities Management Corporation (PSALM) provide the Group with a right to receive a transfer of the power plant upon termination of the IPPA Agreement at the end of the cooperation period or in case of buy-out. In accounting for the Group's IPPA Agreements, the Group's management has made a judgment that the IPPA Agreements are agreements that contain a lease.

The Group's management has also made a judgment that it has substantially acquired all the risks and rewards incidental to the ownership of the power plants. Accordingly, the Group accounted for the agreements as a finance lease and recognized the power plants and finance lease liabilities at the present value of the agreed monthly payments to PSALM (Notes 6 and 13).

Finance lease liabilities recognized in the consolidated statements of financial position amounted to P154,793,690 and P170,089,536 as of December 31, 2017 and 2016, respectively (Notes 6, 30 and 31).

The combined carrying amounts of power plants under finance lease amounted to P172,573,492 and P177,759,894 as of December 31, 2017 and 2016, respectively (Note 13).

*Operating Lease Commitments - Group as Lessor/Lessee.* The Group has entered into various lease agreements either as a lessor or a lessee. The Group had determined that it retains all the significant risks and rewards of ownership of the property leased out on operating leases while the significant risks and rewards for property leased from third parties and related parties are retained by the lessors (Note 6).

Rent income recognized in the consolidated statements of income amounted to P10,686, P21,147 and P28,104 in 2017, 2016 and 2015, respectively (Notes 6 and 26).

Rent expense recognized in the consolidated statements of income amounted to P376,499, P351,091 and P360,091 in 2017, 2016 and 2015, respectively (Notes 6 and 25).

*Applicability of Philippine Interpretation IFRIC 12.* In accounting for the Group's transactions in connection with its Concession Agreement with ALECO, significant judgment was applied to determine the most appropriate accounting policy to use.

Management used Philippine Interpretation IFRIC 12 as guide and determined that the Concession Agreement is within the scope of the Interpretation. Management determined that the consideration receivable, in exchange for the fulfillment of the Group's obligation under the Concession Agreement, is an intangible asset in the form of a right (license) to charge fees to users. Judgment was further exercised by management in determining the costs components of acquiring the right (Notes 3, 6 and 15).

*Power Concession Right.* The Group's power concession right represents the right to operate and maintain the franchise of ALECO; i.e., the right to collect electricity fees from the consumers of ALECO. At the end of the concession period, all assets and improvements shall be returned to ALECO and any additions and improvements to the system shall be transferred to ALECO.

Difference in judgment in respect to the accounting treatment of the transactions would materially affect the assets, liabilities and operating results of the Group.

*Classification of Joint Arrangements.* The Group has determined that it has rights only to the net assets of the joint arrangements based on the structure, legal form, contractual terms, and other facts and circumstances of the arrangement. As such, the Group classified its joint arrangements in Angat Hydropower Corporation (AHC) and KWPP Holdings Corporation (KWPP) as joint venture (Note 12).

*Adequacy of Tax Liabilities.* The Group takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Group believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretation of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Group to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

*Classifying Financial Instruments*. The Group exercises judgments in classifying a financial instrument, or its component parts, on initial recognition as a financial asset, a financial liability, or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial asset or liability. The substance of a financial instrument, rather than its legal form, governs its classification in the consolidated statements of financial position.

*Contingencies.* The Group is currently involved in various pending claims and cases which could be decided in favor of or against the Group. The Group's estimate of the probable costs for the resolution of these pending claims and cases has been developed in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these matters and is based on an analysis of potential results. The Group currently does not believe that these pending claims and cases will have a material adverse effect on its financial position and financial performance. It is possible, however, that future financial performance could be materially affected by the changes in the estimates or in the effectiveness of strategies relating to these proceedings (Note 33).

Estimates and Assumptions

The key estimates and assumptions used in the consolidated financial statements are based upon the Group's evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from such estimates.

*Fair Value Measurements.* A number of the Group's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities.

The Group has an established control framework with respect to the measurement of fair values. This includes a valuation team that has the overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values. The valuation team regularly reviews significant unobservable inputs and valuation adjustments. If third party information is used to measure fair values, then the valuation team assesses the evidence obtained to support the conclusion that such valuations meet the requirements of PFRS, including the level in the fair value hierarchy in which such valuations should be classified.

The Group uses market observable data when measuring the fair value of an asset or liability. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques (Note 3).

If the inputs used to measure the fair value of an asset or a liability can be categorized in different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy based on the lowest level input that is significant to the entire measurement.

The Group recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

The methods and assumptions used to estimate the fair values for both financial and non-financial assets and liabilities are discussed in Note 31.

*Allowance for Impairment Losses on Trade and Other Receivables.* Provisions are made for specific and groups of accounts, where objective evidence of impairment exists. The Group evaluates these accounts on the basis of factors that affect the collectability of the accounts. These factors include, but are not limited to, the length of the Group's relationship with the customers and counterparties, the current credit status based on third party credit reports and known market forces, average age of accounts, collection experience and historical loss experience. The amount and timing of the recorded expenses for any period would differ if the Group made different judgments or utilized different methodologies. An increase in the allowance for impairment losses would increase the recorded selling and administrative expenses and decrease current assets.

The allowance for impairment losses on trade and other receivables amounted to P2,451,818 as of December 31, 2017 and 2016. The carrying amount of trade and other receivables amounted to P20,435,068 and P22,342,846 as of December 31, 2017 and 2016, respectively (Note 8).

*Write-down of Inventory.* The Group writes-down the cost of inventory to net realizable value whenever net realizable value becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made of the amount the inventories are expected to be realized. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the reporting date to the extent that such events confirm conditions existing at the reporting date.

The Group assessed that no write-down of inventories to net realizable value is necessary as of December 31, 2017 and 2016.

The carrying amount of inventories amounted to P3,147,668 and P2,272,289 as of December 31, 2017 and 2016, respectively (Note 9).

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

In addition, estimation of the useful lives of property, plant and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of property, plant and equipment would increase the recorded cost of power sold and selling and administrative expenses and decrease noncurrent assets.

Property, plant and equipment, net of accumulated depreciation and amortization, amounted to P250,961,307 and P246,488,027 as of December 31, 2017 and 2016, respectively. Accumulated depreciation and amortization of property, plant and equipment amounted to P42,776,912 and P36,822,438 as of December 31, 2017 and 2016, respectively (Note 13).

*Estimating Coal Reserves.* Coal reserve estimates are based on measurements and geological interpretation obtained from natural outcrops, trenches, tunnels and drillholes. In contrast with "coal resource" estimates, profitability of mining the coal during a defined operating period or "mine-life" is a necessary attribute of "coal reserve". Proven reserves estimates are attributed to future development projects only where there is a significant commitment to project funding and execution and for which applicable governmental and regulatory approvals have been secured or are reasonably certain to be secured. All proven reserve estimates are subject to revision, either upward or downward, based on new information, such as from block grading and production activities or from changes in economic factors, including product prices, contract terms or development plans. Estimates of reserves for undeveloped areas are subject to greater uncertainty over their future life than estimates of reserves for areas that are substantially developed and depleted.

The Philippine Department of Energy (DOE) is the government agency authorized to implement coal operating contracts (COC) and regulate the operation of contractors pursuant to DOE Circular No. 81-11-10: Guidelines for Coal Operations in the Philippines. For the purpose of the 5-year development and production program required for each COC, the agency classifies coal reserves, according to increasing degree of uncertainty, into (i) positive, (ii) probable, and (iii) inferred. The DOE also prescribes the use of "total in-situ reserves" as the sum of positive reserves and 2/3 of probable reserve; and "mineable reserve" as 60% of total in-situ reserve for underground, and 85% for surface (including open-pit) coal mines (Note 14).

*Recoverability of Deferred Exploration and Development Costs.* A valuation allowance is provided for estimated unrecoverable deferred exploration and development costs based on the Group's assessment of the future prospects of the mining properties, which are primarily dependent on the presence of economically recoverable reserves in those properties.

The Group's mining activities remain in the preparatory stages as of December 31, 2017. All related costs and expenses from the mining activities are currently deferred as exploration and development costs, which will be amortized upon commencement of commercial operations. The Group has not identified any facts and circumstances which suggest that the carrying amount of the deferred exploration and development costs exceeded the recoverable amounts as of December 31, 2017 and 2016.

Deferred exploration and development costs amounted to P699,001 and P693,379 as of December 31, 2017 and 2016, respectively (Note 14).

*Estimated Useful Lives of Intangible Assets.* The useful lives of intangible assets are assessed at the individual asset level as having either a finite or an indefinite life. Intangible assets are regarded to have an indefinite useful life when, based on analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group.

The Group estimates the useful life of intangible assets with finite useful life based on the period over which the asset are expected to be available for use. The estimated useful life of intangible asset with finite useful life is reviewed periodically and is updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

In addition, estimation of the useful life of intangible assets with finite useful life is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful life of intangible assets with finite useful life would increase recorded cost and expenses and decrease noncurrent assets.

There is no change in estimated useful lives of property, plant and equipment, intangible assets with finite useful lives and investment property based on management's review at the reporting date.

Intangible assets with finite useful lives such as mining rights and computer software and licenses amounted to P1,803,386 and P1,874,279 as of December 31, 2017 and 2016, respectively (Note 15).

Intangible assets with indefinite useful life amounted to P8,866 as of December 31, 2017 and 2016 (Note 15).

*Estimated Useful Lives of Intangible Assets - Power Concession Right.* The Group estimates the useful life of power concession right based on the period over which the assets are expected to be available for use. The Group has not included any renewal period on the basis of uncertainty of the probability of securing renewal contract at the end of the original contract term as of the reporting date.

The amortization period and method are reviewed when there are changes in the expected term of the contract or the expected pattern of consumption of future economic benefits embodied in the asset.

The carrying amount of power concession right amounted to P781,884 and P688,974 as of December 31, 2017 and 2016, respectively (Notes 6 and 15).

*Impairment of Goodwill.* The Group determines whether the goodwill acquired in business combination is impaired at least annually. This requires the estimation of value in use of the cash-generating units to which the goodwill is allocated. Estimating value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and to choose a suitable discount rate to calculate the present value of those cash flows.

The carrying amount of goodwill amounted to P8,866 as of December 31, 2017 and 2016 (Note 15).

*Acquisition Accounting.* At the time of acquisition, the Group considers whether the acquisition represents an acquisition of a business or a group of assets. The Group accounts for an acquisition as a business combination if it acquires an integrated set of business processes in addition to the group of assets acquired.

The Group accounts for acquired businesses using the acquisition method of accounting which requires that the assets acquired and the liabilities assumed are recognized at the date of acquisition based on their respective fair values.

The application of the acquisition method requires certain estimates and assumptions concerning the determination of the fair values of acquired intangible assets and property, plant and equipment as well as liabilities assumed at the acquisition date. Moreover, the useful lives of the acquired intangible assets and property, plant and equipment have to be determined. Accordingly, for significant acquisitions, the Group obtains assistance from valuation specialists. The valuations are based on information available at the acquisition date.

The carrying amount of goodwill and mining rights as a result of the business combination amounted to P8,866 and P1,719,726, respectively, as of December 31, 2017 and 2016 (Note 15).

*Realizability of Deferred Tax Assets.* The Group reviews its deferred tax assets at each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Group's assessment on the recognition of deferred tax assets on deductible temporary differences and carryforward benefits of MCIT and NOLCO is based on the projected taxable income in the following periods.

Deferred tax assets arising from MCIT and NOLCO have not been recognized because the management believes that it is not probable that future taxable income will be available against which the Group can utilize the benefits therefrom (Note 27).

Deferred tax assets from temporary differences amounted to P1,316,926 and P2,955,570 as of December 31, 2017 and 2016, respectively (Note 27).

*Impairment of Non-financial Assets.* PFRS requires that an impairment review be performed on investments and advances, property, plant and equipment, deferred exploration and development costs and intangible assets with finite useful lives when events or changes in circumstances indicate that the carrying amounts may not be recoverable. Determining the recoverable amounts of these assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable amounts and any resulting impairment loss could have a material adverse impact on the financial performance.

The Group assessed that its non-financial assets are not impaired as of December 31, 2017 and 2016.

The combined carrying amounts of investments and advances, property, plant and equipment, deferred exploration and development costs and intangible assets with finite useful lives amounted to P270,866,709 and P265,990,113 as of December 31, 2017 and 2016, respectively (Notes 12, 13, 14 and 15).

*Present Value of Defined Benefit Retirement Obligation.* The present value of the defined benefit retirement obligation depends on a number of factors that are determined on an actuarial basis using a number of assumptions. These assumptions are described in Note 21 to the consolidated financial statements and include discount rate and salary increase rate.

The Group determines the appropriate discount rate at the end of each reporting period. It is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the retirement obligations. In determining the appropriate discount rate, the Group considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid. The terms to maturity of these bonds should approximate the terms of the related retirement obligation.

Other key assumptions for the defined benefit retirement obligation are based in part on current market conditions.

While it is believed that the Group's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Group's defined benefit retirement obligation.

The present value of defined benefit retirement obligation amounted to P78,104 and P69,364 as of December 31, 2017 and 2016, respectively (Note 21).

*ARO.* Determining ARO requires estimation of the costs of dismantling and restoring leased properties to their original condition. The Group recognizes an obligation to retire the power plants of SMCPC and SCPC at the end of their respective lease term or operating life, whichever comes earlier. This represents the best estimate of the expenditures required to settle the present obligation, as adjusted for the effects of inflation, at the end of the current reporting date. Such cost estimates, expressed at current price levels at the date of the estimate, are discounted using the credit-adjusted risk-free rate of 8.371% at reporting date to take into account the timing of payments. Changes in ARO 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 in the related asset.

While the Group has made its best estimate in establishing the asset retirement obligation, because of potential changes in technology as well as safety and environmental requirements, plus the actual time scale to complete the retirement activities, the ultimate provision requirements could either increase or decrease significantly from the Group's current estimates.

The Group's ARO presented under "Other noncurrent liabilities" account in the consolidated statements of financial position amounted to P157,632 as at December 31, 2017.

## 5. Segment Information

Operating Segments

The Group's operations are segmented into four businesses: a) power generation, b) retail and other power-related services, c) coal mining and d) others consistent with the reports prepared internally for use by the Group's CODM in reviewing the business performance of the operating segments. The differing economic characteristics and activities of these power plants make it more useful to users of the consolidated financial statements to have information about each component of the Group's profit or loss, assets and liabilities.

The coal mining companies, which were acquired in 2010, have not yet started commercial operations and remain in the preparatory stages of mining activities (Note 14). The mining companies' total assets do not exceed 10% of the combined assets of all operating segments. Accordingly, management believes that as of December 31, 2017 and 2016, the information about this component of the Group would not be useful to the users of the consolidated financial statements.

Segment Assets and Liabilities

Segment assets include all operating assets used by a segment except investments and advances, intangible assets and goodwill and deferred tax assets. Segment liabilities include all operating liabilities except long-term debt, deferred tax liabilities and income tax payable. Capital expenditures consist of additions to property, plant and equipment of each reportable segment.

Inter-segment Transactions

The Group's inter-segment sales are accounted for based on contracts entered into by the parties and are eliminated in the consolidation. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transactions are eliminated in consolidation.

The Group operates only in the Philippines which is treated as a single geographical segment.

*Major Customers*

The Group sells, retails and distributes power, through power supply agreements, retail supply contracts, concession agreement and other power-related service agreements (Note 6), either directly to customers (other generators, distribution utilities, electric cooperatives and industrial customers) or through the Philippine Wholesale Electricity Spot Market (WESM). Sale, retail and/or distribution of power to individual external customers that represents 10% or more of the Group's total revenues is as follows:

| | **2017** | 2016 | 2015 |
|---|---|---|---|
| Manila Electric Company (Meralco) | **P43,404,148** | P39,565,977 | P40,889,098 |
| WESM | **4,467,399** | 4,153,980 | 6,217,243 |

For management reporting purposes, the Group's operating segments are organized and managed separately as follows:

Operating Segments

Financial information about reportable segments follows:

| | For the Years Ended December 31 | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Power Generation | | | Retail and Other Power-related Services | | | Coal Mining | | | Others | | | Eliminations | | | Consolidated | | |
| | **2017** | 2016 | 2015 | **2017** | 2016 | 2015 | **2017** | 2016 | 2015 | **2017** | 2016 | 2015 | **2017** | 2016 | 2015 | **2017** | 2016 | 2015 |
| **Revenues** | | | | | | | | | | | | | | | | | | |
| External | **P70,494,762** | P72,250,309 | P73,849,465 | **P12,295,813** | P5,722,121 | P3,657,226 | **P -** | P - | P - | **P -** | P - | P - | **P -** | P - | P - | **P82,790,575** | P77,972,430 | P77,506,691 |
| Inter-segment | **14,258,684** | 8,964,899 | 6,769,834 | **98,501** | 14,629 | - | **-** | - | - | **309,330** | 132,000 | - | **(14,666,515)** | (9,111,528) | (6,769,834) | **-** | - | - |
| | **84,753,446** | 81,215,208 | 80,619,299 | **12,394,314** | 5,736,750 | 3,657,226 | **-** | - | - | **309,330** | 132,000 | - | **(14,666,515)** | (9,111,528) | (6,769,834) | **82,790,575** | 77,972,430 | 77,506,691 |
| **Costs and Expenses** | | | | | | | | | | | | | | | | | | |
| Cost of power sold | **56,942,906** | 48,198,409 | 51,933,914 | **11,694,501** | 5,711,781 | 3,723,643 | **-** | - | - | **-** | - | - | **(14,958,644)** | (8,907,750) | (6,757,630) | **53,678,763** | 45,002,440 | 48,899,927 |
| Selling and administrative expenses | **4,763,396** | 6,111,655 | 4,791,985 | **218,091** | 849,499 | 226,397 | **22,663** | 28,495 | 17,831 | **2,177,596** | 1,599,204 | 1,294,215 | **(2,346,214)** | (2,349,203) | (1,426,293) | **4,835,532** | 6,239,650 | 4,904,135 |
| | **61,706,302** | 54,310,064 | 56,725,899 | **11,912,592** | 6,561,280 | 3,950,040 | **22,663** | 28,495 | 17,831 | **2,177,596** | 1,599,204 | 1,294,215 | **(17,304,858)** | (11,256,953) | (8,183,923) | **58,514,295** | 51,242,090 | 53,804,062 |
| **Segment Result** | **P23,047,144** | P26,905,144 | P23,893,400 | **P481,722** | (P824,530) | (P292,814) | **(P22,663)** | (P28,495) | (P17,831) | **(P1,868,266)** | (P1,467,204) | (P1,294,215) | **P2,638,343** | P2,145,425 | P1,414,089 | **P24,276,280** | P26,730,340 | P23,702,629 |
| Interest income | | | | | | | | | | | | | | | | **460,958** | 200,502 | 414,444 |
| Gain on sale of power plant and other equipment | | | | | | | | | | | | | | | | **-** | 116,357 | - |
| Equity in net losses of associates and joint ventures | | | | | | | | | | | | | | | | **(40,396)** | (294,795) | (528,445) |
| Interest expense and other financing charges | | | | | | | | | | | | | | | | **(13,244,581)** | (12,354,229) | (13,130,252) |
| Other income (charges) - net | | | | | | | | | | | | | | | | **2,944,165** | (6,881,754) | (5,926,050) |
| Income tax expense - net | | | | | | | | | | | | | | | | **(6,179,510)** | (3,365,759) | (2,703,408) |
| **Consolidated Net Income** | | | | | | | | | | | | | | | | **P8,216,916** | P4,150,662 | P1,828,918 |

| | For the Years Ended December 31 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Power Generation** | | **Retail and Other Power-related Services** | | **Coal Mining** | | **Others** | | **Eliminations** | | **Consolidated** | |
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| **Other Information** | | | | | | | | | | | | |
| Segment assets | **P317,738,519** | P300,511,384 | **P4,791,648** | P2,765,423 | **P723,848** | P734,328 | **P36,352,591** | P34,520,658 | **(P29,965,804)** | (P26,355,752) | **P329,640,802** | P312,176,041 |
| Investments and advances - net | **9,836,060** | 9,832,438 | **177,219** | 196,723 | **-** | - | **53,297,475** | 52,595,284 | **(46,689,623)** | (46,378,991) | **16,621,131** | 16,245,454 |
| Intangible assets and goodwill - net | | | | | | | | | | | **2,594,136** | 2,572,119 |
| Deferred tax assets | | | | | | | | | | | **1,316,926** | 2,955,570 |
| **Consolidated Total Assets** | | | | | | | | | | | **P350,172,995** | P333,949,184 |
| Segment liabilities | **P219,179,600** | P232,894,743 | **P5,262,850** | P3,704,565 | **P788,714** | P776,554 | **P1,460,026** | P751,230 | **(P34,488,425)** | (P30,084,673) | **P192,202,765** | P208,042,419 |
| Long-term debt | | | | | | | | | | | **90,728,701** | 66,323,726 |
| Income tax payable | | | | | | | | | | | **151,906** | 127,198 |
| Deferred tax liabilities | | | | | | | | | | | **7,324,111** | 4,785,217 |
| **Consolidated Total Liabilities** | | | | | | | | | | | **P290,407,483** | P279,278,560 |
| Capital expenditures | **P8,870,396** | P14,849,968 | **P -** | P - | **P -** | P - | **P41,135** | P12,165 | **P -** | P - | **P8,911,531** | P14,862,133 |
| Depreciation and amortization of property, plant and equipment and intangible assets | **5,911,084** | 6,201,578 | **31,005** | 25,639 | **10,760** | 15,229 | **112,082** | 99,485 | **-** | - | **6,064,931** | 6,341,931 |
| Noncash items other than depreciation and amortization | **693,563** | 7,755,076 | **(19,846)** | 779,891 | **1** | (3) | **72,807** | 769,731 | **-** | - | **746,525** | 9,304,695 |

## 6. Significant Agreements and Lease Commitments

a. Independent Power Producer (IPP) Administration (IPPA) Agreements

As a result of the biddings conducted by PSALM for the Appointment of the IPP Administrator for the capacity of the following power plants, the Group was declared the winning bidder to act as IPP Administrator through the following appointed subsidiaries:

| Subsidiary | Power Plant | Location |
|---|---|---|
| SMEC | Sual Coal - Fired Power Station (Sual Power Plant) | Sual, Pangasinan Province |
| SPDC | San Roque Hydroelectric Multi-purpose Power Plant (San Roque Power Plant) | San Roque, Pangasinan Province |
| SPPC | Ilijan Natural Gas - Fired Combined Cycle Power Plant (Ilijan Power Plant) | Ilijan, Batangas Province |

The IPPA Agreements are with the conformity of the National Power Corporation (NPC), a government-owned and controlled corporation created by virtue of Republic Act (RA) No. 6395, as amended, whereby NPC confirms, acknowledges, approves and agrees to the terms of the IPPA Agreements and further confirms that for so long as it remains the counterparty of the IPP, it will comply with its obligations and exercise its rights and remedies under the original agreement with the IPP at the request and instruction of PSALM.

The IPPA Agreements include, among others, the following common salient rights and obligations:

i. the right and obligation to manage and control the capacity of the power plant for its own account and at its own cost and risks;

ii. the right to trade, sell or otherwise deal with the capacity (whether pursuant to the spot market, bilateral contracts with third parties or otherwise) and contract for or offer related ancillary services, in all cases for its own account and at its own cost and risks. Such rights shall carry the rights to receive revenues arising from such activities without obligation to account therefore to PSALM or any third party;

iii. the right to receive a transfer of the power plant upon termination of the IPPA Agreement at the end of the cooperation period or in case of buy-out;

iv. for SMEC and SPPC, the right to receive an assignment of NPC's interest in existing short-term bilateral power supply contracts;

v. the obligation to supply and deliver, at its own cost, fuel required by the IPP and necessary for the Sual Power Plant to generate the electricity required to be produced by the IPP;

vi. maintain the performance bond in full force and effect with a qualified bank; and

vii. the obligation to pay PSALM the monthly payments and energy fees in respect of all electricity generated from the capacity, net of outages.

Relative to the IPPA Agreements, SMEC, SPDC and SPPC have to pay PSALM monthly payments for 15 years until October 1, 2024, 18 years until April 26, 2028 and 12 years until June 26, 2022, respectively. Energy fees amounted to P23,726,459, P20,477,903 and P23,224,178 in 2017, 2016 and 2015, respectively (Note 24). SMEC and SPDC renewed their performance bonds in United States dollar (US$) amounting to US$58,187 and US$20,305 which will expire on November 3, 2018 and January 25, 2018, respectively. Subsequently, the performance bond of SPDC was renewed up to January 25, 2019.

On June 16, 2015, SPPC renewed its performance bond amounting to US$60,000 with a validity period of one year. This performance bond was subsequently drawn by PSALM on September 4, 2015 which is subject to an ongoing case (Note 33).

The finance lease liabilities are carried at amortized cost using the US dollar and Philippine peso discount rates as follows:

| | US Dollar | Philippine Peso |
|---|---|---|
| SMEC | 3.89% | 8.16% |
| SPPC | 3.85% | 8.05% |
| SPDC | 3.30% | 7.90% |

The discount determined at inception of the agreement is amortized over the period of the IPPA Agreement and recognized as part of "Interest expense and other financing charges" account in the consolidated statements of income. Interest expense amounted to P9,074,226, P9,667,662 and P10,212,753 in 2017, 2016 and 2015, respectively.

The future minimum lease payments for each of the following periods are as follows:

| **2017** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$255,784** | **P12,771,279** | **P12,249,270** | **P25,020,549** |
| More than 1 year and not later than 5 years | **1,114,370** | **55,640,495** | **53,374,792** | **109,015,287** |
| Later than 5 years | **567,483** | **28,334,431** | **27,214,567** | **55,548,998** |
| | **1,937,637** | **96,746,205** | **92,838,629** | **189,584,834** |
| Less: Future finance charges on finance lease liabilities | **244,014** | **12,183,624** | **22,607,520** | **34,791,144** |
| Present values of finance lease liabilities | **US$1,693,623** | **P84,562,581** | **P70,231,109** | **P154,793,690** |

| 2016 | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$252,950 | P12,576,692 | P12,112,310 | P24,689,002 |
| More than 1 year and not later than 5 years | 1,117,374 | 55,555,827 | 53,512,338 | 109,068,165 |
| Later than 5 years | 820,263 | 40,783,474 | 39,326,292 | 80,109,766 |
| | 2,190,587 | 108,915,993 | 104,950,940 | 213,866,933 |
| Less: Future finance charges on finance lease liabilities | 310,216 | 15,423,939 | 28,353,458 | 43,777,397 |
| Present values of finance lease liabilities | US$1,880,371 | P93,492,054 | P76,597,482 | P170,089,536 |

The present values of minimum lease payments for each of the following periods are as follows:

| **2017** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$196,709** | **P9,821,652** | **P7,022,779** | **P16,844,431** |
| More than 1 year and not later than 5 years | **963,978** | **48,131,431** | **39,493,581** | **87,625,012** |
| Later than 5 years | **532,936** | **26,609,498** | **23,714,749** | **50,324,247** |
| | **US$1,693,623** | **P84,562,581** | **P70,231,109** | **P154,793,690** |

| 2016 | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$191,961 | P9,544,293 | P6,799,953 | P16,344,246 |
| More than 1 year and not later than 5 years | 770,562 | 38,312,364 | 24,671,265 | 62,983,629 |
| Later than 5 years | 917,848 | 45,635,397 | 45,126,264 | 90,761,661 |
| | US$1,880,371 | P93,492,054 | P76,597,482 | P170,089,536 |

b. Market Participation Agreements (MPA)

SMEC, SPDC, SPPC and SCPC entered into a MPA with the Philippine Electricity Market Corporation (PEMC) to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. Under the WESM Rules, the cost of administering and operating the WESM shall be recovered through a charge imposed on all WESM members or transactions, as approved by the ERC. PEMC's market fees charged to SMEC, SPDC, SPPC and SCPC recognized in the consolidated statements of income amounted to P146,550, P160,669 and P219,681 in 2017, 2016 and 2015, respectively (Note 25).

Market fees charged to SCPC during its testing and commissioning phase, recognized as part of CPIP under the "Property, plant and equipment" account in the consolidated statements of financial position, amounted to P531 as of December 31, 2016 (Note 13).

In March 2013, SMELC entered into a MPA for Supplier as Direct WESM Member - Customer Trading Participant Category with the PEMC to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. SMELC has a standby letter of credit, expiring on December 26, 2018, to secure the full and prompt performance of obligations for its transactions as a Direct Member and trading participant in the WESM.

c. Power Supply Agreements (PSA)

SMEC, SPPC, SPDC, SMCPC and SCPC have PSA with various counterparties, including related parties, to sell electricity produced by the power plants. Most of the agreements provide for renewals or extensions subject to mutually agreed terms and conditions by the parties and applicable rules and regulations.

Certain customers, particularly electric cooperatives and industrial customers, are billed using energy-based pricing, such as time-of-use (TOU), flat generation rate or fixed energy rate, while others are billed at capacity-based rate. As stipulated in the contracts, each energy-based customer has to pay based on actual energy consumption using the basic energy charge and/or adjustments. For capacity-based contracts, the customers are charged with the capacity fees based on the contracted capacity plus the energy fees for the associated energy taken during the month.

SMEC, SPPC, SPDC, SMCPC and SCPC can also purchase power from WESM and other power generation companies during periods when the power generated from the power plants is not sufficient to meet customers' power requirements. Power purchases amounted to P10,725,490, P7,836,564 and P8,330,550 in 2017, 2016 and 2015, respectively (Note 24).

The PSA of SPI with Petron Corporation (Petron), an entity under common control, was terminated effective December 23, 2016 pursuant to the sale of SPI's power plant to Petron (Note 13).

d. Memorandum of Agreement (MOA) with San Roque Power Corporation (SRPC)

On December 6, 2012, SPDC entered into a 5-year MOA with SRPC to sell a portion of the capacity of the San Roque Power Plant. Under the MOA, i) SRPC shall purchase a portion of the capacity sourced from the San Roque Power Plant; ii) SRPC shall pay a settlement amount to SPDC for the capacity; and iii) the MOA may be earlier terminated or extended subject to terms and mutual agreement of the parties. As of December 31, 2017, SPDC and SRPC are finalizing the extension of the MOA until March 25, 2020.

Revenue from sale of capacity of the San Roque Power Plant amounted to P944,139, P758,134 and P1,274,893 in 2017, 2016 and 2015, respectively, and was recognized as part of "Revenues" account in the consolidated statements of income (Note 23).

e. Coal Supply Agreements

SMEC, SMCPC and SCPC have supply agreements with various coal suppliers for the coal requirements of the power plants.

f. Operations and Maintenance (O&M) Services Agreement

In exchange for the O&M services rendered by Petron, SPI pays for all the documented costs and expenses incurred in relation to the operation, maintenance and repair of its 4 x 35 MW Limay Co-generation Solid Fuel-fired Power Plant (Limay Co-gen Power Plant). The agreement is effective for 25 years from September 2013 until 2038 and was terminated upon sale of SPI's power plant to Petron on December 23, 2016 (Note 13).

g. Retail Supply Contracts

SMELC and SCPC have retail supply contracts with contestable customers, including related parties, to supply or sell electricity either produced by SCPC or purchased from WESM, SMEC or other affiliate power generators. Most contracts provide for renewals or extensions subject to terms and conditions mutually agreed upon by the parties and applicable rules and regulations.

Certain contestable customers are billed using energy-based pricing, such as TOU, flat generation rate or fixed energy rate, while others are billed at capacity-based rates. As stipulated in the contracts, each energy-based customer has to pay based on actual energy consumption using the basic energy charge and/or adjustments. For capacity-based contracts, the customers are charged with the capacity fees based on the contracted capacity plus the energy fees for the associated energy taken during the month.

h. Distribution Wheeling Service (DWS) Agreements

SMELC and SCPC, related to its Retail Electricity Supplier (RES) licenses, entered into DWS Agreements with certain Distribution Utilities (DU) for the conveyance of electricity through its distribution systems in order to meet the demand of the contestable customers. The agreements are valid and binding upon execution unless terminated by either party.

The DWS charges from the DUs are passed on to its customers as mandated by ERC thru the “Single-Billing Policy”.

i. Lease Agreements

*Group as Lessee*

i. The Group has operating lease agreements with San Miguel Properties, Inc., an entity under common control, for a period of 1 to 6 years which is renewable annually or upon agreement between parties.

ii. SPI subleases its plant premises from New Ventures Realty Corporation (NVRC), an entity under common control. The existing lease agreement is for a 25-year period up to September 30, 2038, subject to renewal. The yearly rental is subject to an automatic 3.0% per annum escalation rate for the 4 years following the negotiation under the lease terms. Pursuant to the sale of power plant to Petron, all agreements between SPI and Petron and its subsidiaries were terminated effective December 23, 2016.

iii. SMEC entered into a lease agreement with Challenger Aero Air Corporation (Challenger), an entity under common control, for the lease of certain aircrafts for a period of 1 year from October 1, 2014 to September 30, 2015. The lease agreement was pre-terminated on April 30, 2015.

   Subsequently, SMEC entered into a new lease agreement with Challenger for the lease of the same aircrafts for a period of 1 year from May 1, 2015 to April 30, 2016. The lease agreement was renewed up to December 31, 2017.

iv. In November 2015, SCPC leased parcels of land from NVRC for the construction of its 2 x 150 MW Circulating Fluidized Bed (CFB) Coal-fired Power Plant (Phase I Limay Power Plant) and ash dump facility. This is covered by two lease agreements, each having an initial term of 25 years with an option to renew for a further 25 years. The agreements contain a clause allowing annual escalation adjustments of rental rates starting on certain anniversary dates.

v. On December 7, 2015, LPPC leased a parcel of land from NVRC for the construction of its 2 x 150 MW CFB Coal-fired Power Plant (Phase II Limay Power Plant) for a period of 25 years from the effective date with an option to renew this lease for another 25 years. The rent shall be increased annually by 6.0% starting from the second anniversary of the lease execution. The lease agreement was assigned to SCPC pursuant to the sale of the Phase II Limay Power Plant on June 22, 2017.

vi. DAMI leases a parcel of land in General Santos City with SMC. The existing lease agreement is for a 10-year period up to June 30, 2023, subject to renewal. The rent is subject to an automatic 10.0% per annum escalation rate. Rent for the year, capitalized in "Deferred exploration and development costs" account in the consolidated statements of financial position, amounted to P490 and P402 as of December 31, 2017 and 2016, respectively (Note 14).

vii. In 2016, SMCPC entered into an agreement with Kyron Landholdings Inc. for the sublease of a parcel of land for the construction, erection and installation of its 2 x 150 MW CFB Coal-fired Power Plant in Malita, Davao Occidental (Malita Power Plant). The initial term of the lease is for a period of 25 years with the option to renew for a further 25 years. Beginning January 1, 2018 until the end of the term, the rental shall be increased by 5.1% per annum.

viii. On December 13, 2017, SCPC leased a foreshore area of 465,967 square meters from the Department of Environment and Natural Resources for the construction of pier and jetty facility. The lease is for a period of 25 years with an option to renew for another 25 years. The agreement contains a clause to increase annual rental based on appraised value of land and improvements every 10 years.

Relative to the lease agreements, the Group was required to pay advance rental and security deposits which are included under "Trade and other receivables - net" or "Prepaid expenses and other current assets" accounts in the consolidated statements of financial position (Notes 8 and 10).

Future minimum lease payments under the non-cancellable operating lease agreements are as follows:

| | **2017** | 2016 |
|---|---:|---:|
| Not later than 1 year | **P88,782** | P119,335 |
| More than 1 year and not later than 5 years | **357,321** | 244,067 |
| Later than 5 years | **2,293,501** | 1,871,061 |
| | **P2,739,604** | P2,234,463 |

Rent expense recognized in the consolidated statements of income amounted to P376,499, P351,091 and P360,091 in 2017, 2016 and 2015, respectively (Notes 4 and 25).

*Group as Lessor*

i. In 2014, the Parent Company has an operating sub-lease agreement with Clariden Holdings, Inc., an entity under common control, for a period of 2 years which is renewable upon agreement between the parties. The agreement expired on December 31, 2016.

ii. In May 2011, GPII entered into an agreement with NVRC, for the lease of certain parcels of land located in Limay, Bataan with a total area of 612,193 square meters. The lease term is for a period of 10 years up to May 2021, with an option to renew not later than 6 months prior to expiration and a 3.0% escalation rate of the rental every year from signing of the contract. This Agreement was subsequently amended, reducing the leased area to 340,646 square meters effective October 1, 2013. This was further amended reducing the leased area to 130,980 square meters and with a corresponding reduction in the monthly rental effective on December 1, 2016. On June 20, 2017, NVRC assigned its leasehold rights to Petron.

    There are no restrictions imposed on these lease agreements such as those concerning dividends, additional debt and further leasing.

Future minimum lease receivables under the non-cancellable operating lease agreements are as follows:

| | **2017** | 2016 |
|---|---|---|
| Not later than 1 year | **P6,187** | P6,007 |
| More than 1 year and not later than 5 years | **15,705** | 21,892 |
| | **P21,892** | P27,899 |

Rent income recognized under the "Miscellaneous income (charges) - net" account in "Other income (charges)" account in the consolidated statements of income amounted to P10,686, P21,147, and P28,104 in 2017, 2016 and 2015, respectively (Notes 4 and 26).

j. Concession Agreement

The Parent Company entered into a 25-year Concession Agreement with ALECO on October 29, 2013. It became effective upon confirmation of the National Electrification Administration on November 7, 2013.

On January 24, 2014, the Parent Company and APEC entered into an Assignment Agreement whereby APEC assumed all the rights, interests and obligations of the Parent Company under the Concession Agreement effective January 2, 2014.

The Concession Agreement include, among others, the following rights and obligations:

i. as Concession Fee, APEC shall pay to ALECO: (1) separation pay of ALECO employees in accordance with the Concession Agreement and (2) the amount of P2,100 every quarter for the upkeep of residual ALECO (fixed concession fee);

ii. if the net cash flow of APEC is positive within 5 years or earlier from date of signing of the Concession Agreement, 50% of the Net Cash Flow each month shall be deposited in an escrow account until the cumulative nominal sum reaches P4,048,529;

iii. on the 20th anniversary of the Concession Agreement, the concession period may be extended by mutual agreement between ALECO and APEC; and

iv. at the end of the concession period, all assets and system, as defined in the Concession Agreement, shall be returned by APEC to ALECO in good and usable condition. Additions and improvements to the system shall likewise be transferred to ALECO.

In this regard, APEC shall provide services within the franchise area and shall be allowed to collect fees and charges, as approved by the ERC. APEC formally assumed operations as concessionaire on February 26, 2014.

The Group recognized as intangible assets all costs directly related to the Concession Agreement. The intangible assets consist of: a) concession rights, which include fixed concession fees and separation pay of ALECO employees amounting to P384,317. Fixed concession fees are recognized at present value using the discount rate at the inception date with a corresponding concession payable recognized; and b) infrastructure, which includes the costs of structures and improvements, distribution system and equipment. Cost of infrastructure amounted to P509,419 and P386,083 as of December 31, 2017 and 2016, respectively. Interest expense on concession payable is included as part of "Interest expense and other financing charges" account in the consolidated statements of income amounted to P5,993, P6,127 and P6,254 in 2017, 2016 and 2015, respectively. Amortization of concession assets recognized in the "Depreciation and amortization" account in the consolidated statements of income amounted to P30,426, P25,060 and P21,296 in 2017, 2016 and 2015, respectively.

Maturities of the carrying amount of concession payable are as follows:

| | **2017** | 2016 |
|---|---|---|
| Not later than 1 year | **P2,549** | P2,407 |
| More than 1 year and not later than 5 years | **11,794** | 11,136 |
| Later than 5 years | **87,876** | 91,083 |
| | **P102,219** | P104,626 |

Power concession assets consist of:

| | **Concession Rights** | **Completed Projects/Others** | **Asset Under Construction** | **Total** |
|---|---|---|---|---|
| **Cost** | | | | |
| January 1, 2016 | P384,317 | P159,086 | P - | P543,403 |
| Additions | - | 72,824 | 154,173 | 226,997 |
| December 31, 2016 | 384,317 | 231,910 | 154,173 | 770,400 |
| Additions | - | 115,055 | 8,281 | 123,336 |
| **December 31, 2017** | **384,317** | **346,965** | **162,454** | **893,736** |
| **Accumulated Depreciation and Amortization** | | | | |
| January 1, 2016 | 28,184 | 7,722 | - | 35,906 |
| Additions | 15,373 | 30,147 | - | 45,520 |
| December 31, 2016 | 43,557 | 37,869 | - | 81,426 |
| Additions | 15,373 | 15,053 | - | 30,426 |
| **December 31, 2017** | **58,930** | **52,922** | **-** | **111,852** |
| **Carrying Amount** | | | | |
| December 31, 2016 | P340,760 | P194,041 | P154,173 | P688,974 |
| **December 31, 2017** | **P325,387** | **P294,043** | **P162,454** | **P781,884** |

The Group accounted for revenue and costs relating to construction or upgrade services in accordance with PAS 11 based on the stage of completion of work performed. The fair value of the construction and upgrade services provided is equal to the recorded cost of the intangible asset built up from day one until the construction activity ceases. Construction revenue and construction cost amounted to P123,336, P226,997 and P47,091 in 2017, 2016 and 2015, respectively (Note 26).

## 7. Cash and Cash Equivalents

Cash and cash equivalents consist of:

| | ***Note*** | **2017** | 2016 |
|---|---|---|---|
| Cash in banks and on hand | | **P3,557,558** | P2,089,297 |
| Short-term investments | | **25,097,801** | 19,402,088 |
| | *30, 31* | **P28,655,359** | P21,491,385 |

Cash in banks earn interest at bank deposit rates. Short-term investments include demand deposits which can be withdrawn at anytime depending on the immediate cash requirements of the Group and earn interest at short-term investment rates. Interest income from cash and cash equivalents amounted to P374,509, P176,681 and P261,338 in 2017, 2016 and 2015, respectively.

## 8. Trade and Other Receivables

Trade and other receivables consist of:

| | ***Note*** | **2017** | 2016 |
|---|---|---|---|
| Trade | | **P14,332,102** | P12,269,984 |
| Non-trade | | **6,674,594** | 6,613,459 |
| Amounts owed by related parties | *6, 20* | **1,880,190** | 5,911,221 |
| | | **22,886,886** | 24,794,664 |
| Less allowance for impairment losses | *4* | **2,451,818** | 2,451,818 |
| | *30, 31* | **P20,435,068** | P22,342,846 |

Trade and other receivables are non-interest bearing, unsecured and are generally on a 30-day term or an agreed collection period. The balance of trade receivables is inclusive of VAT on the sale of power collectible from customers.

The movements in the allowance for impairment losses are as follows:

| | **2017** | 2016 |
|---|---|---|
| Balance at beginning of year | **P2,451,818** | P1,241,487 |
| Impairment losses during the year | **-** | 1,210,451 |
| Amounts written-off | **-** | (120) |
| Balance at end of year | **P2,451,818** | P2,451,818 |

Impairment losses are recognized in profit or loss as follows:

| | ***Note*** | 2016 | 2015 |
|---|---|---|---|
| Selling and administrative expenses | *25* | P958,784 | P142,658 |
| Other income (charges) - net | *26* | 251,667 | 232,143 |
| | | P1,210,451 | P374,801 |

No impairment loss on trade and other receivables was recognized during the current year.

The aging of trade and other receivables as of December 31 are as follows:

| | **2017** | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Trade** | **Non-trade** | **Amounts Owed by Related Parties** | **Total** | Trade | Non-trade | Amounts Owed by Related Parties | Total |
| Current | **P6,824,541** | **P647,896** | **P1,106,847** | **P8,579,284** | P5,576,247 | P1,031,133 | P5,282,075 | P11,889,455 |
| Past due: | | | | | | | | |
| 1-30 days | **934,933** | **68,034** | **161,730** | **1,164,697** | 671,466 | 73,200 | 8,900 | 753,566 |
| 31-60 days | **410,187** | **71,377** | **6,362** | **487,926** | 505,682 | 62,467 | 27,134 | 595,283 |
| 61-90 days | **184,690** | **1,001** | **2,414** | **188,105** | 201,448 | 10,207 | 31,563 | 243,218 |
| Over 90 days | **5,977,751** | **5,886,286** | **602,837** | **12,466,874** | 5,315,141 | 5,436,452 | 561,549 | 11,313,142 |
| | **P14,332,102** | **P6,674,594** | **P1,880,190** | **P22,886,886** | P12,269,984 | P6,613,459 | P5,911,221 | P24,794,664 |

Past due trade receivables more than 30 days pertain mainly to output VAT. The Group believes that the unimpaired amounts that are past due and those that are neither past due nor impaired are still collectible based on historical payment behavior and analyses of the underlying customer credit ratings. There are no significant changes in their credit quality. There were no write-offs and reversals in 2017.

Non-trade receivables include the following:

a. Due from PSALM amounting to US$60,000 which pertains to SPPC's performance bond pursuant to the Ilijan IPPA Agreement that was drawn by PSALM on September 4, 2015. The validity of PSALM's action is the subject of an ongoing case filed by SPPC with the Regional Trial Court (RTC) of Mandaluyong City (Note 33).

b. As of December 31, 2017 and 2016, SMEC has receivables for the cost of fuel, market fees, and other charges related to the dispatch of the excess capacity of the Sual Power Plant amounting to P41,413 and P37,568, respectively. Likewise, SMEC has receivables arising from WESM transactions related to the excess capacity amounting to P1,198,200 and P1,245,819 as of December 31, 2017 and 2016, respectively. The issue on excess capacity is subject of ongoing cases (Note 33).

c. On June 16, 2011, SMEC entered into a MOA with Hardrock Coal Mining Pty Ltd. (HCML) and Caason Investments Pty Ltd. (Caason), companies registered in Australia, for the acquisition of shares in HCML. SMEC paid Caason Australian dollars 12,000 (equivalent to P550,000), for an option to subscribe to the shares in HCML (the Deposit) with further option for SMEC to decide not to pursue its investment in HCML, which will result in the return of the Deposit to SMEC plus interest. In a letter dated July 15, 2011, SMEC notified Caason and HCML that it shall not pursue the said investment and therefore asked Caason and HCML for the return of the Deposit with corresponding interest (the Amount Due), pursuant to the terms of the MOA.

On September 2, 2014, SMEC, HCML and Caason agreed to a schedule of payment of the outstanding Amount Due to SMEC. For the years ended December 31, 2017 and 2016, HCML and Caason paid a total amount of P18,925 and nil, respectively. As of December 31, 2017 and 2016, total outstanding receivables from HCML (net of allowance for impairment losses) amounted to nil and P7,145, respectively.

d. The balance mainly pertains to receivables from customers which will be remitted to the Government upon collection.

## 9. Inventories

Inventories at cost consist of:

| | *Note* | 2017 | 2016 |
|---|---|---|---|
| Coal | *6* | **P2,910,853** | P2,120,657 |
| Fuel oil | *20* | **110,858** | 84,885 |
| Materials and supplies | | **96,793** | 53,322 |
| Other consumables | | **29,164** | 13,425 |
| | *4* | **P3,147,668** | P2,272,289 |

There were no inventory write-downs to net realizable value for the years ended December 31, 2017 and 2016. Inventories charged to cost of power sold amounted to P13,039,144, P10,046,687 and P10,376,590 in 2017, 2016 and 2015, respectively (Note 24).

## 10. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of:

| | *Note* | 2017 | 2016 |
|---|---|---|---|
| Input VAT | | **P11,792,871** | P12,398,635 |
| Prepaid tax | | **4,883,278** | 3,735,642 |
| Prepaid rent and others | *6, 20* | **1,115,766** | 1,548,743 |
| | | **P17,791,915** | P17,683,020 |

Input VAT consists of input VAT on purchases of goods and services which can be offset against the output VAT payable (Note 18).

Prepaid tax consists of creditable withholding taxes and excess tax credits which can be used as a deduction against future income tax payable.

Prepaid rent and others pertain to the following:

a. Prepaid rent of the Group from various operating lease agreements amounted to P15,347 and P39,044 as of December 31, 2017 and 2016, respectively (Note 6).

b. PSALM monthly fee outage credits pertain to the approved reduction in future monthly fees payable to PSALM resulting from the outages of the Sual Power Plant in 2017 and 2016.

c. Professional services related to project financing of SCPC for 2016 (Note 19).

## 11. Assets Held For Sale

On September 15, 2016, the BOD of SPI approved the plan to sell certain machinery and equipment. Accordingly, the carrying amount, which is the fair value, of the other equipment amounting to P184,324 was reclassified as "Assets held for sale" account in the consolidated statements of financial position (Note 13). The sale of the machinery and equipment was completed in 2017.

## 12. Investments and Advances

Investments and advances consist of:

| | 2017 | 2016 |
|---|---|---|
| **Investments in Shares of Stock of Associates and Joint Ventures** | | |
| **Cost** | | |
| Balance at beginning of year | **P8,583,462** | P2,074,052 |
| Additions | **-** | 6,509,410 |
| Balance at end of year | **8,583,462** | 8,583,462 |
| **Accumulated Equity in Net Losses** | | |
| Balance at beginning of year | **(886,959)** | (592,164) |
| Equity in net losses during the year | **(28,302)** | (293,113) |
| Adjustment to equity in net losses in prior year [(a)(c)] | **(12,094)** | (1,682) |
| Balance at end of year | **(927,355)** | (886,959) |
| | **7,656,107** | 7,696,503 |
| Advances | **8,965,024** | 8,548,951 |
| | **P16,621,131** | P16,245,454 |

Advances pertain to deposits made for future investment in land holding companies and power-related expansion projects.

The following are the developments relating to the Group's investments in shares of stock of associates and joint ventures:

a. Investment in shares of stock of associates

   i. Olongapo Electricity Distribution Company, Inc. (OEDC)

      In April 2013, SPGC and San Miguel Equity Investments, Inc. (SMEII), an entity under common control, entered into a Deed of Assignment of Subscription Rights whereby SMEII agreed to assign 35% ownership interest in OEDC to SPGC for a consideration of P8,750.

      Subscriptions payable amounted to P28,101 as of December 31, 2017 and 2016, respectively (Note 20).

ii. Mariveles Power Generation Corporation (MPGC)

On June 16, 2016, Meralco Powergen Corporation (MGen), a subsidiary of Meralco, and Zygnet Prime Holdings, Inc. (Zygnet) subscribed to 2,500 and 102 common shares of MPGC, respectively. As a result, the Parent Company now holds 49% of the outstanding capital stock of MPGC while MGen and Zygnet holds 49% and 2%, respectively. MPGC was a wholly-owned subsidiary of the Parent Company prior to the subscription of MGen and Zygnet. Following the change in interest of ownership from 100% to 49% in MPGC, the Parent Company now has significant influence to participate in the financial and operating policy decisions of MPGC and accounts for the investment using the equity method.

MPGC shall develop, construct, finance, own, operate and maintain a 4 x 150 MW CFB Coal-fired Power Plant and associated facilities in Mariveles, Bataan.

On July 13, 2016, the Parent Company subscribed to 9,643,200 shares, representing 49% of the total shares subscribed by all shareholders out of the increase in the authorized capital stock of MPGC, at the subscription price of P100 per share.

On January 9, 2017, the SEC approved the increase in the authorized capital stock of MPGC.

The table below summarizes the financial information of investment in shares of stock of associates which is accounted for using the equity method:

**December 31, 2017 (Unaudited)**

| | **OEDC** | **MPGC** |
|---|---|---|
| **Country of Incorporation** | **Philippines** | **Philippines** |
| Current assets | **P337,757** | **P122,044** |
| Noncurrent assets | **1,175,089** | **1,846,654** |
| Current liabilities | **(687,732)** | **(22,446)** |
| Noncurrent liabilities | **(354,211)** | **-** |
| Net assets | **P470,903** | **P1,946,252** |
| Revenue | **P1,292,324** | **P -** |
| Net losses/total comprehensive losses | **P18,688** | **P10,208** |
| Share in net losses/total comprehensive losses | **P6,541** | **P5,002** |
| Carrying amount of investment | **P177,219**[(a)] | **P953,717** |

*[(a)]This is net of adjustment to equity in net losses of P12,963 based on the 2016 audited balances.*

December 31, 2016 (Audited)

| | OEDC | MPGC |
|---|---|---|
| Country of Incorporation | Philippines | Philippines |
| Current assets | P317,664 | P18,620 |
| Noncurrent assets | 1,181,537 | 1,945,960 |
| Current liabilities | (881,709) | (445) |
| Noncurrent liabilities | (127,901) | - |
| Net assets | P489,591 | P1,964,135 |
| Revenue | P1,323,854 | P - |
| Net losses/total comprehensive losses | P18,771 | P4,334 |
| Share in net losses/total comprehensive losses | P6,570 | P5,851[b] |
| Carrying amount of investment | P196,723 | P958,719 |

*[b]The Group's share in net losses/ total comprehensive losses for the period from June 16, 2016 to December 31, 2016 of MPGC.*

b. Investments in shares of stock of joint ventures

i. AHC and KWPP

The Parent Company, through PVEI, and Korea Water Resources Corporation (K-Water) entered into a joint venture partnership for the acquisition, rehabilitation, operation and maintenance of the 218 MW Angat Hydroelectric Power Plant (Angat Power Plant) awarded by PSALM to K-Water.

On November 18, 2014, PVEI acquired from the individual stockholders and K-Water, 2,817,270 shares or 60% of the outstanding capital stock of AHC and from the individual stockholders, 75 shares representing 60% of KWPP outstanding capital stock.

Subsequently, AHC and KWPP each issued shares in favor of nominee directors of PVEI and K-Water to complete their respective shareholding interest.

In accordance with the entry of PVEI into AHC and KWPP, K-Water and PVEI are jointly in control of the management and operation of AHC and KWPP.

Further, PVEI agreed to pay K-Water a support fee amounting to 3.0% of the total amount of the bridge loan facility which was obtained for the acquisition by AHC of the Angat Power Plant. This was subsequently reduced to 1.5% of the total amount of the bridge loan facility effective August 4, 2015. The obligation to pay support fee terminated on July 15, 2016 with the refinancing of the bridge loan facility.

On July 11, 2016, PVEI, subscribed to 27,724,200 shares, out of the increase in the authorized capital stock of AHC, at the subscription price of P200 per share. Total subscription amounting to P5,544,840 represents PVEI's 60% share in the additional equity infusion required by AHC from its existing stockholders as of date pursuant to AHC's project financing requirements.

AHC

AHC was incorporated on November 15, 2013 and was created to engage in the operations and maintenance of the Angat Power Plant and to supply power generated to power corporations and to electric utilities, to import hydro-electric facilities and equipment, and to do all acts necessary and incidental thereto, in accordance with RA No. 9136 or otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA).

KWPP

KWPP was incorporated on November 27, 2013 and was established for the purpose of acquiring, holding or leasing water and flowage rights.

The table below summarizes the financial information of investments in shares of stock of joint ventures which is accounted for using the equity method:

**December 31, 2017 (Unaudited)**

| | AHC | KWPP |
|---|---|---|
| **Country of Incorporation** | **Philippines** | **Philippines** |
| Current assets | **P2,873,159** | **P5,496** |
| Noncurrent assets | **18,779,052** | **20,253** |
| Current liabilities | **(1,689,697)** | **(8,837)** |
| Noncurrent liabilities | **(11,257,290)** | **(15,850)** |
| Net assets | **P8,705,224** | **P1,062** |
| Revenue | **P2,185,181** | **P -** |
| Net losses/total comprehensive losses | **P27,918** | **P13** |
| Share in net losses/total comprehensive losses | **P16,751** | **P8** |
| Carrying amount of investment | **P6,524,310** | **P861**[c] |

*[c]This is net of adjustment to equity in net income of P1,188 based on the 2016 audited balances, net of unrecognized share in net losses of P319 in 2015 and 2014.*

December 31, 2016 (Audited)

| | AHC | KWPP |
|---|---|---|
| Country of Incorporation | Philippines | Philippines |
| Current assets | P2,784,060 | P3,962 |
| Noncurrent assets | 19,302,652 | 20,391 |
| Current liabilities | (13,333,995) | (7,430) |
| Noncurrent liabilities | (19,576) | (15,850) |
| Net assets | P8,733,141 | P1,073 |
| Revenue | P1,231,068 | P - |
| Net income (losses)/total comprehensive income (losses) | (P489,424) | P1,979 |
| Share in net income (losses)/total comprehensive income (losses) | (P293,655) | P1,188 |
| Carrying amount of investment | P6,541,061 | P - |

Investment in shares of stock of subsidiaries

The following are the developments relating to the subsidiaries:

i. SCPC

In 2013, SCPC started the construction of its Phase I Limay Power Plant (comprising of Units 1 and 2). The 2 Units were successfully synchronized to the Luzon Grid in November 2016 and May 2017, respectively.

On June 22, 2017, SCPC acquired the Phase II Limay Power Plant (comprising of Units 3 and 4) from LPPC. The Unit 3 was synchronized to the Luzon Grid in November 2017 while Unit 4 is still under construction as of December 31, 2017.

Commercial operations of Units 1 and 2 commenced on May 26, 2017 and September 26, 2017, respectively, following the completion of the testing and commissioning phase and the ERC issuance of a Provisional Authority to Operate in favor of SCPC for both units.

ii. SMCPC

In 2013, SMCPC started the construction of its Malita Power Plant. The 2 units were successfully synchronized to the Mindanao Grid in May 2016 and February 2017, respectively.

In 2017, SMCPC deferred the commercial operations of Unit 1 of the power plant until July 25, 2017 which was initially declared to commence on December 26, 2016. This is to conduct further testing of Unit 1 to ensure the stable and reliable operation and readiness of the power plant for its intended use. SMCPC's Unit 1 started commercial operations on July 26, 2017.

On February 26, 2018, SMCPC declared the commercial operations of its Unit 2.

iii. SPI

In 2013, SPI acquired from Petron the 2 x 35 MW Limay Co-gen Power Plant and all other pertinent machineries, equipment, facilities and structures being constructed and installed which comprise the additional 2 x 35 MW Limay Co-gen Power Plant in Bataan.

On September 15, 2016, the BOD of the Parent Company and SPI approved the sale of its 4 x 35 MW Limay Co-gen Power Plant in favor of Petron.

SPI closed the sale of the power plant and all pertinent assets to Petron effective December 23, 2016.

iv. PVEI

In January 2017, PVEI granted shareholder advances amounting to US$31,800 (equivalent to P1,578,870) to its joint venture company, AHC. The advances bear an annual interest rate of 4.50% and are due on April 30, 2017. The due date of the advances may be extended as agreed amongst the parties.

On April 10 and December 27, 2017 PVEI partially collected the foregoing advances amounting to US$19,703 (equivalent to P984,550). Payment date for the remaining balance of the advances amounting to US$12,097 (equivalent to P603,987) was extended to March 31, 2018 (Notes 20, 30 and 31).

On March 1, 2018, PVEI collected an additional US$5,766 (equivalent to P299,366) from AHC as partial payment of the advances.

## 13. Property, Plant and Equipment

Property, plant and equipment consist of:

| | Power Plants (Note 6) | Land and Leasehold Improvements | Other Equipment | Building | Capital Projects in Progress | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| January 1, 2016 | P226,788,832 | P2,996,339 | P1,316,545 | P5,841,443 | P52,426,658 | P289,369,817 |
| Additions | 10,654,500 | 1,054,299 | 730,036 | 31,311 | 2,391,987 | 14,862,133 |
| Disposals/Reclassifications | (12,469,072) | (332,055) | (978,469) | (5,831,097) | (1,126,468) | (20,737,161) |
| Transfers to Assets Held for Sale | - | - | - | - | (184,324) | (184,324) |
| December 31, 2016 | 224,974,260 | 3,718,583 | 1,068,112 | 41,657 | 53,507,853 | 283,310,465 |
| Additions | 112,263 | 715 | 60,252 | - | 8,738,301 | 8,911,531 |
| Reclassifications | 25,458,414 | 234,580 | (446,381) | - | (23,730,390) | 1,516,223 |
| **December 31, 2017** | **250,544,937** | **3,953,878** | **681,983** | **41,657** | **38,515,764** | **293,738,219** |
| **Accumulated Depreciation and Amortization** | | | | | | |
| January 1, 2016 | 32,961,313 | 91,079 | 296,640 | 567,789 | - | 33,916,821 |
| Additions | 5,826,594 | 51,000 | 141,779 | 229,897 | - | 6,249,270 |
| Disposals/Reclassifications | (2,221,036) | (99,617) | (231,534) | (791,466) | - | (3,343,653) |
| December 31, 2016 | 36,566,871 | 42,462 | 206,885 | 6,220 | - | 36,822,438 |
| Additions | 5,811,940 | 43,863 | 95,238 | 3,433 | - | 5,954,474 |
| **December 31, 2017** | **42,378,811** | **86,325** | **302,123** | **9,653** | **-** | **42,776,912** |
| **Carrying Amount** | | | | | | |
| December 31, 2016 | P188,407,389 | P3,676,121 | P861,227 | P35,437 | P53,507,853 | P246,488,027 |
| **December 31, 2017** | **P208,166,126** | **P3,867,553** | **P379,860** | **P32,004** | **P38,515,764** | **P250,961,307** |

a. The combined carrying amounts of power plants under finance lease amounted to P172,573,492 and P177,759,894 as of December 31, 2017 and 2016, respectively (Note 4).

b. The capitalized asset retirement costs, net of accumulated depreciation, amounted to P151,306 as of December 31, 2017.

c. On September 15, 2016, the BOD of the Parent Company and SPI approved the sale of its 4 x 35 MW Limay Co-gen Power Plant located in Petron Bataan Refinery in favor of Petron. Accordingly, the carrying amount of certain property, plant and equipment, amounting to P18,093,254 as of September 30, 2016 were reclassified to "Assets held for sale" account (Note 11). SPI recognized impairment loss of P323,788 at initial classification to measure its assets held for sale at lower of their carrying amount and fair value less costs to sell (Note 26).

   On October 28, 2016, SPI signed an agreement with Petron for the sale of the power plant and all pertinent assets, assignment of contracts to Petron, and the transfer of all remaining inventories, tools, supplies and other working capital necessary for the operation and maintenance of the power plant, among others.

   Effective December 23, 2016, SPI closed the sale of the power plant to Petron for a total consideration of P20,029,983 (inclusive of tax), payable based on the terms of the agreement. Consequently, gain of P114,447 was recognized on the sale and presented as part of "Gain on sale of property, plant and equipment" account in the consolidated statements of income.

   As of December 31, 2016, SPI received P15,966,458 as initial payment, and the remaining P4,063,525 was collected in June 2017 (Notes 8 and 20).

   Pursuant to the sale of the power plant, all SPI agreements mentioned in Note 6 were terminated effective December 23, 2016.

d. Other equipment includes machinery and equipment, transportation equipment, mining equipment, office equipment and furniture and fixtures.

e. Capital projects in progress pertains to the following:

   i. Project of SMCPC for the construction of 2 x 150 MW (Units 1 and 2) Malita Power Plant.

      Following the completion of Unit 1 and the ERC grant of a Provisional Authority to Operate in favor of SMCPC in October 2016, all CPIP costs pertaining to Unit 1 were reclassified to the appropriate property, plant and equipment account. As of December 31, 2017, CPIP pertains to costs of Unit 2 which is still in testing and commissioning phase.

   ii. Projects of SCPC for the construction of 4 x 150MW (Phase I and II) Limay Power Plant.

      Following the completion of Units 1 and 2 and the ERC grant of a Provisional Authority to Operate in favor of SCPC in 2017, all CPIP costs pertaining to Units 1 and 2 were reclassified to the appropriate property, plant and equipment account. As of December 31, 2017, CPIP pertains to costs of Unit 3 which started its testing and commissioning phase in November 2017, and the costs of the ongoing construction of Unit 4.

iii. Plant optimization and pumped-storage hydropower projects of SPDC.

iv. Expenditures for the 500 kilovolts connection facilities in relation to the 600 MW Pagbilao power plant project of CLPPC.

Depreciation and amortization related to property, plant and equipment are recognized in profit or loss as follows:

| | ***Note*** | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Cost of power sold | *24* | **P5,811,941** | P6,139,882 | P6,445,102 |
| Selling and administrative expenses | *25* | **142,533** | 109,388 | 67,983 |
| | | **P5,954,474** | P6,249,270 | P6,513,085 |

Total depreciation and amortization recognized in the consolidated statements of income include amortization of capitalized interest and decommissioning and dismantling costs amounting to P22,451, P10,020 and P13,360 in 2017, 2016 and 2015, respectively.

The Group has borrowing costs amounting to P1,362,871, P610,707 and P105,549 which were capitalized in 2017, 2016 and 2015, respectively. The capitalization rates used to determine the amount of interest eligible for capitalization range from 2.75% to 6.54% and from 3.88% to 6.29% in 2017 and 2016, respectively. The unamortized capitalized borrowing costs amounted to P1,968,151 and P627,126 as of December 31, 2017 and 2016, respectively (Note 19).

## 14. Deferred Exploration and Development Costs

The movement in deferred exploration and development costs is as follows:

| | ***Note*** | **2017** | 2016 |
|---|---|---|---|
| Balance at beginning of year | | **P693,379** | P689,548 |
| Additions | | **5,622** | 3,831 |
| Balance at end of year | *4* | **P699,001** | P693,379 |

Deferred exploration and development costs comprise of expenditures which are directly attributable to the mining activities of DAMI, BERI and SEPC in relation to their respective COC.

In 2010, SMEC acquired DAMI, SEPC and BERI resulting in the recognition of mining rights of P1,719,726 (Notes 4 and 15).

DAMI's coal property covered by COC No. 126, issued by the DOE, is located in South Cotabato consisting of 2 coal blocks with a total area of 2,000 hectares, more or less, and has an In-situ coal resources (measured plus indicated coal resources) of about 93 million metric tons as of December 31, 2017 and 2016.

SEPC has a coal mining property and right over an aggregate area of 7,000 hectares, more or less, composed of 7 coal blocks located in South Cotabato and Sultan Kudarat. As of December 31, 2017 and 2016, COC No. 134 has an In-situ coal resources (measured plus indicated coal resources) of about 35 million metric tons.

BERI's COC No. 138, issued by the DOE is located in Sarangani and South Cotabato consisting of 8 coal blocks with a total area of 8,000 hectares, more or less, and has an In-situ coal resources (measured plus indicated coal resources) of about 24 million metric tons as of December 31, 2017 and 2016.

Status of Operations
In 2006 and 2009, the DOE approved the conversion of the COC for Exploration to COC for Development and Production of DAMI, SEPC and BERI effective on the following dates:

| Subsidiary | COC No. | Effective Date | Term* |
|---|---|---|---|
| DAMI | 126 | November 19, 2006 | 20 years |
| SEPC | 134 | February 23, 2009 | 10 years |
| BERI | 138 | May 26, 2009 | 10 years |

* *The term is followed by another 10-year extension, and thereafter, renewable for a series of 3 year periods not exceeding 12 years under such terms and conditions as may be agreed upon with the DOE.*

On April 27, 2012 and January 26, 2015, the DOE granted the requests by DAMI, SEPC and BERI, for a moratorium on suspension of the implementation of the production timetable as specified under their respective COCs. The request is in connection with a resolution passed by South Cotabato in 2010 prohibiting open-pit mining activities in the area. The moratorium was retrospectively effective from the dates of their respective COCs, when these were converted to Development and Production Phase, until December 31, 2016 or until the ban on open-pit mining pursuant to the Environment Code of South Cotabato has been lifted, whichever comes first. On February 1, 2017, the DOE granted another extension on the moratorium for the 3 COCs valid from January 1, 2017 to December 31, 2017. As of March 9, 2018, DAMI, SEPC and BERI are awaiting DOE's approval of their requests for another extension on the moratorium filed on October 20, 2017.

As of December 31, 2017, the mining activities of DAMI, SEPC and BERI remain in the preparatory stages. All related costs and expenses from exploration are currently deferred as exploration and development costs and will be amortized upon commencement of their commercial operations.

Based on management's assessment, there are no indicators that the carrying amount of the mining rights exceeds its recoverable amount as of December 31, 2017 and 2016.

## 15. Intangible Assets and Goodwill

Intangible assets and goodwill consist of:

| | ***Note*** | **2017** | 2016 |
|---|---|---|---|
| Mining rights | *4, 14* | **P1,719,726** | P1,719,726 |
| Power concession assets - net | *4, 6* | **781,884** | 688,974 |
| Computer software and licenses - net | *4* | **83,660** | 154,553 |
| Goodwill | *4* | **8,866** | 8,866 |
| | | **P2,594,136** | P2,572,119 |

Goodwill
In November 2009 and March 2010, the Parent Company acquired 60% ownership interest in SMEC and SPDC, respectively. As a result of these transactions, the Parent Company recognized goodwill amounting to P8,349 and P517, respectively.

Based on management's assessment, goodwill is not impaired since the recoverable amount of the related net assets of SMEC and SPDC for which the goodwill was attributed still exceeds its carrying amount as of December 31, 2017 and 2016.

Computer Software and Licenses

The movements in computer software and licenses are as follows:

| | *Note* | 2017 | 2016 |
|---|---|---|---|
| **Cost** | | | |
| Balance at beginning of year | | **P229,371** | P184,377 |
| Additions | | **9,138** | 44,994 |
| Balance at end of year | | **238,509** | 229,371 |
| **Accumulated Amortization** | | | |
| Balance at beginning of year | | **74,818** | 7,217 |
| Amortization | *25* | **80,031** | 67,601 |
| Balance at end of year | | **154,849** | 74,818 |
| | | **P83,660** | P154,553 |

## 16. Other Noncurrent Assets

Other noncurrent assets consist of:

| | *Note* | 2017 | 2016 |
|---|---|---|---|
| Restricted cash | *30, 31* | **P5,578,357** | P663,820 |
| Deferred input VAT - net of current portion | | **2,081,126** | 84,876 |
| Amounts owed by related parties | *20, 30, 31* | **199,610** | 227,394 |
| Derivative asset | *20, 30, 31* | **61,903** | - |
| Noncurrent receivables | *30, 31* | **29,488** | 44,681 |
| | | **P7,950,484** | P1,020,771 |

Restricted cash comprises: (a) SCPC's Cash Flow Waterfall accounts (Trust Fund) with a local Trust Company, as required in its Omnibus Loan and Security Agreement (OLSA), amounting to P4,805,175 as of December 31, 2017 (Note 19); (b) the amount received from PEMC totaling to P491,242 and P475,057 as of December 31, 2017 and 2016, respectively, representing the proceeds of sale on WESM for a specific period in 2016, for the electricity generated from the excess capacity of the Sual Power Plant, which SMEC consigned with the RTC of Pasig City (Note 33); and (c) APEC's reinvestment fund for sustainable capital expenditures and contributions collected from customers for membership fees and bill deposits which are refundable amounting to P281,940 and P188,763 as of December 31, 2017 and 2016, respectively.

Amounts owed by related parties mainly pertains to loan granted by SPGC to OEDC which is collectible in equal monthly payments of principal and interest, initially pegged at 4.73% and subject to change every 6 months. The equal monthly payments of OEDC shall be made on the first day of each month commencing in January 2017 until December 2024 (Note 20).

As of December 31, 2017, the deferred input VAT mainly pertains to the input VAT on the purchase of power plant from LPPC in June 2017 (Note 13).

## 17. Loans Payable

Loans payable represents unsecured peso-denominated short-term loan of SMCPC obtained on June 29, 2017 from a local financial institution. Interest rates for the loan ranged from 2.75% to 3.25% in 2017 (Notes 30 and 31).

Interest expense on loans payable amounted to P93,051 (inclusive of P55,371 capitalized in CPIP, Note 13) for the year ended December 31, 2017.

## 18. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of:

| | *Note* | **2017** | 2016 |
|---|---|---|---|
| Trade | *6* | **P14,994,454** | P11,914,211 |
| Non-trade | | **9,693,202** | 19,125,230 |
| Output VAT | | **5,140,417** | 5,569,399 |
| Amounts owed to related parties | *20* | **541,428** | 633,436 |
| Accrued interest | *6, 17, 19* | **427,469** | 283,724 |
| Withholding taxes | | **277,744** | 203,415 |
| | *30, 31* | **P31,074,714** | P37,729,415 |

Trade payables consist of payable related to energy fees, inventories and power purchases. These are generally on a 30-day term and are non-interest bearing.

Non-trade payables include liability relating to power rate adjustments, payables to contractors and other payables to the Government except output VAT and withholding taxes.

Output VAT consists of current and deferred output VAT payable. Deferred output VAT represents the VAT on sale of power which will be remitted to the Government only upon collection from the customers (Note 8).

## 19. Long-term Debt

Long-term debt consists of:

| | *Note* | **2017** | 2016 |
|---|---|---|---|
| **Bonds** | | | |
| Parent Company | | | |
| Peso-denominated | | | |
| Fixed interest rate of 5.3750%, 6.2500% and 6.6250% maturing in 2022, 2024 and 2027, respectively (a) | | **P19,784,249** | P - |
| Fixed interest rate of 4.3458%, 4.7575% and 5.1792% maturing in 2021, 2023 and 2026, respectively (b) | | **14,865,330** | 14,842,563 |
| | | **34,649,579** | 14,842,563 |
| **Term Loans** | | | |
| Parent Company | | | |
| Peso-denominated | | | |
| Fixed interest rate of 6.9265%, with maturities up to 2024 (c) | | **14,856,835** | - |
| Foreign currency-denominated | | | |
| Floating interest rate based on London Interbank Offered Rate (LIBOR) plus margin, maturing in 2018 (d) | | **-** | 34,482,157 |
| Subsidiary | | | |
| Peso-denominated | | | |
| Fixed interest rate of 6.2836% and 6.5362% with maturities up to 2029 (e) | | **41,222,287** | - |
| Foreign currency-denominated | | | |
| Floating interest rate based on LIBOR plus margin, with maturities up to 2022 (f) | | **-** | 16,999,006 |
| | | **56,079,122** | 51,481,163 |
| | *30, 31* | **90,728,701** | 66,323,726 |
| Less current maturities | | **1,139,631** | 1,040,690 |
| | | **P89,589,070** | P65,283,036 |

a. The amount represents the first tranche of the Parent Company's P35,000,000 fixed rate bonds shelf registration. The first tranche, with an aggregate principal amount of P20,000,000, were issued and listed in the Philippine Dealing and Exchange Corp. (PDEx) for trading on December 22, 2017 at the issue price of 100.00% of face value. It comes in three series, with terms and interest rates as follows:

| | **Term** | **Interest Rate Per Annum** |
|---|---|---|
| Series D Bonds | 5 years, due 2022 | 5.3750% |
| Series E Bonds | 7 years, due 2024 | 6.2500% |
| Series F Bonds | 10 years, due 2027 | 6.6250% |

Interest on the Bonds shall be payable quarterly in arrears starting on March 22, 2018, for the first interest payment date, and June 22, September 22, December 22 and March 22 of each year thereafter.

Proceeds from the issuance were used by the Parent Company to refinance its P20,000,000 short-term loans obtained from local banks.

Unamortized debt issue costs amounted to P215,751 as of December 31, 2017. Accrued interest amounted to P23,536 as of December 31, 2017 and interest expense amounted to P29,420 in 2017.

b. The amount represents issuance of the Parent Company of the fixed rate Philippine peso-denominated bonds with an aggregate principal amount of P15,000,000. The Bonds were issued and listed in the PDEx on July 11, 2016 at the issue price of 100.00% of face value in three series with terms and interest rates as follows:

| | **Term** | **Interest Rate Per Annum** |
|---|---|---|
| Series A Bonds | 5 years, due 2021 | 4.3458% |
| Series B Bonds | 7 years, due 2023 | 4.7575% |
| Series C Bonds | 10 years, due 2026 | 5.1792% |

Interest is payable quarterly in arrears starting on October 11, 2016, for the first interest payment date, and January 11, April 11, July 11 and October 11 of each year thereafter.

The net proceeds were used on July 25, 2016 to refinance the US$300,000 short-term loan provided by a local bank of which the proceeds were used for the redemption of the US$300,000 bond in January 2016.

Unamortized debt issue costs amounted to P134,670 and P157,437 as of December 31, 2017 and 2016, respectively. Accrued interest amounted to P127,503 and P159,379 as of December 31, 2017 and 2016, respectively. Interest expense amounted to P708,349 and P336,466 in 2017 and 2016, respectively.

c. The amount represents the availment by the Parent Company of P15,000,000 fixed rate 7-year Term Loan Facility on April 26, 2017 from a local bank. Interest is payable quarterly in arrears on the last day of the agreed interest period. Principal repayment shall be in 13 semi-annual installments starting at the end of the first year from drawdown date. The proceeds were used to fund the payment of the remaining US$300,000 out of the US$700,000 term loan.

Unamortized debt issue costs amounted to P143,165 as of December 31, 2017. Accrued interest amounted to P186,669 as of December 31, 2017 and interest expense amounted to P455,995 in 2017.

d. The amount represents the Parent Company's drawdown of US$500,000 from the US$650,000 5-year term loan Facility Agreement with a syndicate of banks signed on September 9, 2013. Subsequently, on November 15, 2013, the US$650,000 Facility Agreement was amended increasing the loan facility from US$650,000 to US$700,000. The proceeds were used by the Parent Company to refinance the US$200,000 3-year term loan and to finance new investments in power-related assets.

In March 2015, the Parent Company made the final drawdown of US$200,000 for the financing of ongoing construction of power plants in Malita, Davao and Limay, Bataan investments in power-related assets, and for general corporate purposes.

On March 31 and August 31, 2017, the Parent Company prepaid a total of US$400,000 (equivalent to P20,259,000) out of the US$700,000 term loan. The prepayments were funded by short-term loans availed in 2017 from local banks solely for this purpose.

On April 26, 2017, the Parent Company prepaid the remaining US$300,000 (equivalent to P14,911,500), out of the US$700,000 term loan, by availing of a P15,000,000 fixed rate 7-year term loan from a local bank to minimize exposure to foreign exchange losses brought by the continuing peso depreciation against the US dollar.

Unamortized debt issue costs amounted to P321,843 as of December 31, 2016. Accrued interest amounted to P5,128 as of December 31, 2016 and interest expense amounted to P331,817, P921,882 and P734,255 in 2017, 2016 and 2015, respectively.

e. The amount represents the P42,000,000 drawn by SCPC on June 28, 2017 from a P44,000,000 12-year OLSA with a syndicate of banks that was signed on June 22, 2017. The proceeds were used by SCPC for the following purposes:

   i. the settlement of the US$360,000 short-term loan availed on May 8, 2017 from a local bank;

   ii. to fund the acquisition of the Phase II Limay Power Plant, under construction, from LPPC, and

   iii. the repayment of advances by the Parent Company.

   Unamortized debt issue costs amounted to P777,713 as of December 31, 2017. Accrued interest amounted to P17,948 as of December 31, 2017 and interest expense amounted to P1,390,948 in 2017 (inclusive of P872,289 capitalized in CPIP in 2017, Note 13).

   On January 31, 2018, SCPC has drawn the remaining P2,000,000 of the P44,000,000 12-year OLSA.

f. The amount represents the US$400,000 loan facility entered into by SCPC on December 29, 2015. The loan is payable within 7 years up to 2022. Series of drawdowns were made in 2016 for a total of US$359,339 (equivalent to P17,866,304) which included an amount owed to a related party of P2,687,451. Proceeds of the loan were used to finance the construction of the Phase I Limay Power Plant.

   On May 9, 2017, SCPC prepaid the US$359,339 term loan using the proceeds of a US$360,000 (equivalent to P17,949,600) short-term bridge financing loan availed from a local bank solely for this purpose.

   Unamortized debt issue costs amounted to P867,298 as of December 31, 2016. Accrued interest amounted to P50,036 as of December 31, 2016. Interest expense amounted to P378,747 and P519,534 in 2017 and 2016, respectively, (inclusive of P354,731 and P519,534 capitalized in CPIP in 2017 and 2016, respectively, Note 13).

*Valuation Technique for peso-denominated Bonds*
The market value was determined using the market comparison technique. The fair values are based on PDEx. The Bonds are traded in an active market and the quotes reflect the actual transactions in identical instruments.

The fair value of the Bonds, amounting to P35,651,237 and P15,129,886 as of December 31, 2017 and 2016, respectively, has been categorized as Level 1 in the fair value hierarchy based on the inputs used in the valuation techniques (Note 31).

The debt agreements of the Parent Company and SCPC impose a number of covenants including, but not limited to, maintenance of certain financial ratios throughout the duration of the term of the debt agreements. The terms and conditions of the debt agreements also contains negative pledge provision with certain limitations on the ability of the Parent Company and its material subsidiaries and SCPC to create or have outstanding any security interest upon or with respect to any of the present or future business, undertaking, assets or revenue (including any uncalled capital) of the Parent Company or any of its material subsidiaries and SCPC to secure any indebtedness, subject to certain exceptions.

The loan of SCPC is secured by real estate and chattel mortgages on all present and future assets and reserves of SCPC as well as a pledge by the Parent Company of all its outstanding shares of stock in SCPC.

As of December 31, 2017 and 2016, the Group is in compliance with the covenants of the debt agreements.

The movements in debt issue costs are as follows:

| | ***Note*** | **2017** | 2016 |
|---|---|---|---|
| Balance at beginning of year | | **P1,346,578** | P685,839 |
| Additions | | **1,297,703** | 1,142,741 |
| Amortization | | **(1,292,502)** | (369,403) |
| Capitalized amount | *13* | **(80,480)** | (112,599) |
| Balance at end of year | | **P1,271,299** | P1,346,578 |

Repayment Schedule
The annual maturities of the long-term debt are as follows:

| Year | Gross Amount | Debt Issue Costs | Net |
|---|---|---|---|
| 2018 | P1,200,000 | P60,369 | P1,139,631 |
| 2019 | 1,200,000 | 60,871 | 1,139,129 |
| 2020 | 1,620,000 | 170,832 | 1,449,168 |
| 2021 | 8,508,250 | 151,481 | 8,356,769 |
| 2022 | 12,477,960 | 207,849 | 12,270,111 |
| 2023 and thereafter | 66,993,790 | 619,897 | 66,373,893 |
| | P92,000,000 | P1,271,299 | P90,728,701 |

Contractual terms of the Group’s interest bearing loans and borrowings and exposure to interest rate, foreign currency and liquidity risks are discussed in Note 30.

## 20. Related Party Disclosures

The Group, in the normal course of business, purchases products and services from and sells products and renders services to related parties. Transactions with related parties are made at normal market prices and terms. Amounts owed by/owed to related parties are collectible/will be settled in cash. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

The following are the transactions with related parties and the outstanding balances as of December 31:

| | *Note* | Year | Revenues from Related Parties | Purchases from Related Parties | Amounts Owed by Related Parties | Amounts Owed to Related Parties | Terms | Conditions |
|---|---|---|---|---|---|---|---|---|
| SMC | *25* | **2017** | **P215,004** | **P664,262** | **P87,697** | **P9,273** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | P - | P660,590 | P252 | P6,201 | | |
| | *16* | **2017** | **-** | **-** | **61,903** | **-** | More than 1 year; non-interest bearing | Unsecured; no impairment |
| | | 2016 | - | - | - | - | | |
| Entities Under Common Control | *6, 8, 9, 18, 25* | **2017** | **2,365,748** | **1,134,950** | **741,814** | **484,482** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 10,248,500 | 3,300,854 | 1,589,923 | 562,408 | | |
| | *8, 13* | **2017** | **-** | **-** | **-** | **-** | 180 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 17,883,913 | - | 4,063,525 | - | | |
| Associates | *8, 18* | **2017** | **902,864** | **-** | **98,556** | **29,643** | 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 956,610 | 201 | 88,838 | 28,299 | | |
| | *16* | **2017** | **13,458** | **-** | **250,603** | **-** | 9 years; interest bearing | Unsecured; no impairment |
| | | 2016 | 12,929 | - | 254,827 | - | | |
| Joint Venture | | **2017** | **24,183** | **416,058** | **1,937** | **18,522** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 48,357 | 198,244 | 1,929 | 7,741 | | |
| | | **2017** | **64,797** | **-** | **635,163** | **-** | 92 days; interest bearing | Unsecured; no impairment |
| | | 2016 | - | - | - | - | | |
| Associates of Entities Under Common Control | *6, 8, 9* | **2017** | **850,515** | **23,880** | **133,236** | **-** | 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 763,309 | 199,635 | 102,256 | 28,787 | | |
| | *19* | **2017** | **-** | **-** | **-** | **-** | 7 years; interest Bearing | Secured |
| | | 2016 | - | - | - | 2,687,451 | | |
| Others | *8, 18* | **2017** | **45,161** | **-** | **130,794** | **-** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2016 | 84,493 | - | 37,065 | - | | |
| | | **2017** | **P4,481,730** | **P2,239,150** | **P2,141,703** | **P541,920** | | |
| | | 2016 | P29,998,111 | P4,359,524 | P6,138,615 | P3,320,887 | | |

a. Amounts owed by related parties consist of trade and other receivables, derivative asset and security deposits (Notes 8 and 16).

b. Amounts owed to related parties consist of trade and non-trade payables, management fees, purchases of fuel, reimbursement of expenses, rent, insurance and services rendered by related parties, customers' deposits and subscriptions payable to OEDC (Notes 9, 12 and 18).

c. Amounts owed by associates mainly consist of interest bearing loan granted to OEDC included as part of "Trade and other receivables" and "Other noncurrent assets" accounts in the consolidated statements of financial position (Notes 8 and 16).

d. Amounts owed by a joint venture consists of interest bearing loan granted and management fees charged to AHC by PVEI included as part of “Trade and other receivables” accounts in the consolidated statements of financial position (Notes 8, 12 and 26).

e. The amount owed to associate of an entity under common control consists of interest bearing loan obtained from Bank of Commerce included as part of “Long-term debt” account in the consolidated statements of financial position (Note 19).

f. The compensation of key management personnel of the Group, by benefit type, follows:

| | ***Note*** | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Short-term employee benefits | | **P81,537** | P42,432 | P37,226 |
| Retirement cost | *21* | **1,398** | 1,205 | 283 |
| | | **P82,935** | P43,637 | P37,509 |

## 21. Retirement Plan

The Parent Company and SMEC have unfunded, noncontributory, defined benefit retirement plans covering all of their permanent employees. Retirement benefits expense pertains to accrual of expected retirement benefits of active employees in accordance with RA No. 7641, *The Philippine Retirement Law*. Retirement benefits expense and liability is determined using the projected unit credit method. The Group’s latest actuarial valuation date is December 31, 2017. Valuations are obtained on a periodic basis.

The following table shows reconciliation of the net defined benefit retirement obligation and its component:

| | **2017** | 2016 |
|---|---|---|
| **Balance at beginning of year** | **P69,364** | P45,657 |
| **Recognized in Profit or Loss** | | |
| Current service cost | **8,942** | 6,174 |
| Interest cost | **3,711** | 2,214 |
| | **12,653** | 8,388 |
| **Recognized in Other Comprehensive Income** | | |
| Remeasurements: | | |
| Actuarial (gains) losses arising from: | | |
| Experience adjustments | **23,523** | 17,502 |
| Changes in financial assumptions | **(2,514)** | (2,183) |
| Changes in demographic assumptions | **(24,922)** | - |
| | **(3,913)** | 15,319 |
| **Balance at end of year** | **P78,104** | P69,364 |

Defined benefit retirement obligation included as part of “Other noncurrent liabilities” account in the consolidated statements of financial position amounted to P78,104 and P69,364 as of December 31, 2017 and 2016, respectively.

The retirement costs amounting to P12,653, P8,388 and P6,611 in 2017, 2016 and 2015, respectively, are recognized as part of "Salaries, wages and benefits" under "Selling and administrative expenses" account in the consolidated statements of income (Note 25).

The equity reserve for retirement plan as of December 31, 2017 and 2016 includes accumulated net actuarial gains and losses recognized in other comprehensive income, net of related tax, amounting to P23,632 and P26,371, respectively.

The principal actuarial assumptions used to determine retirement benefits are as follows:

| | **2017** | 2016 |
|---|---|---|
| Discount rate | **5.70%** | 4.93% - 5.38% |
| Salary increase rate | **7.00%** | 7.00% |

Assumptions for mortality and disability rates are based on published statistics and mortality and disability tables.

The weighted average duration of the defined benefit retirement obligation ranges from 7.0 to 9.5 years and 8.0 to 9.0 years as of December 31, 2017 and 2016, respectively.

Sensitivity Analysis

As of December 31, 2017 and 2016, the reasonably possible changes to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit retirement obligation by the amounts shown below:

| | **Defined Benefit Retirement Obligation** | | | |
|---|---|---|---|---|
| | **2017** | | 2016 | |
| | **1% Increase** | **1% Decrease** | 1% Increase | 1% Decrease |
| Discount rate | **(P6,791)** | **P7,935** | (P4,151) | P4,558 |
| Salary increase rate | **7,131** | **(6,260)** | 4,063 | (3,793) |

Risks and Management of Risks

The defined benefit retirement obligation exposes the Group to actuarial risks, such as longevity risk and interest rate risk.

The defined benefit retirement obligation is calculated using a discount rate set with reference to government bond yields as such is exposed to market factors including inflation. Higher inflation will lead to higher liability. Also, the defined benefit retirement obligations are to provide benefits for the life of members, so increase in life expectancy will result in an increase in the plan's liability. These risks are managed with the objective of reducing the impact of these risks to the cash flows of the Group.

The Group does not have a formal retirement plan and therefore has no plan assets to match against the liability under the defined benefit retirement obligation. Also, benefit claims under the defined benefit retirement obligation will be paid directly by the Group when they become due.

## 22. Equity

Capital Stock

As of December 31, 2017 and 2016, the Parent Company's authorized capital stock is P2,000,000, divided into 2,000,000,000 common shares with par value of P1 per share.

Capital stock consists of:

| | **2017** | 2016 |
|---|---|---|
| Subscribed capital stock | **P1,250,004** | P1,250,004 |
| Less subscription receivable | **187,500** | 187,500 |
| | **P1,062,504** | P1,062,504 |

The number of shares subscribed is 1,250,004,000 and 1,250,003,500 common shares as of December 31, 2017 and 2016, respectively.

Equity Reserves

In September 2010, the Parent Company acquired the remaining 40% non-controlling ownership interest of SMC in SMEC and SPDC. The difference between the price paid and carrying amount of net assets transferred was recognized in equity.

Retained Earnings

The Parent Company's retained earnings available for dividend declaration, calculated based on the regulatory requirements of the Philippine SEC, amounted to P3,054,068 and P508,785 as at December 31, 2017 and 2016, respectively. The difference between the consolidated retained earnings and the Parent Company's retained earnings available for dividend declaration primarily consist of undistributed earnings of subsidiaries and equity method investees. Stand-alone earnings of the subsidiaries and share in net earnings of equity method investees are not available for dividend declaration by the Parent Company until declared by the subsidiaries and equity investees as dividends.

The Parent Company's BOD declared cash dividends as follows:

December 31, 2016

| Date of Declaration | Stockholders of Record | Date Payable | Dividend Per Share | Amount |
|---|---|---|---|---|
| June 7, 2016 | June 7, 2016 | June 14, 2016 | P1.20 | P1,500,000 |
| August 11, 2016 | August 11, 2016 | August 18, 2016 | 1.20 | 1,500,000 |
| | | | | P3,000,000 |

December 31, 2015

| Date of Declaration | Stockholders of Record | Date Payable | Dividend Per Share | Amount |
|---|---|---|---|---|
| March 25, 2015 | March 25, 2015 | March 31, 2015 | P1.20 | P1,500,000 |
| July 2, 2015 | July 2, 2015 | July 9, 2015 | 1.20 | 1,500,000 |
| November 5, 2015 | November 5, 2015 | November 10, 2015 | 1.20 | 1,500,000 |
| | | | | P4,500,000 |

There were no cash dividend declarations during the year ended December 31, 2017.

*Parent Company*
On December 23, 2015, the BOD approved the appropriation amounting to P7,700,000 for the payment of the US$700,000, 5-year term loan that will mature in September 2018 (Note 19). Reversals during 2015 pertain to: (a) construction of power plant amounting to P2,092,750; (b) interest on bonds payable amounting to P446,250; (c) interest on loans payable amounting to P104,000; and (d) expansion projects amounting to P9,128,000.

In 2017 and 2016, reversals amounted to P1,154,000 and P2,966,000, respectively, for the debt servicing of the US$700,000 loan, as intended.

Total appropriated retained earnings of the Parent Company amounted to P3,580,000, P4,734,000 and P7,700,000 as at December 31, 2017, 2016, and 2015 respectively.

*SMEC, SPPC and SPDC*
On December 23, 2015, the BOD of SMEC, SPPC and SPDC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P4,990,000, P1,806,300 and P352,400, respectively, pursuant to the IPPA Agreements and additional funding requirements on their expansion project.

On December 21, 2016, the BOD of SMEC and SPPC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P1,099,300 and P2,990,300, respectively, pursuant to the IPPA Agreements and additional funding requirements on their expansion project.

On December 18, 2017, the BOD of SMEC, SPPC and SPDC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P2,585,000, P3,514,050 and P474,000, respectively, pursuant to the IPPA Agreements.

The appropriations reversed in 2016 and 2015 were used for the required capital expenditures and fixed monthly payments of SMEC and SPDC to PSALM, as intended.

Total combined appropriated retained earnings of SMEC, SPPC and SPDC amounted to P27,080,250, P20,507,200 and P17,455,600 as at December 31, 2017, 2016 and 2015, respectively.

USCS
The Parent Company issued and listed on the Singapore Stock Exchange the following USCS at an issue price of 100%:

| Date of Issuance | Distribution Payment Date | Initial Rate of Distribution | Step-Up Date | Amount of USCS Issued | Amount in Philippine Peso |
|---|---|---|---|---|---|
| August 26, 2015 | August 26 and February 26 of each year | 6.75% per annum | February 26, 2021 | US$300,000 | P13,823,499 |
| May 7, 2014 | May 7 and November 7 of each year | 7.5% per annum | November 7, 2019 | 300,000 | 13,110,066 |
| | | | | **US$600,000** | **P26,933,565** |

The holders of the USCS have conferred a right to receive distributions on a semi-annual basis from their issuance dates at the initial rate of distribution, subject to the step-up rate. The Parent Company has a right to defer this distribution under certain conditions.

The USCS have no fixed redemption date and are redeemable in whole, but not in part, at the Parent Company's option on step-up date, or any distribution payment date thereafter or upon the occurrence of certain other events at the principal amounts of the USCS plus any accrued, unpaid or deferred distribution.

The proceeds were used by the Parent Company to finance investments in power-related assets and other general corporate purposes.

Details of distributions paid to USCS holders are as follows:

| | **2017** | 2016 | 2015 |
|---|---|---|---|
| February | **P720,611** | P689,223 | P - |
| May | **799,583** | 756,804 | 714,616 |
| August | **729,868** | 681,412 | - |
| November | **824,142** | 777,134 | 736,072 |
| | **P3,074,204** | P2,904,573 | P1,450,688 |

On February 22, 2018, the Parent Company paid distributions to holders of the US$300,000 USCS issued in August 2015, amounting to P746,068.

On March 9, 2018, the Parent Company's BOD approved the payment of distribution in the total amount of US$11,250, plus applicable taxes, on May 7, 2018 to the holders of the US$300,000 USCS issued in May 2014.

## 23. Revenues

Revenues consist of:

| | ***Note*** | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Sale of power | *20* | **P70,494,762** | P72,250,309 | P73,849,465 |
| Retail and other power-related services | *6, 20* | **12,295,813** | 5,722,121 | 3,657,226 |
| | | **P82,790,575** | P77,972,430 | P77,506,691 |

## 24. Cost of Power Sold

Cost of power sold consist of:

| | ***Note*** | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Energy fees | *5, 6* | **P23,726,459** | P20,477,903 | P23,224,178 |
| Coal, fuel oil and other consumables | *5, 6, 9, 20* | **13,039,144** | 10,046,687 | 10,376,590 |
| Power purchases | *5, 6* | **10,725,490** | 7,836,564 | 8,330,550 |
| Depreciation and amortization | *5, 6, 13, 15* | **5,842,367** | 6,164,942 | 6,466,398 |
| Plant operations and maintenance fees | *5, 6, 20* | **345,303** | 476,344 | 502,211 |
| | | **P53,678,763** | P45,002,440 | P48,899,927 |

## 25. Selling and Administrative Expenses

Selling and administrative expenses consist of:

| | *Note* | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Taxes and licenses | | **P945,406** | P982,855 | P946,801 |
| Salaries, wages and benefits | *20, 21* | **708,162** | 361,854 | 222,994 |
| Management fees | *20* | **664,493** | 652,167 | 1,196,789 |
| Rent | *4, 6, 20* | **376,499** | 351,091 | 360,091 |
| Corporate special program | | **349,667** | 384,166 | 245,736 |
| Donations | | **303,426** | 738,980 | 59,781 |
| Depreciation and amortization | *5, 13, 15* | **222,564** | 176,989 | 73,414 |
| Supplies | | **210,687** | 250,200 | 105,617 |
| Outside services | | **189,268** | 212,975 | 749,207 |
| Market fees | *6* | **146,550** | 160,669 | 219,681 |
| Professional fees | | **136,397** | 137,303 | 124,221 |
| Travel and transportation | | **132,869** | 141,463 | 57,544 |
| Repairs and maintenance | | **126,906** | 308,335 | 138,067 |
| Advertising and promotions | | **70,772** | 119,874 | 59,653 |
| Insurance | | **19,198** | 63,827 | 65,434 |
| Impairment losses on trade receivables | *8* | **-** | 958,784 | 142,658 |
| Miscellaneous | | **232,668** | 238,118 | 136,447 |
| | | **P4,835,532** | P6,239,650 | P4,904,135 |

Donations represent contributions to registered donee institutions for their programs on education, environment and disaster-related projects. Corporate special program pertains to the Group’s corporate social responsibility projects.

## 26. Other Income (Charges)

Other income (charges) consist of:

| | *Note* | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| PSALM monthly fees reduction | *6* | **P3,283,745** | P1,509,225 | P1,858,506 |
| Construction revenue | *4, 6* | **123,336** | 226,997 | 47,091 |
| Construction cost | *4, 6* | **(123,336)** | (226,997) | (47,091) |
| Foreign exchange losses - net | *30* | **(632,416)** | (8,075,159) | (7,582,548) |
| Miscellaneous income (charges) - net | *4, 6, 8 13, 20* | **292,836** | (315,820) | (202,008) |
| | | **P2,944,165** | (P6,881,754) | (P5,926,050) |

Miscellaneous income (charges) recognized in 2017 mostly pertain to management income, rent income and sale of fly ash to related parties. In 2016, the Group recognized impairment losses on non-trade receivables and property, plant and equipment, management income and rent income charged to related parties (Notes 4, 6, 8, 13 and 20).

## 27. Income Taxes

The components of income tax expense are as follows:

| | *Note* | **2017** | 2016 | 2015 |
|---|---|---|---|---|
| Current | *28* | **P2,003,146** | P2,668,503 | P2,181,771 |
| Deferred | | **4,176,364** | 697,256 | 521,637 |
| | | **P6,179,510** | P3,365,759 | P2,703,408 |

Deferred tax assets (liabilities) - net arise from the following:

| | *Note* | **2017** | 2016 |
|---|---|---|---|
| **Items Recognized in Profit or Loss** | | | |
| Allowance for impairment losses on trade and other receivables | *8* | **P458,043** | P458,043 |
| Defined benefit retirement obligation | *21* | **13,303** | 9,507 |
| Difference of amortization of borrowing costs over payments and others | | **(1,410,812)** | (268,192) |
| Difference of depreciation and other related expenses over monthly lease payments | *6* | **(5,077,847)** | (2,040,307) |
| **Item Recognized in Other Comprehensive Income** | | | |
| Equity reserve for retirement plan | *21* | **10,128** | 11,302 |
| | | **(P6,007,185)** | (P1,829,647) |

The deferred taxes are reported in the consolidated statements of financial position as follows:

| | **2017** | 2016 |
|---|---|---|
| Deferred tax assets | **P1,316,926** | P2,955,570 |
| Deferred tax liabilities | **(7,324,111)** | (4,785,217) |
| | **(P6,007,185)** | (P1,829,647) |

The movements in deferred tax assets (liabilities) - net are as follows:

| **December 31, 2017** | **Balance at Beginning of Year** | **Recognized in Profit or Loss** | **Recognized in Other Comprehensive Income** | **Balance at End of Year** |
|---|---|---|---|---|
| **Allowance for impairment losses on trade and other receivables** | **P458,043** | **P -** | **P -** | **P458,043** |
| **Defined benefit retirement obligation** | **9,507** | **3,796** | **-** | **13,303** |
| **Difference of amortization of borrowing costs over payments and others** | **(268,192)** | **(1,142,620)** | **-** | **(1,410,812)** |
| **Difference of depreciation and other related expenses over monthly lease payments** | **(2,040,307)** | **(3,037,540)** | **-** | **(5,077,847)** |
| **Equity reserve for retirement plan** | **11,302** | **-** | **(1,174)** | **10,128** |
| **Net liabilities** | **(P1,829,647)** | **(P4,176,364)** | **(P1,174)** | **(P6,007,185)** |

| December 31, 2016 | Balance at Beginning of Year | Recognized in Profit or Loss | Recognized in Other Comprehensive Income | Balance at End of Year |
|---|---|---|---|---|
| Allowance for impairment losses on trade and other receivables | P170,443 | P287,600 | P - | P458,043 |
| Defined benefit retirement obligation | 6,991 | 2,516 | - | 9,507 |
| Difference of amortization of borrowing costs over payments and others | (471,750) | 203,558 | - | (268,192) |
| Difference of depreciation and other related expenses over monthly lease payments | (849,377) | (1,190,930) | - | (2,040,307) |
| Equity reserve for retirement plan | 6,706 | - | 4,596 | 11,302 |
| Net liabilities | (P1,136,987) | (P697,256) | P4,596 | (P1,829,647) |

As of December 31, 2017, the NOLCO and MCIT of the Group that can be claimed as deduction from future taxable income and deduction from corporate income tax due, respectively, are as follows:

| **Year Incurred/Paid** | **Carryforward Benefits Up To** | **NOLCO** | **MCIT** |
|---|---|---|---|
| Year 2017 | December 31, 2020 | P9,509,739 | P36,617 |
| Year 2016 | December 31, 2019 | 3,137,496 | 17,641 |
| Year 2015 | December 31, 2018 | 2,931,633 | 10,195 |
| | | P15,578,868 | P64,453 |

The reconciliation between the statutory income tax rate on income before income tax and the Group's effective income tax rate is as follows:

| | **2017** | 2016 | 2015 |
|---|---|---|---|
| Statutory income tax rate | **30.00%** | 30.00% | 30.00% |
| Increase (decrease) in the income tax rate resulting from: | | | |
| Unrecognized deferred tax assets | **18.06%** | 17.85% | 30.43% |
| Availment of optional standard deduction and others | **(5.14%)** | (3.07%) | (0.78%) |
| Effective income tax rate | **42.92%** | 44.78% | 59.65% |

## 28. Registrations and License

Registrations with the Board of Investments (BOI)

i. In 2013, SMCPC and SCPC were granted incentives by the BOI on a pioneer status for 6 years subject to the representations and commitments set forth in the application for registration, the provisions of Omnibus Investments Code of 1987, (Executive Order (EO) No. 226), the rules and regulations of the BOI and the terms and conditions prescribed. On October 5, 2016, BOI granted SCPC's request to move the start of its commercial operation and Income Tax Holiday (ITH) reckoning date from February 2016 to September 2017 or when the first kilowatt-hour (kWh) of energy was transmitted after commissioning or testing, or 1 month from the date of such commissioning or testing, whichever comes earlier as certified by the National Grid Corporation of the Philippines. Subsequently, on December 21, 2016, BOI granted a similar request of SMCPC to move the start of its commercial operation and ITH reckoning date from December 2015 to July 2016, or the actual date of commercial operations subject to compliance with the specific terms and conditions, due to delay in the implementation of the project for reasons beyond its control. SMCPC has a pending request with BOI on the further extension of the ITH reckoning date from July 2016 to September 2017. The ITH period for Unit 1 and Unit 2 of SCPC commenced on May 26, 2017 and September 26, 2017, respectively. The ITH incentives shall only be limited to the conditions given under the specific terms and conditions of their respective BOI registrations.

ii. On September 20, 2016, LPPC was registered with the BOI under the Omnibus Investment Code of 1987 as expanding operator of 2 x 150 MW CFB Coal-fired Power Plant (Phase II Limay Power Plant) on a non-pioneer status. The BOI categorized LPPC as an “Expansion” based on the 2014 to 2016 IPP's Specific Guidelines for “Energy” in relation to SCPC's 2 x 150 MW Coal-fired Power Plant (Phase I Limay Power Plant). As a registered entity, LPPC is entitled to certain incentives that include, among others, an ITH for 3 years from January 2018 or date of actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration. The ITH incentives shall only be limited to the conditions given under the specific terms and conditions of LPPC's BOI registrations.

   In June 2017, the BOI approved the transfer of ownership and registration of Phase II Limay Power Plant from LPPC to SCPC. SCPC has a pending request with BOI on the extension of the ITH reckoning date for Phase II Limay Power Plant from January 2018 to December 2018 or actual start of commercial operations, whichever is earlier.

iii. On August 26, 2015, February 11, 2016 and October 26, 2016, the BOI issued a Certificate of Authority (COA) to SMCPC, SCPC and LPPC, respectively, subject to provisions and implementing rules and regulations of EO No. 70, entitled “Reducing the Rates of Duty on Capital Equipment, Spare Parts and Accessories imported by BOI Registered New and Expanding Enterprises.” The COA shall be valid for 1 year from the date of issuance. All capital equipment, spare parts and accessories imported by SMCPC and SCPC for the construction of the power plants were ordered, delivered and completed within the validity period of their respective COAs.

On July 10, 2017, the BOI issued a new COA to SCPC, as the new owner of the Phase II Limay Power Plant, subject to provisions and implementing rules and regulations of EO No. 22 (which replaced EO No. 70), also entitled "Reducing the Rates of Duty on Capital Equipment, Spare Parts and Accessories imported by BOI Registered New and Expanding Enterprises". The COA shall be valid for 1 year from the date of issuance or up to the expiration of EO No. 22 or until a new law amending the Omnibus Investments Code of 1987 is enacted, whichever comes earlier.

iv. SMEC, SPDC and SPPC are registered with the BOI as administrator/operator of their respective power plants on a pioneer status with non-pioneer incentives and were granted ITH for 4 years without extension beginning August 1, 2010 up to July 31, 2014, subject to compliance with certain requirements under their registrations. The ITH incentive availed was limited only to the sale of power generated from the power plants. Upon expiration of the ITH in 2014, SMEC, SPDC and SPPC are now subject to the regular income tax rate.

v. On August 21, 2007, SEPC was registered with the BOI under the Omnibus Investments Code of 1987, as New Domestic Producer of Coal on a Non-pioneer Status.

License Granted by the ERC

On August 22, 2011 and August 24, 2016, SMELC and SCPC, respectively, were granted a RES License by the ERC pursuant to Section 29 of the EPIRA which requires all suppliers of electricity to the contestable market to secure a license from the ERC. The term of the RES License is for a period of 5 years from the time it was granted and renewable thereafter.

On August 19, 2016, the ERC approved the renewal of SMELC's RES License for another 5 years from August 22, 2016 up to August 21, 2021.

## 29. Basic and Diluted Earnings (Loss) Per Share

Basic and diluted EPS is computed as follows:

| | **2017** | 2016 | 2015 |
|---|---|---|---|
| Net income attributable to equity holders of the Parent Company | **P8,216,916** | P4,150,662 | P1,828,918 |
| Distributions to USCS holders for the year | **(3,076,042)** | (2,938,623) | (1,918,382) |
| Net income (loss) attributable to common shareholders of the Parent Company (a) | **5,140,874** | 1,212,039 | (89,464) |
| Weighted average number of common shares outstanding (in thousands) (b) | **1,250,004** | 1,250,004 | 1,250,004 |
| Basic/Diluted Earnings (Loss) Per Share (a/b) | **P4.11** | P0.97 | (P0.07) |

As of December 31, 2017, 2016 and 2015, the Group has no dilutive debt or equity instruments.

## 30. Financial Risk and Capital Management Objectives and Policies

Objectives and Policies

The Group has significant exposure to the following financial risks primarily from its use of financial instruments:

- Interest Rate Risk
- Foreign Currency Risk
- Commodity Price Risk
- Liquidity Risk
- Credit Risk

This note presents information about the exposure to each of the foregoing risks, the objectives, policies and processes for measuring and managing these risks, and for management of capital.

The principal non-trade related financial instruments of the Group include cash and cash equivalents, restricted cash, noncurrent receivables, loans payable, long-term debt and derivative instruments. These financial instruments, except derivative instruments, are used mainly for working capital management purposes. The trade-related financial assets and financial liabilities of the Group such as trade and other receivables, accounts payable and accrued expenses, finance lease liabilities and other noncurrent liabilities arise directly from, and are used to facilitate, its daily operations.

The outstanding derivative instruments of the Group which is fixed swaps are intended mainly for risk management purposes. The Group uses derivatives to manage its exposures to foreign currency and commodity price risks arising from the operating and financing activities. The accounting policies in relation to derivatives are set out in Note 3 to the consolidated financial statements.

The BOD has the overall responsibility for the establishment and oversight of the risk management framework of the Group.

The risk management policies of the Group are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The BOD constituted the Audit and Risk Oversight Committee to assist the BOD in fulfilling its oversight responsibility of the Group's corporate governance process relating to the: a) quality and integrity of the consolidated financial statements and financial reporting process and the systems of internal accounting and financial controls; b) performance of the internal auditors; c) annual independent audit of the consolidated financial statements, the engagement of the independent auditors and the evaluation of the independent auditors' qualifications, independence and performance; d) compliance with tax, legal and regulatory requirements; e) evaluation of management's process to assess and manage the enterprise risk issues; and f) fulfillment of the other responsibilities set out by the BOD. The Audit and Risk Oversight Committee shall prepare such reports as may be necessary to document the activities of the committee in the performance of its functions and duties. Such reports shall be included in the annual report of the Group and other corporate disclosures as may be required by the SEC and/or the PDEx.

The Audit and Risk Oversight Committee also oversees how management monitors compliance with the risk management policies and procedures of the Group and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. Internal Audit assists the Audit and Risk Oversight Committee in monitoring and evaluating the effectiveness of the risk management and governance processes of the Group. Internal Audit undertakes both regular and special reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Oversight Committee.

Interest Rate Risk

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group's exposure to changes in interest rates relates primarily to the long-term borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest cost by using an optimal combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rate and ensures that the mark-up rates charged on its borrowings are optimal and benchmarked against the rates charged by other creditor banks.

On the other hand, the investment policy of the Group is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the operations and working capital management. However, the Group invests only in high-quality short-term investments while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term fluctuations on the earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by nil, P14,127 and P2,092 in 2017, 2016 and 2015, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. These changes are considered to be reasonably possible given the observation of prevailing market conditions in those periods. There is no impact on the Group's other comprehensive income.

The Group does not account for any fixed-rate financial assets or financial liabilities at FVPL and the Group does not designate derivatives as hedging instruments under a fair value hedge accounting model. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

Interest Rate Risk Table
The terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

| **December 31, 2017** | **1 Year or Less** | **>1-2 Years** | **>2-3 Years** | **>3-4 Years** | **>4-5 Years** | **>5 Years** | **Total** |
|---|---|---|---|---|---|---|---|
| **Fixed Rate** | | | | | | | |
| Philippine peso-denominated | **P1,200,000** | **P1,200,000** | **P1,620,000** | **P8,508,250** | **P12,477,960** | **P66,993,790** | **P92,000,000** |
| Interest rate | **6.2836% to 6.9265%** | **6.2836% to 6.9265%** | **6.2836% to 6.9265%** | **4.3458% to 6.9265%** | **5.3750% to 6.9265%** | **4.7575% to 6.9265%** | |
| | **P1,200,000** | **P1,200,000** | **P1,620,000** | **P8,508,250** | **P12,477,960** | **P66,993,790** | **P92,000,000** |

| December 31, 2016 | 1 Year or Less | >1-2 Years | >2-3 Years | >3-4 Years | >4-5 Years | >5 Years | Total |
|---|---|---|---|---|---|---|---|
| Fixed Rate | | | | | | | |
| Philippine peso-denominated | P - | P - | P - | P - | P6,153,250 | P8,846,750 | P15,000,000 |
| Interest rate | | | | | 4.3458% | 4.7575% to 5.1792% | |
| Floating Rate | | | | | | | |
| Foreign currency-denominated (expressed in Philippine peso) | 1,218,482 | 36,392,314 | 1,681,219 | 1,768,764 | 1,892,042 | 9,717,483 | 52,670,304 |
| Interest rate | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | |
| | P1,218,482 | P36,392,314 | P1,681,219 | P1,768,764 | P8,045,292 | P18,564,233 | P67,670,304 |

Foreign Currency Risk
The functional currency is the Philippine peso, which is the denomination of the Group's revenues. The exposure to foreign currency risk results from significant movements in foreign exchange rates that adversely affect the foreign currency-denominated transactions of the Group. The risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity. The Group enters into foreign currency hedges using derivative instruments such as foreign currency forwards to manage its foreign currency risk exposure.

Short-term currency forward contracts (non-deliverable) are entered into to manage foreign currency risks arising from foreign currency denominated obligations.

Information on the Group's foreign currency-denominated monetary assets and monetary liabilities and their Philippine peso equivalents as of December 31 are as follows:

| | | **2017** | | 2016 | |
|---|---|---|---|---|---|
| | ***Note*** | **US Dollar** | **Peso Equivalent** | US Dollar | Peso Equivalent |
| **Assets** | | | | | |
| Cash and cash equivalents | *7* | **US$102,067** | **P5,096,218** | US$108,229 | P5,381,123 |
| Trade and other receivables | *8* | **85,664** | **4,277,192** | 80,301 | 3,992,573 |
| | | **187,731** | **9,373,410** | 188,530 | 9,373,696 |
| **Liabilities** | | | | | |
| Accounts payable and accrued expenses | *18* | **122,259** | **6,104,423** | 312,823 | 15,553,551 |
| Long-term debt (including current maturities) | *19* | **-** | **-** | 1,059,339 | 52,670,304 |
| Finance lease liabilities (including current portion) | *6* | **1,693,623** | **84,562,581** | 1,880,371 | 93,492,054 |
| | | **1,815,882** | **90,667,004** | 3,252,533 | 161,715,909 |
| **Net foreign currency-denominated monetary liabilities** | | **US$1,628,151** | **P81,293,594** | US$3,064,003 | P152,342,213 |

The Group reported net losses on foreign exchange amounting to P632,416, P8,075,159 and P7,582,548 in 2017, 2016 and 2015, respectively, with the translation of its foreign currency-denominated assets and liabilities (Note 26). These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

| | **US Dollar to Philippine Peso** |
|---|---|
| **December 31, 2017** | **49.93** |
| December 31, 2016 | 49.72 |
| December 31, 2015 | 47.06 |

The management of foreign currency risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various foreign currency exchange rate scenarios.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) for the years ended December 31:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **P1 Decrease in the US Dollar Exchange Rate** | **P1 Increase in the US Dollar Exchange Rate** | P1 Decrease in the US Dollar Exchange Rate | P1 Increase in the US Dollar Exchange Rate |
| Cash and cash equivalents | **(P102,067)** | **P102,067** | (P108,229) | P108,229 |
| Trade and other receivables | **(85,664)** | **85,664** | (80,301) | 80,301 |
| | **(187,731)** | **187,731** | (188,530) | 188,530 |
| Accounts payable and accrued expenses | **122,259** | **(122,259)** | 312,823 | (312,823) |
| Long-term debt (including current maturities) | **-** | **-** | 1,059,339 | (1,059,339) |
| Finance lease liabilities (including current portion) | **1,693,623** | **(1,693,623)** | 1,880,371 | (1,880,371) |
| | **1,815,882** | **(1,815,882)** | 3,252,533 | (3,252,533) |
| | **P1,628,151** | **(P1,628,151)** | P3,064,003 | (P3,064,003) |

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

<u>Commodity Price Risk</u>
Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in commodity prices.

The Group, through SMC, enters into commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show marked-to-market losses; however, any loss in the marked-to-market position is offset by the resulting lower physical raw material cost.

*Commodity Swaps.* Commodity swaps are used to manage the Group's exposures to volatility in prices of coal.

Liquidity Risk

Liquidity risk pertains to the risk that the Group will encounter difficulty to meet payment obligations when they fall due under normal and stress circumstances.

The Group's objectives to manage its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps and surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted receipts and payments used for liquidity management as of December 31:

| **2017** | **Carrying Amount** | **Contractual Cash Flow** | **1 Year or Less** | **>1 Year - 2 Years** | **>2 Years - 5 Years** | **Over 5 Years** |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | **P28,655,359** | **P28,655,369** | **P28,655,369** | **P -** | **P -** | **P -** |
| Trade and other receivables - net* | **20,384,934** | **20,384,934** | **20,384,934** | **-** | **-** | **-** |
| Derivative asset (included under "Other noncurrent assets - net" account) | **61,903** | **61,903** | **-** | **61,903** | **-** | **-** |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | **278,965** | **322,012** | **60,773** | **39,371** | **115,904** | **105,964** |
| Restricted cash (included under "Other noncurrent assets - net" account) | **4,805,175** | **4,805,175** | **-** | **4,805,175** | **-** | **-** |
| **Financial Liabilities** | | | | | | |
| Loans payable | **5,930,000** | **5,938,566** | **5,938,566** | **-** | **-** | **-** |
| Accounts payable and accrued expenses* | **24,818,444** | **24,818,444** | **24,818,444** | **-** | **-** | **-** |
| Long-term debt - net (including current maturities) | **90,728,701** | **133,277,391** | **6,837,616** | **6,760,234** | **38,229,217** | **81,450,324** |
| Finance lease liabilities (including current portion) | **154,793,690** | **189,584,834** | **25,020,549** | **26,220,439** | **82,794,848** | **55,548,998** |
| Other noncurrent liabilities (including current portion of concession liability) | **171,174** | **246,756** | **8,400** | **74,118** | **25,200** | **139,038** |

**Excluding statutory receivables and payables*

| 2016 | Carrying Amount | Contractual Cash Flow | 1 Year or Less | >1 Year - 2 Years | >2 Years - 5 Years | Over 5 Years |
|---|---|---|---|---|---|---|
| Financial Assets | | | | | | |
| Cash and cash equivalents | P21,491,385 | P21,491,385 | P21,491,385 | P - | P - | P - |
| Trade and other receivables - net* | 22,316,325 | 22,316,325 | 22,316,325 | - | - | - |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | 298,437 | 353,700 | 38,634 | 77,195 | 116,640 | 121,231 |
| Financial Liabilities | | | | | | |
| Accounts payable and accrued expenses* | 31,095,490 | 31,095,490 | 31,095,490 | - | - | - |
| Long-term debt - net (including current maturities) | 66,323,726 | 77,424,824 | 3,618,010 | 38,428,920 | 15,077,705 | 20,300,189 |
| Finance lease liabilities (including current portion) | 170,089,536 | 213,866,933 | 24,689,002 | 24,966,835 | 84,101,330 | 80,109,766 |
| Other noncurrent liabilities (including current portion of concession liability) | 156,512 | 238,086 | 8,400 | 8,400 | 25,200 | 196,086 |

**Excluding statutory receivables and payables*

Credit Risk
Credit risk is the risk of financial loss to the Group when a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from trade and other receivables. The Group manages its credit risk mainly through the application of transaction limits and close risk monitoring. It is the Group's policy to enter into transactions with a wide diversity of creditworthy counterparties to mitigate any significant concentration of credit risk.

The Group has regular internal control reviews to monitor the granting of credit and management of credit exposures.

*Trade and Other Receivables*
The exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry in which customers operate, as these factors may have an influence on the credit risk.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the standard payment and delivery terms and conditions are offered. The Group ensures that sales on account are made to customers with appropriate credit history. The Group has detailed credit criteria and several layers of credit approval requirements before engaging a particular customer or counterparty. The review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer and are reviewed on a regular basis. Customers that fail to meet the benchmark creditworthiness may transact with the Group only on a prepayment basis.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance include a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Financial information on the Group's maximum exposure to credit risk as of December 31, without considering the effects of other risk mitigation techniques, is presented below.

| | **2017** | 2016 |
|---|---|---|
| Cash and cash equivalents (excluding cash on hand) | **P28,653,631** | P21,490,065 |
| Trade and other receivables - net* | **20,384,934** | 22,316,325 |
| Derivative asset (included under "Other noncurrent assets - net" account) | **61,903** | - |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | **278,965** | 298,437 |
| Restricted cash (included under "Other noncurrent assets - net" account) | **4,805,175** | - |
| | **P54,184,608** | P44,104,827 |

**Excluding statutory receivables*

The credit risk for cash and cash equivalents and restricted cash is considered negligible, since the counterparties are reputable entities with high quality external credit ratings.

The Group has significant concentration of credit risk. Sale of power to Meralco accounts for 52%, 51% and 53% of the Group's total revenues for the years ended December 31, 2017, 2016 and 2015, respectively. The Group does not execute any credit guarantee in favor of any counterparty.

Capital Management

The Group maintains a sound capital base to ensure its ability to continue as a going concern, thereby continue to provide returns to stockholders and benefits to other stakeholders and to maintain an optimal capital structure to reduce cost of capital.

The Group manages its capital structure and makes adjustments in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, distribution payment, pay-off existing debts, return capital to shareholders or issue new shares, subject to compliance with certain covenants of its long-term debt and USCS (Notes 19 and 22).

The Group defines capital as capital stock, additional paid-in capital, USCS and retained earnings, both appropriated and unappropriated. Other components of equity such as equity reserves and equity reserve for retirement plan are excluded from capital for purpose of capital management.

The Group monitors capital on the basis of debt-to-equity ratio, which is calculated as total debt divided by total equity. Total debt is defined as total current liabilities and total noncurrent liabilities, while equity is total equity as shown in the consolidated statements of financial position.

The BOD has overall responsibility for monitoring capital in proportion to risk. Profiles for capital ratios are set in the light of changes in the external environment and the risks underlying the Group's business, operation and industry.

There were no changes in the Group's approach to capital management during the year.

## 31. Financial Assets and Financial Liabilities

The table below presents a comparison by category of the carrying amounts and fair values of the Group's financial instruments as of December 31:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value |
| **Financial Assets** | | | | |
| Cash and cash equivalents | **P28,655,359** | **P28,655,359** | P21,491,385 | P21,491,385 |
| Trade and other receivables - net* | **20,384,934** | **20,384,934** | 22,316,325 | 22,316,325 |
| Derivative asset (included under "Other noncurrent assets - net" account) | **61,903** | **61,903** | - | - |
| Noncurrent receivables (included under "Other noncurrent assets - net" account; including current portion) | **278,965** | **278,965** | 298,437 | 298,437 |
| Restricted cash (included under "Other noncurrent assets - net" account) | **4,805,175** | **4,805,175** | - | - |
| | **P54,186,336** | **P54,186,336** | P44,106,147 | P44,106,147 |
| **Financial Liabilities** | | | | |
| Loans Payable | **P5,930,000** | **P5,930,000** | P - | P - |
| Accounts payable and accrued expenses* | **24,818,444** | **24,818,444** | 31,095,490 | 31,095,490 |
| Long-term debt - net (including current maturities) | **90,728,701** | **96,948,336** | 66,323,726 | 66,611,049 |
| Finance lease liabilities (including current portion) | **154,793,690** | **154,793,690** | 170,089,536 | 170,089,536 |
| Other noncurrent liabilities (including current portion of concession liability) | **171,174** | **171,174** | 156,512 | 156,512 |
| | **P276,442,009** | **P282,661,644** | P267,665,264 | P267,952,587 |

**Excluding statutory receivables and payables*

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

*Cash and Cash Equivalents and Trade and Other Receivables (excluding statutory receivables).* The carrying amounts of cash and cash equivalents and trade and other receivables approximate their fair values primarily due to the relatively short-term maturities of these financial instruments.

*Restricted Cash and Noncurrent Receivables.* The carrying amounts of restricted cash and noncurrent receivables approximate their fair values, since the effect of discounting is not considered material.

*Derivatives.* The fair values of freestanding currency and commodity derivatives are determined based on quoted prices obtained from their respective active markets. The fair values of the derivatives have been categorized as Level 2 in the fair value hierarchy.

*Loans Payable and Accounts Payable and Accrued Expenses (excluding statutory payables).* The carrying amount of loans payable and accounts payable and accrued expenses approximates fair value due to the relatively short-term maturities of these financial instruments.

*Long-term Debt, Finance Lease Liabilities and Other Noncurrent Liabilities*. The fair value of interest-bearing fixed-rate loans is based on the discounted value of expected future cash flows using the applicable market rates for similar types of instruments as of reporting date. Discount rates used for Philippine peso-denominated loans range from 2.47% to 5.70% and 2.18% to 4.88% as of December 31, 2017 and 2016, respectively. The carrying amounts of floating rate loans with quarterly interest rate repricing approximate their fair values.

The fair value of peso-denominated bonds has been categorized as Level 1 and interest-bearing fixed-rate loans, finance lease liabilities and other noncurrent liabilities have been categorized as Level 2 in the fair value hierarchy.

<u>Derivative Financial Instruments</u>
The Group's derivative financial instruments according to the type of financial risk being managed and the details of freestanding derivative financial instruments are discussed below.

The Group entered into currency and commodity derivative contracts to manage its exposure on foreign currency and commodity price risk. The portfolio is a mixture of instruments including forwards and swaps.

<u>Derivative Instruments not Designated as Hedges</u>
The Group enters into certain derivatives as economic hedges of certain underlying exposures. These include freestanding derivatives which are not designated as accounting hedges. Changes in fair value of these instruments are accounted for directly in the consolidated statements of income. Details are as follows:

*Freestanding Derivatives*
Freestanding derivatives consist of currency and commodity derivatives entered into by the Group.

*Currency Forwards*
As of December 31, 2017, the Group has no outstanding currency forwards.

*Commodity Swap*
The Group has an outstanding fixed swap agreement covering its purchase of coal for calendar year 2019. Under the agreement, payment is made either by the Group or its counterparty for the difference between the hedged fixed price and the relevant monthly average index price. The outstanding equivalent notional quantity covered by the commodity swap is 60,000 metric tons as of December 31, 2017. The positive fair value of this swap amounted to P61,903 as of December 31, 2017.

## 32. Supplemental Cash Flows Information

Changes in liabilities arising from financing activities:

| | Loans Payable | Long-term Debt | Finance Lease Liabilities | Total |
|---|---|---|---|---|
| **Balance as of January 1, 2017** | **P -** | **P66,323,726** | **P170,089,536** | **P236,413,262** |
| **Changes from financing cash flows** | | | | |
| Proceeds from borrowings | 113,419,200 | 77,000,000 | - | 190,419,200 |
| Payments of borrowings | (107,782,255) | (53,110,468) | - | (160,892,723) |
| Payments of finance lease liabilities | - | - | (24,874,993) | (24,874,993) |
| **Total changes from financing cash flows** | **5,636,945** | **23,889,532** | **(24,874,993)** | **4,651,484** |
| Effect of changes in foreign exchange rates | 293,055 | 440,164 | 497,704 | 1,230,923 |
| Other changes | - | 75,279 | 9,081,443 | 9,156,722 |
| **Balance as of December 31, 2017** | **P5,930,000** | **P90,728,701** | **P154,793,690** | **P251,452,391** |

## 33. Other Matters

a. EPIRA

The EPIRA sets forth the following: (i) Section 49 created PSALM to take ownership and manage the orderly sale, disposition and privatization of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets; (ii) Section 31(c) requires the transfer of the management and control of at least 70% of the total energy output of power plants under contract with NPC to the IPP Administrators as one of the conditions for retail competition and open access; and (iii) Pursuant to Section 51(c), PSALM has the power to take title to and possession of the IPP contracts and to appoint, after a competitive, transparent and public bidding, qualified independent entities who shall act as the IPP Administrators in accordance with the EPIRA. In accordance with the bidding procedures and supplemented bid bulletins thereto to appoint an IPP Administrator relative to the capacity of the IPP contracts, PSALM has conducted a competitive, transparent and open public bidding process following which the Group was selected winning bidder of the IPPA Agreements (Note 6).

The EPIRA requires generation and DU companies to undergo public offering within 5 years from the effective date, and provides cross ownership restrictions between transmission and generation companies. If the holding company of generation and DU companies is already listed with the PSE, the generation company or the DU need not comply with the requirement since such listing of the holding company is deemed already as compliance with the EPIRA.

A DU is allowed to source from an associated company engaged in generation up to 50% of its demand except for contracts entered into prior to the effective date of the EPIRA. Generation companies are restricted from owning more than 30% of the installed generating capacity of a grid and/or 25% of the national installed generating capacity. The Group is in compliance with the restrictions as of December 31, 2017 and 2016.

b. Contingencies

The Group is a party to certain cases or claims which are either pending decision by the court/regulators or are subject to settlement agreements. The outcome of these cases or claims cannot be presently determined (Note 4).

i. *Generation Payments to PSALM*

SPPC and PSALM are parties to the Ilijan IPPA Agreement covering the appointment of SPPC as the IPP Administrator of the Ilijan Power Plant.

SPPC and PSALM have an ongoing dispute arising from differing interpretations of certain provisions related to generation payments under the Ilijan IPPA Agreement. As a result of such dispute, the parties have arrived at different computations regarding the subject payments. In a letter dated August 6, 2015, PSALM has demanded payment of the difference between the generation payments calculated based on its interpretation and the amount which has already been paid by SPPC, plus interest, covering the period December 26, 2012 to April 25, 2015.

On August 12, 2015, SPPC initiated a dispute resolution process with PSALM as provided under the terms of the Ilijan IPPA Agreement, while continuing to maintain that it has fully paid all of its obligations to PSALM. Notwithstanding the bona fide dispute, PSALM issued a notice terminating the Ilijan IPPA Agreement on September 4, 2015. On the same day, PSALM also called on the Performance Bond posted by SPPC pursuant the Ilijan IPPA Agreement.

On September 8, 2015, SPPC filed a Complaint with the RTC of Mandaluyong City. In its Complaint, SPPC requested the RTC that its interpretation of the relevant provisions of the Ilijan IPPA Agreement be upheld. The Complaint also asked that a 72-hour Temporary Restraining Order (TRO) be issued against PSALM for illegally terminating the Ilijan IPPA Agreement and drawing on the Performance Bond. On even date, the RTC issued a 72-hour TRO which prohibited PSALM from treating SPPC as being in Administrator Default and from performing other acts that would change the status quo ante between the parties before PSALM issued the termination notice and drew on the Performance Bond. The TRO was extended for until September 28, 2015.

On September 28, 2015, the RTC issued an Order granting a Preliminary Injunction enjoining PSALM from proceeding with the termination of the Ilijan IPPA Agreement while the main case is pending.

On October 22, 2015, the RTC also issued an Order granting the Motion for Intervention and Motion to Admit Complaint-in-intervention by Meralco.

In an Order dated June 27, 2016, the RTC denied PSALM's: (1) Motion for Reconsideration of the Order dated September 28, 2015, which issued a writ of preliminary injunction enjoining PSALM from further proceedings with the termination of the IPPA Agreement while the case is pending; (2) Motion for Reconsideration of the Order, which allowed Meralco to intervene in the case; and (3) Motion to Dismiss. In response to this Order, PSALM filed a petition for certiorari with the Court of Appeals (CA) seeking to annul the RTC's Orders granting the writ of preliminary injunction, allowing Meralco's intervention, and the Orders denying PSALM's motions for reconsideration of said injunction and intervention orders. PSALM also prayed for the issuance of a TRO and/or writ of preliminary injunction "against public respondent RTC and its assailed Orders." The CA, however, denied the petition filed by PSALM in its Decision dated December 19, 2017.

The preliminary conference on the RTC case was suspended to pave way for mediation between the parties. During the last mediation conference on January 6, 2017, mediation between the parties was terminated. Thereafter, the case was referred to judicial dispute resolution. During the dispute conference between the parties on September 28, 2017, the judicial dispute process was terminated. The parties were required to submit their respective position papers on whether or not the case should be re-raffled. In compliance with the Order of the RTC dated October 24, 2017, on December 8, 2017 SPPC filed its Comment and Opposition to the Motion for Inhibition filed by PSALM. On December 18, 2017, the presiding judge of the RTC who conducted the judicial dispute resolution issued an Order inhibiting himself in the instant case. The case was then re-raffled to another RTC judge in Mandaluyong City which scheduled the Pre-Trial Conference on May 11, 2018. SPPC filed a Request for Motion for Production of Documents on February 28, 2018, while PSALM filed its Manifestation with Motion to Hear Affirmative Defenses and Objections Ad Cautelam. Both motions are still pending with the court as of March 9, 2018.

Meanwhile, there are no restrictions or limitations on the ability of SPPC to supply power from the Ilijan Power Plant to Meralco under its PSA with the latter.

By virtue of the Preliminary Injunction issued by the RTC, SPPC continues to be the IPP Administrator for the Ilijan Power Plant.

*ii. Criminal Cases*

SPPC

On September 29, 2015, SPPC filed a criminal complaint for estafa and for violation of Section 3(e) of RA No. 3019, otherwise known as the Anti-Graft and Corrupt Practices Act, before the Department of Justice (DOJ), against certain officers of PSALM, in connection with the termination of SPPC's IPPA Agreement, which was made by PSALM with manifest partiality and evident bad faith. Further, it was alleged that PSALM fraudulently misrepresented its entitlement to draw on the Performance Bond posted by SPPC, resulting in actual injury to SPPC in the amount of US$60,000. The case is still pending with the DOJ as of December 31, 2017.

SMEC
On October 21, 2015, SMEC filed a criminal complaint for Plunder and violation of Section 3(e) and 3(f) of RA 3019, before the DOJ against a certain officer of PSALM, and certain officers of Team Philippines Energy Corp. (TPEC) and TSC, relating to the illegal grant of the so-called “excess capacity” of the Sual Power Plant in favor of TPEC which enabled it to receive a certain amount at the expense of the Government and SMEC.

In a Resolution dated July 29, 2016, the DOJ found probable cause to file Information against the respondents for (a) Plunder; (b) Violation of Sec. 3(e) of the Anti-Graft and Corrupt Practices Act; and (c) Violation of Sec. 3(f) of the Anti-Graft and Corrupt Practices Act. The DOJ further resolved to forward the entire records of the case to the Office of the Ombudsman for their proper action. Respondents have respectively appealed said DOJ’s Resolution of July 29, 2016 with the Secretary of Justice. On October 25, 2017, the DOJ issued a Resolution partially granting the Petition for Review by reversing the July 29, 2016 DOJ Resolution insofar as the conduct of the preliminary investigation. On November 17, 2017, SMEC filed a motion for partial reconsideration of said October 25, 2017 DOJ Resolution.

On June 17, 2016, SMEC filed with the RTC Pasig a civil complaint for consignation against PSALM arising from PSALM’s refusal to accept SMEC’s remittances corresponding to the proceeds of the sale on the WESM of electricity generated from capacity in excess of the 1000 MW of the Sual Power Plant (“Sale of the Excess Capacity”). With the filing of the complaint, SMEC also consigned with the RTC Pasig, the amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods December 26, 2015 to April 25, 2016.

On October 3, 2016, SMEC filed an Omnibus Motion (To Admit Supplemental Complaint and To Allow Future Consignation without Tender). Together with this Omnibus Motion, SMEC consigned with the RTC Pasig an additional amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods from April 26, 2016 to July 25, 2016.

Pending for resolution are (a) PSALM’s Motion for Preliminary Hearing and Special and Affirmative Defenses and (b) SMEC’s Omnibus Motion (to Admit Supplemental Complaint and to Allow Future Consignations without Tender).

On December 1, 2016, SMEC received a copy of a Complaint filed by TPEC and TSC with the ERC against SMEC and PSALM in relation to the Excess Capacity issues, which issues have already been raised in the abovementioned cases. SMEC filed a Motion to Dismiss and Motion to Suspend Proceeding of the instant case.

On July 5, 2017, SMEC consigned with the RTC Pasig the amount representing additional proceeds of Sale of the Excess Capacity for the billing period July 26, 2016 to August 25, 2016. SMEC also filed a Motion to Admit Second Supplemental Complaint in relation to said consignation. With the submission of manifestation from PSALM, the Motion to Admit Second Supplemental Complaint is submitted for resolution.

As of December 31, 2017 and 2016, the total amount consigned with the RTC Pasig is P491,242 and P475,057, respectively, included under “Other noncurrent assets”, particularly “Restricted cash” account, in the consolidated statements of financial position.

iii. *TRO Issued to Meralco*

On December 23, 2013, the Supreme Court (SC) issued a TRO, effective immediately, preventing Meralco from collecting from its customers the power rate increase pertaining to November 2013 billing. As a result, Meralco was constrained to fix its generation rate to its October 2013 level of P5.67/kWh. Claiming that since the power supplied by generators, including SMEC and SPPC is billed to Meralco's customers on a pass-through basis, Meralco deferred a portion of its payment on the ground that it was not able to collect the full amount of its generation cost. Further, on December 27, 2013, the DOE, the ERC and PEMC, acting as a tripartite committee, issued a joint resolution setting a reduced price cap on the WESM of P32/kWh. The price will be effective for 90 days until a new cap is decided upon.

On January 16, 2014, the SC granted Meralco’s plea to include other power supplier and generation companies, including SMEC and SPPC, as respondents to an inquiry. On February 18, 2014, the SC extended the period of the TRO until April 22, 2014 and enjoined the respondents (PEMC and the generators) from demanding and collecting the deferred amounts.

On March 3, 2014, the ERC issued an order declaring the November and December 2013 Luzon WESM prices void and imposed the application of regulated prices. Accordingly, SMEC, SPPC and SPDC recognized a reduction in the sale of power while SMELC recognized a reduction in its power purchases. Consequently, a payable and receivable were also recognized for the portion of over-collection or over-payment, the settlement of which have been covered by a 24-month Special Payment Arrangement with PEMC which was already completed on May 25, 2016. On June 26, 2014, SMEC, SPPC, SPDC and SPI filed with the CA a Petition for Review of these orders.

In a Decision dated November 7, 2017 (“Decision”), the CA granted the Petition for Review filed by SMEC, SPPC, SPDC and SPI, declaring the aforesaid ERC Order null and void and set aside the Orders of the ERC dated March 3, 2014, March 27, 2014, May 9, 2014 and October 15, 2014 and accordingly reinstated and declared as valid the WESM prices for Luzon for the supply of months of November to December 2013.

Upon finality of the Decision, a claim for refund may be made by the relevant subsidiaries with PEMC for an amount up to P2,625,585, plus interest.

c. Commitments

The outstanding purchase commitments of the Group amounted to P1,996,473 and P1,588,516 as of December 31, 2017 and 2016, respectively.

Amount authorized but not yet disbursed for capital projects as of December 31, 2017 and 2016 is approximately P12,861,746 and P23,038,949, respectively.

## 34. Events After the Reporting Date

Acquisition of Subsidiaries

On December 17, 2017, the Parent Company executed a Share Purchase Agreement with AES Phil Investment Pte. Ltd. (AES Phil) and Gen Plus B. V. (Gen Plus) for the purchase by the Parent Company of (a) 51% and 49% equity interests of AES Phil and Gen Plus, respectively, in Masin-AES Pte. Ltd. (the "Target Company"); (b) 100% equity interest of The AES Corporation in AES Transpower Private Ltd. (ATPL); and (c) 100% equity interest of AES Phil in AES Philippines Inc. (API), (collectively, the "Transaction").

The Target Company, through its subsidiaries [including Masinloc Power Partners Co. Ltd. (MPPCL)], owns and/or operates (i) the 2 x 315 MW coal-fired power plant; (ii) the under construction project expansion of the 335 MW unit known as Unit 3; (iii) the 10 MW battery energy storage project, all located in the Province of Zambales, Philippines; and (iv) the 2 x 20 MW battery energy storage facility in Kabankalan, Negros Occidental, which is still at the pre-development stage. ATPL has a Philippine Regional Office and Headquarters which provides the corporate support services to MPPCL, while API provides energy marketing services to MPPCL.

With the acquisition by the Parent Company of the Target Company, ATPL and API, the Group aims to improve its existing baseload capacity to further ensure its ability to provide affordable and reliable supply of power to its customers. The additional power assets provide an opportunity for the Group to increase its footprint in clean coal technology that provides reliable and affordable power, particularly in Luzon. The Transaction will result in the production of electricity in an environmentally responsible way.

The total consideration for the Transaction is US$1,900,000, subject to a post-closing purchase price adjustment. The total consideration will be paid in cash by the Parent Company to be funded through a combination of its (a) availment of US dollar-denominated long-term borrowings from various financial institutions totaling to US$1,200,000 and (b) issuing Redeemable Perpetual Securities to, and obtaining advances from, SMC amounting to US$650,000 and US$150,000, respectively.

On February 23, 2018, the Philippine Competition Commission ("PCC") issued its decision which states that the Transaction does not result in a substantial lessening of competition in the relevant markets, and as such, the PCC resolved that it will take no further action with respect to the Transaction (the "PCC Decision").

Other than the issuance of the PCC Decision, there are other conditions precedent that are required for the closing and completion of the Transaction.

As of March 9, 2018, all parties to the Transaction have yet to complete the conditions precedent for the closing and completion of the Transaction.

The following summarizes the initial financial information as of December 31, 2017 of assets to be acquired and liabilities to be assumed:

| | Provisionary Amounts |
|---|---|
| **Assets** | |
| Cash and cash equivalents | P2,152,225 |
| Trade and other receivables - net | 2,609,037 |
| Inventories | 1,616,060 |
| Prepaid expenses and other current assets | 1,515,826 |
| Property, plant and equipment - net | 56,693,900 |
| Other noncurrent assets | 1,727,896 |
| **Liabilities** | |
| Loans payable | (2,243,250) |
| Accounts payable and accrued expenses | (9,473,903) |
| Finance lease liabilities - net (including current portion) | (41,709) |
| Long-term debt - net (including current maturities) | (28,080,053) |
| Other noncurrent liabilities | (285,053) |
| **Total identifiable net assets** | **P26,190,976** |

Based on the foregoing initial amounts of net assets to be acquired, the goodwill is estimated to be as follows:

| | Provisionary Amounts |
|---|---|
| Consideration transferred | P94,867,000 |
| Non-controlling interest measured at proportionate interest in identifiable net assets | 87,639 |
| Total identifiable net assets | (26,190,976) |
| **Goodwill** | **P68,763,663** |

The estimates above will be updated to their fair values as at the date of acquisition when the Transaction is closed for purposes of recognizing the business combination and will involve identification and recognition of identifiable assets or intangible assets and will likely reduce the amount of initial goodwill above.

*Acquisition-related Costs*
As of December 31, 2017, the Parent Company incurred acquisition-related costs of P194,688 which have been included in the “Selling and administrative expenses” account in the consolidated statements of income.

Goodwill expected to arise from the Transaction is attributable to the benefit of expected synergies, revenue growth, future development and the assembled workforce. These benefits are not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets.

# SMC GLOBAL POWER HOLDINGS CORP.
# AND SUBSIDIARIES
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2016, 2015 and 2014**

R.G. Manabat & Co.
The KPMG Center, 9/F
6787 Ayala Avenue, Makati City
Philippines 1226
Telephone +63 (2) 885 7000
Fax +63 (2) 894 1985
Internet www.kpmg.com.ph
Email ph-inquiry@kpmg.com.ph

**REPORT OF INDEPENDENT AUDITORS**

The Board of Directors and Stockholders
SMC Global Power Holdings Corp.
155 EDSA, Brgy. Wack-Wack
Mandaluyong City, Metro Manila

**Report on the Audit of the Consolidated Financial Statements**

*Opinion*

We have audited the consolidated financial statements of SMC Global Power Holdings Corp. and Subsidiaries (the "Group"), which comprise the consolidated statements of financial position as at December 31, 2016 and 2015, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2016, and notes, comprising significant accounting policies and other explanatory information.

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

*Basis for Opinion*

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

*Key Audit Matter*

Key audit matter is a matter that, in our professional judgment, is of most significance in our audit of the consolidated financial statements of the current period. This matter is addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on this matter.

*Valuation of Trade and Other Receivables*

*The risk -*
The Group's disclosures about the measurement and impairment assumptions to determine the recoverability and carrying amount of trade and other receivables are included in the significant accounting policies in Notes 3, 4 and 8 in the consolidated financial statements. As required by Philippine Accounting Standard 39, an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or a group of financial assets measured at amortized cost is impaired. The determination of the recoverable amounts is subject to significant estimation, as a result, we assessed that the impairment testing is a key audit matter. Given the significant estimation, there is a risk that potential impairment loss in trade and other receivables may not be adequately provided for resulting in over valuation of the Group's trade and other receivables.

*Our response -*
Our audit procedures included, among others, the identification of any events and objective evidence that impairment may exists individually for trade and other receivables that are individually significant and collectively for trade and other receivables that are not individually significant. We evaluated the possible impact that these indications might have on the recoverability of trade and other receivables.

We have:

- Assessed the recoverability of trade and other receivables with reference to the historical levels of impairment losses on trade receivables and credit history of the counterparties.
- Considered the consistency of judgments by the management regarding the recoverability of trade and other receivables to consider whether there is evidence of management bias through discussion with management on their rationale and obtained evidence to support judgment areas.
- Discussed with management regarding the level and aging of trade and other receivables and recoverability of amounts due from customers.
- Evaluated the calculations of the impairment testing as well as the presentation and the relevant disclosures within the consolidated financial statements.

*Other Information*

Management is responsible for the other information. The other information comprises the information included in the SEC Form 20-IS (Definitive Information Statement) and SEC Form 17-A for the year ended December 31, 2016, but does not include the consolidated financial statements and our auditors' report thereon. The SEC Form 20-IS (Definitive Information Statement) and SEC Form 17-A for the year ended December 31, 2016 are expected to be made available to us after the date of this auditors' report.

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

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

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

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

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

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

*Auditors' Responsibilities for the Audit of the Consolidated Financial Statements*

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine the matter that was of most significance in the audit of the consolidated financial statements of the current period and is therefore the key audit matter. We describe the matter in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Mr. Wilfredo Z. Palad.

**R.G. MANABAT & CO.**

WILFREDO Z. PALAD
Partner
CPA License No. 0045177
SEC Accreditation No. 0027-AR-4, Group A, valid until August 24, 2018
Tax Identification No. 106-197-186
BIR Accreditation No. 08-001987-6-2016
Issued April 12, 2016; valid until April 11, 2019
PTR No. 5904939MD
Issued January 3, 2017 at Makati City

March 13, 2017
Makati City, Metro Manila

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**
**DECEMBER 31, 2016 AND 2015**
(In Thousands)

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current Assets** | | | |
| Cash and cash equivalents | *7, 27, 28* | **P21,491,385** | P22,241,361 |
| Trade and other receivables - net | *4, 6, 8, 19, 27, 28* | **22,342,846** | 18,473,625 |
| Inventories | *4, 6, 9, 19* | **2,272,289** | 1,263,218 |
| Prepaid expenses and other current assets | *6, 10* | **17,683,020** | 15,068,747 |
| | | **63,789,540** | 57,046,951 |
| Assets held for sale | *11, 13* | **184,324** | - |
| **Total Current Assets** | | **63,973,864** | 57,046,951 |
| **Noncurrent Assets** | | | |
| Investments and advances - net | *4, 12* | **16,245,454** | 10,612,937 |
| Property, plant and equipment - net | *4, 13* | **246,488,027** | 255,452,996 |
| Deferred exploration and development costs | *4, 6, 14* | **693,379** | 689,548 |
| Intangible assets and goodwill - net | *4, 14, 15* | **2,572,119** | 2,413,249 |
| Deferred tax assets | *4, 24* | **2,955,570** | 2,745,943 |
| Other noncurrent assets - net | *16, 19, 27, 28* | **1,020,771** | 2,248,226 |
| **Total Noncurrent Assets** | | **269,975,320** | 274,162,899 |
| | | **P333,949,184** | P331,209,850 |
| | | | |
| **LIABILITIES AND EQUITY** | | | |
| **Current Liabilities** | | | |
| Accounts payable and accrued expenses | *17, 19, 27, 28* | **P37,729,415** | P32,841,050 |
| Finance lease liabilities - current portion | *4, 6, 27, 28* | **16,344,246** | 16,546,763 |
| Current maturities of long-term debt - net of debt issue costs | *18, 27, 28* | **1,040,690** | 15,647,244 |
| Income tax payable | | **127,198** | 99,275 |
| **Total Current Liabilities** | | **55,241,549** | 65,134,332 |
| **Noncurrent Liabilities** | | | |
| Long-term debt - net of current maturities and debt issue costs | *18, 27, 28* | **65,283,036** | 42,960,617 |
| Finance lease liabilities - net of current portion | *4, 6, 27, 28* | **153,745,290** | 162,646,430 |
| Deferred tax liabilities | *24* | **4,785,217** | 3,882,930 |
| Other noncurrent liabilities | *6, 20* | **223,468** | 150,283 |
| **Total Noncurrent Liabilities** | | **224,037,011** | 209,640,260 |
| **Total Liabilities** | | **279,278,560** | 274,774,592 |

*Forward*

| | Note | 2016 | 2015 |
|---|---|---|---|
| **Equity** | *21* | | |
| Capital stock | | **P1,062,504** | P1,062,504 |
| Additional paid-in capital | | **2,490,000** | 2,490,000 |
| Undated subordinated capital securities | | **26,933,565** | 26,933,565 |
| Equity reserves | | **785,279** | 785,279 |
| Reserve for retirement plan | *20* | **(26,371)** | (15,648) |
| Retained earnings | | **23,425,647** | 25,179,558 |
| **Total Equity** | | **54,670,624** | 56,435,258 |
| | | **P333,949,184** | P331,209,850 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**
(In Thousands, Except Per Share Data)

| | *Note* | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| **REVENUES** | *5, 6, 19, 29* | | | |
| Sale of power | | **P72,250,309** | P73,849,465 | P80,080,157 |
| Retail and other power-related services | | **5,722,121** | 3,657,226 | 4,213,433 |
| | | **77,972,430** | 77,506,691 | 84,293,590 |
| **COST AND EXPENSES** | | | | |
| Cost of power sold: | | | | |
| Energy fees | *5, 6* | **20,477,903** | 23,224,178 | 30,775,896 |
| Coal, fuel oil and other consumables | *5, 6, 9, 19* | **10,046,687** | 10,376,590 | 11,945,280 |
| Power purchases | *5, 6* | **7,836,564** | 8,330,550 | 6,045,468 |
| Depreciation and amortization | *5, 6, 13, 15* | **6,164,942** | 6,466,398 | 6,143,866 |
| Plant operations and maintenance fees | *5, 6, 19, 22* | **476,344** | 502,211 | 575,632 |
| Operating expenses | *5, 6, 19, 22* | **6,239,650** | 4,904,135 | 2,911,930 |
| | | **51,242,090** | 53,804,062 | 58,398,072 |
| **INCOME FROM OPERATIONS** | | **26,730,340** | 23,702,629 | 25,895,518 |
| **INTEREST INCOME** | *5, 7, 16* | **200,502** | 414,444 | 549,977 |
| **GAIN ON SALE OF PROPERTY, PLANT AND EQUIPMENT** | *5, 13* | **116,357** | - | - |
| **EQUITY IN NET LOSSES OF ASSOCIATES AND JOINT VENTURES** | *5, 12* | **(294,795)** | (528,445) | (22,345) |
| **INTEREST EXPENSE AND OTHER FINANCING CHARGES** | *5, 6, 18* | **(12,354,229)** | (13,130,252) | (13,168,470) |
| **OTHER INCOME (CHARGES)** - Net | *5, 6, 23* | **(6,881,754)** | (5,926,050) | 68,225 |
| **INCOME BEFORE INCOME TAX** | | **7,516,421** | 4,532,326 | 13,322,905 |
| **INCOME TAX EXPENSE** - Net | *5, 24, 25* | **3,365,759** | 2,703,408 | 2,693,423 |
| **NET INCOME** | | **P4,150,662** | P1,828,918 | P10,629,482 |
| **Basic/Diluted Earnings (Loss) Per Share** | *26* | **P0.97** | (P0.07) | P7.73 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**
(In Thousands)

| | ***Note*** | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| **NET INCOME** | | **P4,150,662** | P1,828,918 | P10,629,482 |
| **OTHER COMPREHENSIVE INCOME** | | | | |
| **Item that will not be reclassified to profit or loss** | | | | |
| Reserve for retirement plan | *20* | **(15,319)** | (22,354) | - |
| Income tax benefit | *24* | **4,596** | 6,706 | - |
| | | **(10,723)** | (15,648) | - |
| **TOTAL COMPREHENSIVE INCOME** | | **P4,139,939** | P1,813,270 | P10,629,482 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
# FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014

(In Thousands)

| | *Note* | Capital Stock | Additional Paid-in Capital | Undated Subordinated Capital Securities | Equity Reserves | Reserve for Retirement Plan | Retained Earnings | Total Equity |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2016** | | **P1,062,504** | **P2,490,000** | **P26,933,565** | **P785,279** | **(P15,648)** | **P25,179,558** | **P56,435,258** |
| Net income for the year | | **-** | **-** | **-** | **-** | **-** | **4,150,662** | **4,150,662** |
| Equity reserve for retirement plan - net of tax | *20* | **-** | **-** | **-** | **-** | **(10,723)** | **-** | **(10,723)** |
| Total comprehensive income for the year | | **-** | **-** | **-** | **-** | **(10,723)** | **4,150,662** | **4,139,939** |
| Cash dividends and distributions: | | | | | | | | |
| Common | *21* | **-** | **-** | **-** | **-** | **-** | **(3,000,000)** | **(3,000,000)** |
| Undated subordinated capital securities | *21* | **-** | **-** | **-** | **-** | **-** | **(2,904,573)** | **(2,904,573)** |
| **Balance as of December 31, 2016** | | **P1,062,504** | **P2,490,000** | **P26,933,565** | **P785,279** | **(P26,371)** | **P23,425,647** | **P54,670,624** |
| Balance as of January 1, 2015 | | P1,062,504 | P2,490,000 | P13,110,066 | P785,279 | P - | P29,301,328 | P46,749,177 |
| Net income for the year | | - | - | - | - | - | 1,828,918 | 1,828,918 |
| Equity reserve for retirement plan - net of tax | *20* | - | - | - | - | (15,648) | - | (15,648) |
| Total comprehensive income for the year | | - | - | - | - | (15,648) | 1,828,918 | 1,813,270 |
| Issuance of undated subordinated capital securities | *21* | - | - | 13,823,499 | - | - | - | 13,823,499 |
| Cash dividends and distributions: | | | | | | | | |
| Common | *21* | - | - | - | - | - | (4,500,000) | (4,500,000) |
| Undated subordinated capital securities | *21* | - | - | - | - | - | (1,450,688) | (1,450,688) |
| Balance as of December 31, 2015 | | P1,062,504 | P2,490,000 | P26,933,565 | P785,279 | (P15,648) | P25,179,558 | P56,435,258 |
| Balance as of January 1, 2014 | | P1,062,504 | P2,490,000 | P - | P785,279 | P - | P29,395,060 | P33,732,843 |
| Net income/total comprehensive income for the year | | - | - | - | - | - | 10,629,482 | 10,629,482 |
| Issuance of undated subordinated capital securities | *21* | - | - | 13,110,066 | - | - | - | 13,110,066 |
| Cash dividends and distributions: | | | | | | | | |
| Common | *21* | - | - | - | - | - | (10,000,000) | (10,000,000) |
| Undated subordinated capital securities | *21* | - | - | - | - | - | (723,214) | (723,214) |
| Balance as of December 31, 2014 | | P1,062,504 | P2,490,000 | P13,110,066 | P785,279 | P - | P29,301,328 | P46,749,177 |

*See Notes to the Consolidated Financial Statements.*

**SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES**
**(A Wholly-owned Subsidiary of San Miguel Corporation)**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014**
(In Thousands)

| | *Note* | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | |
| Income before income tax | | **P7,516,421** | P4,532,326 | P13,322,905 |
| Adjustments for: | | | | |
| Interest expense and other financing charges | *5, 6, 18* | **12,354,229** | 13,130,252 | 13,168,470 |
| Unrealized foreign exchange losses - net | | **7,446,813** | 7,505,369 | 1,584,500 |
| Depreciation and amortization | *5, 6, 13, 15, 22* | **6,341,931** | 6,539,813 | 6,187,640 |
| Impairment losses on trade and other receivables | *8, 22, 23* | **1,210,451** | 374,801 | 144,393 |
| Impairment losses on property, plant and equipment | *13* | **323,788** | - | - |
| Equity in net losses of associates and joint venture | *5, 12* | **294,795** | 528,445 | 22,345 |
| Impairment losses on concession assets | | **20,460** | - | - |
| Retirement benefit expense | *20* | **8,388** | 6,611 | 8,978 |
| Gain on sale of property, plant and equipment | *5, 13* | **(116,357)** | - | - |
| Interest income | *5, 7, 16* | **(200,502)** | (414,444) | (549,977) |
| Operating income before working capital changes | | **35,200,417** | 32,203,173 | 33,889,254 |
| Decrease (increase) in: | | | | |
| Trade and other receivables - net | *8* | **(657,993)** | (749,571) | (3,037,652) |
| Inventories | *9* | **(1,009,071)** | 101,815 | 134,102 |
| Prepaid expenses and other current assets | *10* | **(2,614,273)** | (6,647,768) | (1,902,310) |
| Other noncurrent assets | *16* | **1,227,455** | 221,001 | 1,290,895 |
| Increase (decrease) in: | | | | |
| Accounts payable and accrued expenses | *17* | **4,505,312** | 4,686,593 | 5,136,893 |
| Other noncurrent liabilities | | **49,479** | (565,860) | 670,486 |
| Cash generated from operations | | **36,701,326** | 29,249,383 | 36,181,668 |
| Interest income received | | **203,493** | 426,480 | 546,350 |
| Income taxes paid | | **(2,640,580)** | (1,517,632) | (1,675,452) |
| Finance cost paid | | **(3,182,682)** | (2,907,116) | (2,196,778) |
| Net cash flows provided by operating activities | | **31,081,557** | 25,251,115 | 32,855,788 |

*Forward*

| | *Note* | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | |
| Proceeds from sale of property, plant and equipment | *13* | **P13,820,388** | P - | P - |
| Proceeds from sale of investment | | **-** | - | 16,228,991 |
| Noncurrent receivable | *16* | **-** | (253,812) | - |
| Additions to deferred exploration and development costs | *14* | **(3,831)** | (17,765) | (145,784) |
| Additions to intangible assets | *6, 15* | **(271,991)** | (117,735) | (593,649) |
| Net additions to investments and advances | *12* | **(5,927,312)** | (529,105) | (4,622,823) |
| Additions to property, plant and equipment | *13, 18* | **(14,862,133)** | (33,832,759) | (17,299,444) |
| Net cash flows used in investing activities | | **(7,244,879)** | (34,751,176) | (6,432,709) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | |
| Net proceeds from long-term debt | *18* | **30,684,375** | 8,825,000 | 1,500,000 |
| Proceeds from short-term borrowing | | **14,364,000** | - | - |
| Proceeds from issuance of undated subordinated capital securities | *21* | **-** | 13,823,499 | 13,110,066 |
| Distributions to undated subordinated capital securities holders | *21* | **(2,904,573)** | (1,450,688) | (723,214) |
| Cash dividends paid | *21* | **(3,000,000)** | (4,500,000) | (10,000,000) |
| Payment of short-term borrowing | | **(14,364,000)** | - | - |
| Payments of finance lease liabilities | *6* | **(23,873,363)** | (22,280,118) | (20,123,987) |
| Payment of long-term debt | *18* | **(25,514,700)** | (1,373,100) | (193,200) |
| Net cash flows used in financing activities | | **(24,608,261)** | (6,955,407) | (16,430,335) |
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS** | | **21,607** | 392,535 | (813,621) |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | | **(749,976)** | (16,062,933) | 9,179,123 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | | **22,241,361** | 38,304,294 | 29,125,171 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | *7* | **P21,491,385** | P22,241,361 | P38,304,294 |

*See Notes to the Consolidated Financial Statements.*

# SMC GLOBAL POWER HOLDINGS CORP. AND SUBSIDIARIES
## (A Wholly-owned Subsidiary of San Miguel Corporation)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Thousands, Except Per Share Data and Number of Shares)

## 1. Reporting Entity

SMC Global Power Holdings Corp. (the Parent Company) was incorporated in the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on January 23, 2008, and its primary purpose of business is to purchase, sell, lease, develop and dispose of all properties of every kind and description, and shares of stocks or other securities or obligations, created or issued by any corporation or other entity. The Parent Company's registered office address is located at 155 EDSA, Brgy. Wack-Wack, Mandaluyong City, Metro Manila.

The accompanying consolidated financial statements comprise the financial statements of the Parent Company and its Subsidiaries (collectively referred to as the Group) and the Group's interests in associates and joint ventures.

The Parent Company is a wholly-owned subsidiary of San Miguel Corporation (SMC). The ultimate parent company of the Group is Top Frontier Investment Holdings, Inc. (Top Frontier). SMC and Top Frontier are public companies under Section 17.2 of the Securities Regulation Code and whose shares are listed on The Philippine Stock Exchange, Inc. (PSE).

## 2. Basis of Preparation

Statement of Compliance

The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations issued by the Philippine Financial Reporting Standards Council (FRSC).

The consolidated financial statements were approved and authorized for issue in accordance with a resolution by the Board of Directors (BOD) on March 13, 2017.

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis of accounting, except for the defined benefit retirement liability which is measured at present value of the defined benefit retirement obligation.

Functional and Presentation Currency

The consolidated financial statements are presented in Philippine peso, which is the Parent Company's functional currency. All financial information are rounded off to the nearest thousand (P000), except when otherwise indicated.

Basis of Consolidation

The Parent Company's subsidiaries, primarily engaged in power generation, retail and other power-related services and coal mining are incorporated in the Philippines and registered with the Philippine SEC. The consolidated financial statements include the accounts of the Parent Company and its subsidiaries as follows:

| | Percentage of Ownership | |
|---|---|---|
| | **2016** | 2015 |
| *Power Generation* | | |
| San Miguel Energy Corporation (SMEC) | **100** | 100 |
| South Premiere Power Corp. (SPPC) | **100** | 100 |
| Strategic Power Devt. Corp. (SPDC) | **100** | 100 |
| SMC PowerGen Inc. (SPI) | **100** | 100 |
| Limay Power Generation Corporation *(c)* | **100** | 100 |
| SMC Consolidated Power Corporation (SCPC) *(b)* | **100** | 100 |
| San Miguel Consolidated Power Corporation (SMCPC) *(i)* | **100** | 100 |
| Central Luzon Premiere Power Corp. (CLPPC) *(e)* | **100** | 100 |
| Limay Premiere Power Corp. (LPPC) *(b) (e)* | **100** | 100 |
| Mariveles Power Generation Corporation (MPGC) *(e) (g)* | **49** | 100 |
| PowerOne Ventures Energy Inc. (PVEI) *(j)* | **100** | 100 |
| *Retail and Other Power-related Services* | | |
| San Miguel Electric Corp. (SMELC) | **100** | 100 |
| Albay Power and Energy Corp. (APEC) | **100** | 100 |
| SMC Power Generation Corp. (SPGC) *(k)* | **100** | 100 |
| *Coal Mining* | | |
| Daguma Agro-Minerals, Inc. (DAMI) *(a)* | **100** | 100 |
| Sultan Energy Phils. Corp. (SEPC) *(a)* | **100** | 100 |
| Bonanza Energy Resources, Inc. (BERI) *(a)* | **100** | 100 |
| *Others* | | |
| Mantech Power Dynamics Services Inc. (MPDSI) *(h) (l)* | **100** | 100 |
| Safetech Power Services Corp. (SPSC) *(h) (l)* | **100** | 100 |
| Ondarre Holding Corporation (OHC) *(d) (m)* | **100** | 100 |
| Golden Quest Equity Holdings Inc. (GQEHI) *(a) (e) (m)* | **100** | 100 |
| Grand Planters International, Inc. (GPII) *(f) (m)* | **100** | 100 |

*(a) Indirectly owned by the Parent Company through SMEC and has not yet started commercial operations as of December 31, 2016.*
*(b) Construction of power plants on-going as of December 31, 2016.*
*(c) Indirectly owned by the Parent Company through SPI and has not yet started commercial operations as of December 31, 2016.*
*(d) Acquired in February 2015 and has not yet started commercial operations as of December 31, 2016.*
*(e) Incorporated in 2015 and has not yet started commercial operations as of December 31, 2016.*
*(f) Acquired in September 2015.*
*(g) On June 16, 2016, ownership of the Parent Company was reduced to 49% due to the purchase of MPGC common shares by Meralco Powergen Corporation and Zygnet Prime Holdings, Inc., representing 49% and 2% interest in MPGC, respectively.*
*(h) Incorporated in 2015 and started commercial operations in 2016.*
*(i) On December 26, 2016, SMCPC started its commercial operations for Unit 1 of 2 x 150 Mega Watt (MW) Coal-fired Power Plant in Malita, Davao.*
*(j) PVEI owns 60% of the outstanding capital stock of Angat Hydropower Corporation and KWPP Holdings Corporation as joint ventures.*
*(k) SPGC owns 35% of the outstanding capital stock of Olongapo Electricity Distribution Company, Inc., as an associate.*
*(l) Involved in providing local manpower services for operating and maintaining power generation facilities.*
*(m) For investing in land properties.*

A subsidiary is an entity controlled by the Group. The Group controls an entity if and only if, the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control.

When the Group has less than majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including the contractual arrangement with the other vote holders of the investee, rights arising from other contractual arrangements and the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are included in the consolidated financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The financial statements of the subsidiaries are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the consolidated financial statements.

A change in the ownership interest in a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, the Group: (i) derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests and the cumulative transaction differences recorded in equity; (ii) recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in the consolidated statements of income; and (iii) reclassify the Parent Company's share of components previously recognized in other comprehensive income to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

## 3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards and Interpretations
The FRSC approved the adoption of a number of new and amended standards and interpretations as part of PFRS.

*Amendments to Standards and Interpretations Adopted in 2016*

The Group has adopted the following PFRS starting January 1, 2016 and accordingly, changed its accounting policies in the following areas:

- Disclosure Initiative *(Amendments to PAS 1, Presentation of Financial Statements)*. The amendments clarify the following: (i) the materiality requirements apply to the whole financial statements and an entity shall not reduce the understandability of the financial statements by obscuring material information with immaterial information or by aggregating material items that have different nature or function; (ii) that specific line items to be presented in the statements of financial position, statements of income and statements of comprehensive income can be disaggregated and additional guidance on subtotals to be presented in these statements; (iii) that entities have flexibility as to the order in which they present the notes to the financial statements; and (iv) that share of other comprehensive income of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to statements of income.

- Accounting for Acquisitions of Interests in Joint Operations *(Amendments to PFRS 11, Joint Arrangements).* The amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitutes a business. Business combination accounting also applies to the acquisition of additional interests in a joint operation while the joint operator retains joint control. The additional interest acquired will be measured at fair value. The previously held interests in the joint operation will not be remeasured. The amendments place the focus firmly on the definition of a business, because this is key to determining whether the acquisition is accounted for as a business combination or as the acquisition of a collection of assets. As a result, this places pressure on the judgment applied in making this determination.

- Clarification of Acceptable Methods of Depreciation and Amortization *(Amendments to PAS 16, Property, Plant and Equipment and PAS 38, Intangible Assets).* The amendments to PAS 38 introduce a rebuttable presumption that the use of revenue-based amortization methods for intangible assets is inappropriate. This presumption can be overcome only when revenue and the consumption of the economic benefits of the intangible asset are highly correlated, or when the intangible asset is expressed as a measure of revenue. The amendments to PAS 16 explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment. This is because such methods reflect factors other than the consumption of economic benefits embodied in the asset - e.g., changes in sales volumes and prices.

- *Annual Improvements to PFRS Cycles 2012 - 2014* contain changes to four standards, of which Changes in Method for Disposal *(Amendments to PFRS 5, Noncurrent Assets Held for Sale and Discontinued Operations)* is applicable to the Group. PFRS 5 is amended to clarify that: (a) if an entity changes the method of disposal of an asset or disposal group - i.e., reclassifies an asset or disposal group from held-for-distribution to owners to held-for-sale, or vice versa, without any time lag - the change in classification is considered a continuation of the original plan of disposal and the entity continues to apply held-for-distribution or held-for-sale accounting. At the time of the change in method, the entity measures the carrying amount of the asset or disposal group and recognizes any write-down (impairment loss) or subsequent increase in the fair value of the asset or disposal group, less costs to sell or distribute; and (b) if an entity determines that an asset or disposal group no longer meets the criteria to be classified as held-for-distribution, then it ceases held-for-distribution accounting in the same way as it would cease held-for-sale accounting. Any change in method of disposal or distribution does not, in itself, extend the period in which a sale has to be completed.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the consolidated financial statements.

*New and Amended Standards and Interpretations Not Yet Adopted*

A number of new and amended standards and interpretations are effective for annual periods beginning after January 1, 2016 and have not been applied in preparing the consolidated financial statements. Unless otherwise indicated, none of these are expected to have a significant effect on the consolidated financial statements.

The Group will adopt the following new and amended standards on the respective effective dates:

- Disclosure Initiative (Amendments to PAS 7, Statement of Cash Flows). The amendments address financial statements users' requests for improved disclosures about an entity's net debt relevant to understanding an entity's cash flows. The amendments require entities to provide disclosures that enable users of the financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g. by providing a reconciliation between the opening and closing balances in the statements of financial position for liabilities arising from financing activities.

  The amendments are effective for annual periods beginning on or after January 1, 2017, with early adoption permitted. When the Group first applies the amendments, it is not required to provide comparative information for preceding periods.

- *Recognition of Deferred Tax Assets for Unrealized Losses (Amendments to PAS 12, Income Taxes)*. The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.

  The amendments are to be applied retrospectively for annual periods beginning on or after January 1, 2017, with early adoption permitted. On initial application of the amendment, the change in the opening equity of the earliest comparative period may be recognized in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. If the Group applies this relief, it shall disclose that fact.

- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which the following are applicable to the Group:

  - *Clarification of the Scope of the Standard (Amendments to PFRS 12, Disclosure of Interests in Other Entities)*. The amendments clarify that the disclosure requirements for interests in other entities also apply to interests that are classified as held for sale or distribution. The amendments are to be applied retrospectively for annual periods beginning on or after January 1, 2017, with early adoption permitted.

  - *Measuring an associate or joint venture at fair value (Amendments to PAS 28, Investments in Associates).* The amendments provide that a venture capital organization, or other qualifying entity, may elect to measure its investments in an associate or joint venture at fair value through profit or loss. This election can be made on an investment-by-investment basis. The amendments also provide that a non-investment entity investor may elect to retain the fair value accounting applied by an investment entity associate or investment entity joint venture to its subsidiaries. This election can be made separately for each investment entity associate or joint venture.

    The amendments are to be applied retrospectively on or after January 1, 2018, with early application permitted.

- PFRS 9 (2014), *Financial Instruments*, replaces PAS 39, *Financial Instruments: Recognition and Measurement,* and supersedes the previously published versions of PFRS 9 that introduced new classifications and measurement requirements (in 2009 and 2010) and a new hedge accounting model (in 2013). PFRS 9 includes revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment of all financial assets that are not measured at Fair Value through Profit or Loss (FVPL), which generally depends on whether there has been a significant increase in credit risk since initial recognition of a financial asset, and supplements the new general hedge accounting requirements published in 2013. The new model on hedge accounting requirements provides significant improvements by aligning hedge accounting more closely with risk management.

  The new standard is required to be applied retrospectively for annual periods beginning on or after January 1, 2018, with early adoption permitted.

- Classification and Measurement of Share-based Payment Transactions (*Amendments to PFRS 2, Share-based Payment*). The amendments clarify that a cash-settled share-based payment is measured using the same approach as for equity-settled share-based payments - i.e. the modified grant date method. The amendments also introduce an exception stating that, for classification purposes, a share-based payment transaction with employees is accounted for as equity-settled if: (a) the terms of the arrangement permit or require a company to settle the transaction net by withholding a specified portion of the equity instruments to meet the statutory tax withholding requirement (the net settlement feature); and (b) the entire share-based payment transaction would otherwise be classified as equity-settled if there were no net settlement feature. The exception does not apply to equity instruments that the company withholds in excess of the employee’s tax obligation associated with the share-based payment. The amendments also clarify that the Group is to apply the following approach when a share-based payment is modified from cash-settled to equity-settled: (a) at the modification date, the liability for the original cash-settled share-based payment is derecognized and the equity-settled share-based payment is measured at its fair value and recognized to the extent that the goods or services have been received up to that date; and (b) the difference between the carrying amount of the liability derecognized as at the modification date and the amount recognized in equity as at that date is recognized in profit or loss immediately.

  The amendments are required to be applied prospectively for annual periods beginning on or after January 1, 2018, with early application permitted. The amendments were approved by the FRSC on September 14, 2016 but are still subject to the approval by the Board of Accountancy.

- PFRS 15, *Revenue from Contracts with Customers,* replaces PAS 11, *Construction Contracts*, PAS 18, *Revenue*, International Financial Reporting Interpretations Committee (IFRIC) 13, *Customer Loyalty Programmes*, IFRIC 18, *Transfer of Assets from Customers* and Standard Interpretation Committee - 31, *Revenue - Barter Transactions Involving Advertising Services*. The new standard introduces a new revenue recognition model for contracts with customers which specifies that revenue should be recognized when (or as) a company transfers control of goods or services to a customer at the amount to which the company expects to be entitled. Depending on whether certain criteria are met, revenue is recognized over time, in a manner that best reflects the company's performance, or at a point in time, when control of the goods or services is transferred to the customer. The standard does not apply to insurance contracts, financial instruments or lease contracts, which fall in the scope of other PFRS. It also does not apply if two companies in the same line of business exchange nonmonetary assets to facilitate sales to other parties. Furthermore, if a contract with a customer is partly in the scope of another PFRS, then the guidance on separation and measurement contained in the other PFRS takes precedence. The new standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

- *Philippine Interpretation IFRIC-22 Foreign Currency Transactions and Advance Consideration.* The amendments clarifies that the transaction date to be used for translation for foreign currency transactions involving an advance payment or receipt is the date on which the entity initially recognizes the prepayment or deferred income arising from the advance consideration. For transactions involving multiple payments or receipts, each payment or receipt gives rise to a separate transaction date. The interpretation applies when an entity pays or receives consideration in a foreign currency and recognizes a non-monetary asset or liability before recognizing the related item. The interpretation is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

- PFRS 16, *Leases,* supersedes PAS 17, *Leases,* and the related Philippine Interpretations. The new standard introduces a single lease accounting model for lessees under which all major leases are recognized on-balance sheet, removing the lease classification test. Lease accounting for lessors essentially remains unchanged except for a number of details including the application of the new lease definition, new sale-and-leaseback guidance, new sub-lease guidance and new disclosure requirements. Practical expedients and targeted reliefs were introduced including an optional lessee exemption for short-term leases (leases with a term of 12 months or less) and low-value items, as well as the permission of portfolio-level accounting instead of applying the requirements to individual leases. New estimates and judgmental thresholds that affect the identification, classification and measurement of lease transactions, as well as requirements to reassess certain key estimates and judgments at each reporting date were introduced.

  PFRS 16 is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply PFRS 15 at or before the date of initial application of PFRS 16. The Group is currently assessing the potential impact of PFRS 16 and plans to adopt this new standard on leases on the required effective date.

- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture *(Amendments to PFRS 10, Consolidated Financial Statements, and PAS 28, Investments in Associates).* The amendments address an inconsistency in the requirements in PFRS 10 and PAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require that a full gain or loss is recognized when a transaction involves a business whether it is housed in a subsidiary or not. A partial gain or loss is recognized when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

  Originally, the amendments apply prospectively for annual periods beginning on or after January 1, 2016, with early adoption permitted. However on January 13, 2016, the FRSC decided to postpone the effective date until the International Accounting Standards Board has completed its broader review of the research project on equity accounting that may result in the simplification of accounting for such transactions and of other aspects of accounting for associates and joint ventures.

<u>Financial Assets and Financial Liabilities</u>
*Date of Recognition.* The Group recognizes a financial asset or a financial liability in the consolidated statements of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

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

*'Day 1' Difference.* Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and the fair value (a 'Day 1' difference) in the consolidated statements of income unless it qualifies for recognition as some other type of asset. In cases where data used is not observable, the difference between the transaction price and model value is only recognized in the consolidated statements of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' difference amount.

*<u>Financial Assets</u>*
The Group classifies its financial assets, at initial recognition, in the following categories: financial assets at FVPL, loans and receivables, available-for-sale (AFS) financial assets and held-to-maturity (HTM) investments. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. The Group determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

The Group has no financial assets at FVPL, AFS financial assets and HTM investments as of December 31, 2016 and 2015.

*Loans and Receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables is recognized as part of “Interest income” account in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The periodic amortization is also included as part of “Interest income” account in the consolidated statements of income. Gains or losses are recognized in the consolidated statements of income when loans and receivables are derecognized or impaired.

Cash includes cash on hand and in banks which are stated at face value. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

The Group’s cash and cash equivalents, trade and other receivables, restricted cash and noncurrent receivable are included under this category (Notes 7, 8, 16, 27 and 28).

*Financial Liabilities*

The Group classifies its financial liabilities, at initial recognition, in the following categories: financial liabilities at FVPL and other financial liabilities. The Group determines the classification of its financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date. All financial liabilities are recognized initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

As of December 31, 2016 and 2015, the Group has no financial liabilities at FVPL.

*Other Financial Liabilities.* This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability. The effective interest rate amortization is included in “Interest expense and other financing charges” account in the consolidated statements of income. Gains and losses are recognized in the consolidated statements of income when the liabilities are derecognized as well as through the amortization process.

The Group’s liabilities arising from its trade or borrowings such as accounts payable and accrued expenses, finance lease liabilities and long-term debt are included under this category (Notes 17, 18, 27 and 28).

Embedded Derivatives
The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid or combined instrument is not recognized as at FVPL.

Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Embedded derivatives that are bifurcated from the host contracts are accounted for either as financial assets or financial liabilities at FVPL.

The Group does not have any embedded derivatives as of December 31, 2016 and 2015.

Derecognition of Financial Assets and Financial Liabilities
*Financial Assets.* A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognized when:

- the rights to receive cash flows from the asset have expired; or

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

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if and to what extent it has retained the risks and rewards of ownership. When it has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the Group continues to recognize the transferred asset to the extent of the Group’s continuing involvement. In that case, the Group also recognizes the associated liability. The transferred asset and the associated liability are measured on the basis that reflects the rights and obligations that the Group has retained.

*Financial Liabilities.* A financial liability is derecognized when the obligation under the liability is discharged or cancelled, or has expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statements of income.

Impairment of Financial Assets
The Group assesses, at the reporting date, whether a financial asset or a group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

*Assets Carried at Amortized Cost.* For financial assets carried at amortized cost such as loans and receivables, the Group first assesses whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets with similar credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

The carrying amount of the asset is reduced either directly or through the use of an allowance account. The impairment loss for the period is recognized in the consolidated statements of income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statements of income, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

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

A financial instrument is classified as liability if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity;

- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or

- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

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

Debt Issue Costs
Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest rate method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are recognized in the consolidated statements of income.

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

Inventories
Inventories are carried at the lower of cost or net realizable value. Cost is determined using specific identification method or first-in-first-out method for materials and supplies, specific identification method or weighted average method for coal inventories and weighted average method for fuel oil and other consumables. Net realizable value is the current replacement cost.

Business Combination
Business combination is accounted for using the acquisition method as at the acquisition date. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included as part of "Operating expenses" account in the consolidated statements of income.

When the Group acquires a business, it assesses the financial assets and financial liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured at the acquisition date fair value and any resulting gain or loss is recognized in the consolidated statements of income.

The Group measures goodwill at the acquisition date as: a) the fair value of the consideration transferred; plus b) the recognized amount of any non-controlling interests in the acquiree; plus c) if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less d) the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed. When the excess is negative, a bargain purchase gain is recognized immediately in the consolidated statements of income. Subsequently, goodwill is measured at cost less any accumulated impairment in value. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying amount may be impaired.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognized in the consolidated statements of income. Costs related to the acquisition, other than those associated with the issuance of debt or equity securities that the Group incurs in connection with a business combination, are expensed as incurred. Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognized in the consolidated statements of income.

- *Goodwill in a Business Combination*
  Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

  - represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and

  - is not larger than an operating segment determined in accordance with PFRS 8.

Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. An impairment loss with respect to goodwill is not reversed.

- *Intangible Assets Acquired in a Business Combination*
  The cost of an intangible asset acquired in a business combination is the fair value as at the date of acquisition, determined using discounted cash flows as a result of the asset being owned.

  Following initial recognition, intangible asset is carried at cost less any accumulated amortization and any impairment losses. The useful life of an intangible asset is assessed to be either finite or indefinite.

  An intangible asset with finite life is amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least at each reporting date. A change in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for as a change in accounting estimate. The amortization expense on intangible asset with finite life is recognized in the consolidated statements of income.

<u>Transactions under Common Control</u>
Transactions under common control entered into in contemplation of each other and business combination under common control designed to achieve an overall commercial effect are treated as a single transaction.

Transfers of assets between commonly controlled entities are accounted for using book value accounting.

<u>Investments in Shares of Stock of Associates and Joint Ventures</u>
An associate is an entity in which the Group has significant influence. Significant influence is the power to participate in the financial and operating policies of the investee, but is not control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The considerations made in determining significant influence or joint control is similar to those necessary to determine control over subsidiaries.

The Group’s investments in shares of stock of associates and joint ventures are accounted for using equity method.

Under the equity method, the investments in shares of stock of associates or joint ventures are initially recognized at cost. The carrying amount of the investments are adjusted to recognize the changes in the Group's share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investments and are neither amortized nor individually tested for impairment.

The Group's share in profit or loss of associates or joint ventures is recognized as "Equity in net losses of associates and joint ventures" account in the consolidated statements of income. Adjustments to the carrying amount may also be necessary for changes in the Group's proportionate interest in the associate or joint venture arising from changes in the associate or joint venture's other comprehensive income. The Group's share on these changes is recognized in the consolidated statements of comprehensive income. Unrealized gains and losses resulting from transactions between the Group and the associates or joint ventures are eliminated to the extent of the interest in the associates or joint ventures.

After application of the equity method, the Group determines whether it is necessary to recognize an impairment loss with respect to the Group's net investments in the shares of stock of associates or joint ventures. At each reporting date, the Group determines whether there is objective evidence that the investments in shares of stock of associates or joint ventures is impaired. If there is such evidence, the Group recalculates the amount of impairment as the difference between the recoverable amount and carrying amount of the investments in shares of stock of associates or joint ventures. Such impairment loss is recognized as part of "Equity in net losses of associates and joint ventures" account in the consolidated statements of income.

Upon loss of significant influence over the associate or joint control over the joint venture, the Group measures and recognizes any retained investment at fair value. Any difference between the carrying amount of the investments in shares of stock of associates or joint ventures upon loss of significant influence or joint control, and the fair value of the retained investment and proceeds from disposal is recognized in the consolidated statements of income.

The financial statements of the associates or joint ventures are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

Property, Plant and Equipment

Property, plant and equipment, except for land, are stated at cost less accumulated depreciation and amortization and any accumulated impairment in value. Such cost includes the cost of replacing part of the property, plant and equipment at the time the cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its construction cost or purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation (ARO). Expenditures incurred after the asset has been put into operation, such as repairs, maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. Major repairs are capitalized as part of property, plant and equipment only when it is probable that future economic benefits associated with the items will flow to the Group and the cost of the items can be measured reliably.

Capital projects in progress (CPIP) represents the amount of accumulated expenditures on unfinished and/or ongoing projects. This includes the costs of construction and other direct costs. Borrowing costs that are directly attributable to the construction of plant and equipment are capitalized during the construction period. CPIP is not depreciated until such time that the relevant assets are ready for use.

Depreciation and amortization, which commence when the assets are available for their intended use, are computed using the straight-line method over the following estimated useful lives of the assets:

| | Number of Years |
|---|---|
| Power plants | 10 - 43 |
| Leasehold improvements | 5 - 25<br>or term of the lease<br>whichever is shorter |
| Other equipment | 2 - 15 |
| Building | 15 - 25 |

The remaining useful lives, residual values, and depreciation and amortization methods are reviewed and adjusted periodically, if appropriate, to ensure that such periods and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amounts may not be recoverable.

Fully depreciated assets are retained in the accounts until they are no longer in use.

An item of property, plant and equipment is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its use or disposal. Any gain or loss arising from the retirement and disposal of an item of property, plant and equipment (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statements of income in the period of retirement and disposal.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value at the date of acquisition. Subsequently, intangible assets are carried at cost less accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditures are recognized in the consolidated statements of income in the year in which the related expenditures are incurred. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible assets may be impaired. The amortization period and amortization method used for an intangible asset with a finite useful life are reviewed at least at each reporting date. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimate. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income consistent with the function of the intangible asset.

Amortization is computed using the straight-line method over the following estimated useful lives of intangible assets with finite lives:

| | Number of Years |
|---|---|
| Power concession right | 25 |
| Computer software and licenses | 3 |

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

*Power Concession Assets and Obligations*
Public-to-private service concession arrangements where: (a) the grantor controls or regulates what services the entities in the Group can provide with the infrastructure, to whom it can provide them, and at what price; and (b) the grantor controls (through ownership, beneficial entitlement or otherwise) any significant residual interest in the infrastructure at the end of the term of the arrangement are accounted for under Philippine Interpretation IFRIC 12, *Service Concession Arrangements.* Infrastructures used in a public-to-private service concession arrangement for its entire useful life (whole-of-life assets) are within the scope of the Interpretation if the conditions in (a) are met.

The Interpretation applies to both: (a) infrastructure that the entities in the Group construct or acquire from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the entity in the Group access for the purpose of the service arrangement.

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

The Group's power concession right pertains to the right granted by the Government to the Parent Company, through APEC, to operate the Albay Electric Cooperative, Inc. (ALECO). The Group's power concession right is carried at cost less accumulated amortization and any accumulated impairment losses.

The power concession right is amortized using the straight-line method over the concession period and assessed for impairment whenever there is an indication that the asset may be impaired.

The useful lives of power concession right are assessed to be either finite or indefinite. Power concession right arising from a service concession arrangement is amortized using straight-line method over the concession period, which is 25 years from the first day of the commencement of operations, or the estimated useful lives of the infrastructure, whichever is shorter, and assessed for impairment whenever there is an indication that the asset may be impaired. The amortization period and method are reviewed at least at each reporting date. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense is recognized in the consolidated statements of income in the expense category consistent with the function of the concession assets.

The power concession right is derecognized on disposal or when no further economic benefits are expected from its use or disposal. Gain or loss from derecognition of the power concession right is measured as the difference between the net disposal proceeds and the carrying amount of the asset, and is recognized in the consolidated statements of income.

An entity recognizes and measures revenue in accordance with PAS 11 and PAS 18 for the services it performs. If an entity performs more than one service under a single contract or arrangement, consideration received or receivable is allocated by reference to the relative fair values of the services delivered when the amounts are separately identifiable.

When an entity provides construction or upgrade services, the consideration received or receivable by the entity is recognized at fair value. An entity accounts for revenue and costs relating to construction or upgrade services in accordance with PAS 11. Revenue from construction contracts is recognized based on the percentage-of-completion method, measured by reference to the proportion of costs incurred to date, to estimated total costs for each contract. The applicable entity account for revenue and costs relating to operation services in accordance with PAS 18.

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

When the applicable entity has contractual obligations to 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 the contractual obligations in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, i.e., at the best estimate of the expenditure that would be required to settle the present obligation at the reporting date.

In accordance with PAS 23, *Borrowing Costs*, borrowing costs attributable to the arrangement are recognized as expenses in the period in which they are incurred unless the applicable entities have 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.

Concession payable is recognized at the date of inception of the concession agreement. Fixed concession fees are recognized at present value using the discount rate at the inception date. This account is debited upon payment of fixed fees and such payments are apportioned between interest payment and payment of the principal. Interest arising from the accretion of concession payable is presented under “Interest expense and other financing charges” account in the consolidated statements of income.

Concession payable that are expected to be settled within 12 months after the reporting date are classified as current liabilities. Otherwise, these are classified as noncurrent liabilities.

*Mining Rights*
The Group's mining rights have finite lives and are carried at cost less accumulated amortization and any accumulated impairment losses.

Subsequent expenditures are capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures are recognized in the consolidated statements of income as incurred.

Amortization of mining rights is recognized in the consolidated statements of income based on the units of production method utilizing only recoverable coal reserves as the depletion base. In applying the units of production method, amortization is normally calculated using the quantity of material extracted from the mine in the period as a percentage of the total quantity of material to be extracted in current and future periods based on proved and probable reserves.

Gain or loss from derecognition of mining rights and evaluation assets is measured as the difference between the net disposal proceeds and the carrying amount of the asset, and is recognized in the consolidated statements of income.

The amortization of mining rights will commence upon commercial operations.

<u>Deferred Exploration and Development Costs</u>
Deferred exploration and development costs comprise expenditures which are directly attributable to:

- Researching and analyzing existing exploration data;
- Conducting geological studies, exploratory drilling and sampling;
- Examining and testing extraction and treatment methods; and
- Compiling pre-feasibility and feasibility studies.

Deferred exploration and development costs also include expenditures incurred in acquiring mining rights and evaluation assets, entry premiums paid to gain access to areas of interest and amounts payable to third parties to acquire interests in existing projects.

Exploration assets are reassessed on a regular basis and tested for impairment provided that at least one of the following conditions is met:

- the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;
- such costs are expected to be recouped in full through successful development and exploration of the area of interest or alternatively, by its sale; or
- exploration and evaluation activities in the area of interest have not yet reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in relation to the area are continuing, or planned for the future.

If the project proceeds to development stage, the amounts included within deferred exploration and development costs are transferred to property, plant and equipment.

<u>Impairment of Non-financial Assets</u>
The carrying amounts of investments and advances, property, plant and equipment, deferred exploration and development costs and intangible assets with finite useful lives are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill are tested for impairment annually either individually or at the cash-generating unit level. If any such indication exists, and if the carrying amount exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of fair value less costs to sell and value in use. The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. Value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the consolidated statements of income in those expense categories consistent with the function of the impaired asset.

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

Fair Value Measurements

The Group measures a number of financial and non-financial assets and liabilities at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or most advantageous market must be accessible to the Group.

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

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and

- Level 3: inputs for the asset or liability that are not based on observable market data.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing the categorization at the end of each reporting period.

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

Provisions
Provisions are recognized when: (a) the Group has a present obligation (legal or constructive) as a result of past events; (b) it is probable (i.e., more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate of the amount of the obligation can be made. Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognized as a separate asset only when it is virtually certain that reimbursement will be received. The amount recognized for the reimbursement shall not exceed the amount of the provision. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

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 the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

Capital Stock and Additional Paid-in Capital
*Common shares.* Common shares are measured at par and are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

*Additional Paid-in Capital.* When the shares are sold at premium, the difference between the proceeds and the par value is credited to the “Additional paid-in capital” account. When shares are issued for a consideration other than cash, the proceeds are measured by the fair value of the consideration received. In case the shares are issued to extinguish or settle the liability of the Parent Company, the shares are measured either at the fair value of the shares issued or fair value of the liability settled, whichever is more reliably determinable.

Undated Subordinated Capital Securities
Undated subordinated capital securities (USCS) are classified as equity when there is no contractual obligation to deliver cash or other financial assets to another person or entity or to exchange financial assets or financial liabilities with another person or entity that is potentially unfavorable to the issuer.

Incremental costs directly attributable to the issuance of undated subordinated capital securities are recognized as a deduction from equity, net of tax. The proceeds received, net of any directly attributable transaction costs, are credited to undated subordinated capital securities.

Retained Earnings
Retained earnings represent the accumulated net income or losses, net of any dividend, distributions and other capital adjustments. Appropriated retained earnings represent that portion which is restricted and therefore not available for any dividend declaration.

Revenue Recognition
Revenue is recognized to the extent that it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty. Revenues are stated at amounts invoiced to customers, inclusive of pass-through charges, net of value-added tax (VAT) and other taxes.

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

*Sale of Power.* Revenue from power generation and trading is recognized in the period when actual power or capacity is generated, transmitted and/or made available to the customers, net of related discounts and adjustments.

*Retail and Other Power-related Services.* Revenues are recognized upon the supply of electricity to the customers. The Uniform Filing Requirements (UFR) on the rate unbundling released by the Energy Regulatory Commission (ERC) on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) system loss charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) currency exchange rate adjustments, where applicable and (h) interclass and life subsidies. Feed-in tariffs allowance, VAT, local franchise tax and universal charges are billed and collected on behalf of the national and local government and do not form part of the Group's revenue. Generation, transmission and system loss charges, which are part of revenues, are pass-through charges.

<u>*Others*</u>
*Interest Income.* Revenue is recognized as the interest accrues, taking into account the effective yield on the asset.

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

*Rent Income.* Rent income from operating lease is recognized on a straight-line basis over the related lease terms. Lease incentives granted are recognized as an integral part of the total rent income over the term of the lease.

*Construction Revenue.* Construction revenue related to the Group's recognition of intangible asset on the right to operate ALECO, which is the fair value of the intangible asset, is earned and recognized as the construction progresses. The Group recognizes the corresponding amount as intangible asset as it recognizes the construction revenue. The Group assumes no profit margin in earning the right to operate ALECO.

The Group uses the cost to cost percentage-of-completion method to determine the appropriate amount of revenue to be recognized in a given period. The stage of completion is measured by reference to the costs incurred related to the construction of ALECO infrastructure up to the end of the reporting period as a percentage of total estimated cost of the construction.

<u>Cost and Expense Recognition</u>
*Costs and Expenses.* Costs and expenses are decreases in economic benefits during the accounting period in the form of outflows or decrease of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants. Cost of power sold is debited for the direct costs related to power generation, retail and distribution of electricity, and/or trading. Expenses are recognized when incurred.

*Interest Expense and Other Financing Charges.* Interest expense and other financing charges comprise finance charges on finance lease liabilities, loans, concession payable and other borrowings. Finance charges on finance lease liabilities, loans and concession payable are recognized in consolidated statements of income using the effective interest rate method.

Share-based Payment Transactions

Under the Group's Long-term Incentive Plan for Stock Options (LTIP) and Employee Stock Purchase Plan (ESPP), executives and employees of the Group receive remuneration in the form of share-based payment transactions, whereby the executives and employees render services as consideration for equity instruments of SMC. Such transactions are handled centrally by SMC.

Share-based transactions in which SMC grants option rights to its equity instruments directly to the Group's employees are accounted for as equity-settled transactions.

The cost of LTIP is measured by reference to the option fair value at the date when the options are granted. The fair value is determined using Black-Scholes option pricing model. In valuing LTIP transactions, any performance conditions are not taken into account, other than conditions linked to the price of the shares of SMC. ESPP is measured by reference to the market price at the time of the grant less subscription price.

The cost of share-based payment transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date when the relevant employees become fully entitled to the award (the "vesting date"). The cumulative expenses recognized for share-based payment transactions at each reporting date until the vesting date reflect the extent to which the vesting period has expired and SMC's best estimate of the number of equity instruments that will ultimately vest. Where the terms of a share-based award are modified, as a minimum, an expense is recognized as if the terms had not been modified. In addition, an expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately.

However, if a new award is substituted for the cancelled award and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award.

Leases

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

(a) there is a change in contractual terms, other than a renewal or extension of the arrangement;

(b) a renewal option is exercised or an extension is granted, unless the term of the renewal or extension was initially included in the lease term;

(c) there is a change in the determination of whether fulfillment is dependent on a specific asset; or

(d) there is a substantial change to the asset.

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

*Finance Lease*
Finance leases, which transfer to the Group substantially all the risks and rewards incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Obligations arising from plant assets under finance lease agreement are classified in the consolidated statements of financial position as finance lease liabilities.

Lease payments are apportioned between financing charges and reduction of the lease liabilities so as to achieve a constant rate of interest on the remaining balance of the liabilities. Financing charges are recognized in the consolidated statements of income.

Capitalized leased assets are depreciated over the estimated useful lives of the assets when there is reasonable certainty that the Group will obtain ownership by the end of the lease term.

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

*Group as Lessor.* Leases where the Group does not transfer substantially all the risks and rewards of ownership of the assets are classified as operating leases. Rent income from operating leases is recognized as income on a straight-line basis over the lease term. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as rent income. Contingent rents are recognized as income in the period in which they are earned.

Borrowing Costs
Borrowing costs directly attributable to the acquisition or construction of an asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized as part of the cost of the respective assets. All other borrowing costs are expensed in the period they occur. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use.

Employee Benefits
*Short-term Employee Benefits.* Short-term employee benefits are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

*Retirement Benefits.* The defined benefit retirement liability or asset is the aggregate of the present value of the amount of future benefit that employees have earned in return for their service in the current and prior periods, reduced by the fair value of plan assets (if any), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of economic benefits available in the form of reductions in future contributions to the plan.

The cost of providing benefits under the defined benefit retirement obligation is actuarially determined using the projected unit credit method. Projected unit credit method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Actuarial gains and losses are recognized in full in the period in which they occur in other comprehensive income. Such actuarial gains and losses are also immediately recognized in equity and are not reclassified to profit or loss in subsequent period.

Defined Benefit Cost comprise the following:

- Service costs
- Net interest on the defined benefit retirement liability or asset
- Remeasurements of defined benefit retirement liability or asset

Service costs which include current service costs, past service costs and gains or losses on non-routine settlements are recognized as expense in the consolidated statements of income. Past service costs are recognized when plan amendment or curtailment occurs. These amounts are calculated periodically by independent qualified actuary.

Net interest on the defined benefit retirement liability or asset is the change during the period as a result of contributions and benefit payments, which is determined by applying the discount rate based on the government bonds to the defined benefit retirement liability or asset. Net interest on the defined benefit retirement liability or asset is recognized as expense or income in the consolidated statements of income.

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

When the benefits of a plan are changed, or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in the consolidated statements of income. The Group recognizes gains and losses on the settlement of a defined benefit retirement liability when the settlement occurs.

<u>Foreign Currency Translations</u>
Transactions in foreign currencies are translated to the functional currency of the Group entities at exchange rates at the dates of the transactions. Monetary assets and monetary liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the reporting date.

Nonmonetary assets denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date the fair value was determined. Nonmonetary items in foreign currencies that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction.

Foreign currency differences arising on translation are recognized in the consolidated statements of income.

Taxes

*Current Tax.* Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

*Deferred Tax.* Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

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

- with respect to taxable temporary differences associated with investments in shares of stock of subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits - Minimum Corporate Income Tax (MCIT) and unused tax losses - Net Operating Loss Carry Over (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except:

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

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

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

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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

In determining the amount of current and deferred tax, the Group takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Group believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretation of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Group to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

Current and deferred tax are recognized in the consolidated statements of income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

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

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

- where the tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and

- receivables and payables that are stated with the amount of tax included.

The net amount of tax recoverable from, or payable to, the taxation authority is included as part of “Prepaid expenses and other current assets” or “Income tax payable” accounts in the consolidated statements of financial position.

<u>Assets Held for Sale</u>
Noncurrent assets, or disposal groups comprising assets and liabilities, are classified as held for sale if their carrying amount will be recovered primarily through sale rather than through continuing use.

The assets or disposal groups are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a *pro rata* basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property or biological assets, which continue to be measured in accordance with the Group’s accounting policies. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognized in the consolidated statements of income. Gains are not recognized in excess of any cumulative impairment losses.

The criteria for held for sale is regarded as met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Actions required to complete the sale should indicate that it is unlikely that significant changes to the sale will be made or that the sale will be withdrawn.

Property, plant and equipment and investment property once classified as held for sale are not amortized or depreciated. In addition, equity accounting of equity accounted investees ceases once classified as held for sale or distribution.

Assets and liabilities classified as held for sale are presented separately as current items in the consolidated statements of financial position.

Related Parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control and significant influence. Related parties may be individuals or corporate entities. Transactions between related parties are on an arm's length basis in a manner similar to transactions with non-related parties.

Basic and Diluted Earnings Per Common Share (EPS)

Basic EPS is computed by dividing the net income for the period attributable to equity holders of the Parent Company, net of distributions to the holders of USCS, by the weighted average number of issued and outstanding common shares during the period.

For the purpose of computing diluted EPS, the net income for the period attributable to equity holders of the Parent Company and the weighted average number of issued and outstanding common shares are adjusted for the effects of all potential dilutive instruments.

As of December 31, 2016, 2015 and 2014, the Group has no dilutive equity instruments as disclosed in Note 26 to the consolidated financial statements.

Operating Segments

The Group's operating segments are organized and managed separately according to the services provided, with each segment representing a strategic business unit that offers different economic characteristic and activities. The Chief Executive Officer (the chief operating decision maker; CODM) reviews management reports on a regular basis.

The measurement policies the Group used for segment reporting under PFRS 8 are the same as those used in the consolidated financial statements. There have been no changes in the measurement methods used to determine reported segment profit or loss from prior periods. All inter-segment transfers are carried out at arm's length prices.

Segment revenues, expenses and performance include sales and purchases between business segments. Such sales and purchases are eliminated in consolidation.

Contingencies
Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed in the notes to the consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed in the notes to the consolidated financial statements when an inflow of economic benefits is probable.

Events After the Reporting Date
Post year-end events that provide additional information about the Group's financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post year-end events that are not adjusting events are disclosed in the notes to the consolidated financial statements when material.

## 4. Use of Judgments, Estimates and Assumptions

The preparation of the consolidated financial statements in accordance with PFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the amounts of assets, liabilities, income and expenses reported in the consolidated financial statements at the reporting date. However, uncertainty about these judgments, estimates and assumptions could result in an outcome that could require a material adjustment to the carrying amount of the affected asset or liability in the future.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions are recognized in the period in which the judgments and estimates are revised and in any future period affected.

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

*Finance Lease - Group as Lessee.* In accounting for its Independent Power Producer Administration (IPPA) Agreements with the Power Sector Assets and Liabilities Management Corporation (PSALM), the Group's management has made a judgment that the IPPA Agreements are agreements that contain a lease.

The Group's management has made a judgment that it has substantially acquired all the risks and rewards incidental to the ownership of the power plants. Accordingly, the Group accounted for the agreements as a finance lease and recognized the power plants and finance lease liabilities at the present value of the agreed monthly payments to PSALM (Notes 6 and 13).

Finance lease liabilities recognized in the consolidated statements of financial position amounted to P170,089,536 and P179,193,193 as of December 31, 2016 and 2015, respectively (Note 6).

The combined carrying amounts of power plants under finance lease amounted to P177,759,894 and P182,946,297 as of December 31, 2016 and 2015, respectively (Note 13).

*Operating Lease Commitments - Group as Lessor/Lessee.* The Group has entered into various lease agreements either as a lessor or a lessee. The Group had determined that it retains all the significant risks and rewards of ownership of the property leased out on operating leases while the significant risks and rewards for property leased from third parties and related parties are retained by the lessors (Notes 6).

Rent income recognized in the consolidated statements of income amounted to P21,147, P28,104 and P18,434 in 2016, 2015 and 2014, respectively (Notes 6 and 23).

Rent expense recognized in the consolidated statements of income amounted to P351,091, P360,091 and P115,849 in 2016, 2015 and 2014, respectively (Notes 6 and 22).

*Applicability of Philippine Interpretation IFRIC 12.* In accounting for the Group's transactions in connection with its Concession Agreement with ALECO, significant judgment was applied to determine the most appropriate accounting policy to use.

Management used Philippine Interpretation IFRIC 12 as guide and determined that the Concession Agreement is within the scope of the Interpretation. Management determined that the consideration receivable, in exchange for the fulfillment of the Group's obligation under the Concession Agreement, is an intangible asset in the form of a right (license) to charge fees to users. Judgment was further exercised by management in determining the costs components of acquiring the right (Notes 3, 6 and 15).

*Power Concession Right.* The Group's power concession right represents the right to operate and maintain the franchise of ALECO; i.e., the right to collect electricity fees from the consumers of ALECO. At the end of the concession period, all assets and improvements shall be returned to ALECO and any additions and improvements to the system shall be transferred to ALECO.

Difference in judgment in respect to the accounting treatment of the transactions would materially affect the assets, liabilities and operating results of the Group.

*Classification of Joint Arrangements.* The Group has determined that it has rights only to the net assets of the joint arrangements based on the structure, legal form, contractual terms, and other facts and circumstances of the arrangement. As such, the Group classified its joint arrangements in Angat Hydropower Corporation (Angat Hydro) and KWPP Holdings Corporation (KWPP) as joint venture (Note 12).

*Asset Acquisition and Business Combinations.* In 2015, the Group acquired land and building, through the acquisition of a legal entity, for purposes of power plant expansion. At the time of acquisition, the Group considered whether the acquisition represented an acquisition of a business or a group of assets. The Group accounts for an acquisition as a business combination if it acquires an integrated set of business processes in addition to the real estate property. The consideration is made to the extent that the significant business processes are acquired and the additional services to be provided.

The acquired land and building were classified as part of property, plant and equipment. The Group had determined that the acquisition did not represent a business since there were no integrated set of activities acquired in addition to the property and the Group has no obligation to perform ancillary services (Note 13).

*Contingencies.* The Group is currently involved in various pending claims and cases which could be decided in favor of or against the Group. The Group's estimate of the probable costs for the resolution of these pending claims and cases has been developed in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these matters and is based on an analysis of potential results. The Group currently do not believe that these pending claims and cases will have a material adverse effect on its financial position and financial performance. It is possible, however, that future financial performance could be materially affected by the changes in the estimates or in the effectiveness of strategies relating to these proceedings (Note 29).

Estimates and Assumptions
The key estimates and assumptions used in the consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from such estimates.

*Fair Value Measurements.* A number of the Group's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities. The Group has an established control framework with respect to the measurement of fair values. This includes a valuation team that has the overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values. The valuation team regularly reviews significant unobservable inputs and valuation adjustments. If third party information is used to measure fair values, then the valuation team assesses the evidence obtained to support the conclusion that such valuations meet the requirements of PFRS, including the level in the fair value hierarchy in which such valuations should be classified.

The Group uses market observable data when measuring the fair value of an asset or liability. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques (Note 3).

If the inputs used to measure the fair value of an asset or a liability can be categorized in different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy based on the lowest level input that is significant to the entire measurement.

The Group recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

The methods and assumptions used to estimate the fair values for both financial and non-financial assets and liabilities are discussed in Note 28.

*Allowance for Impairment Losses on Trade and Other Receivables.* Provisions are made for specific and groups of accounts, where objective evidence of impairment exists. The Group evaluates these accounts on the basis of factors that affect the collectability of the accounts. These factors include, but are not limited to, the length of the Group's relationship with the customers and counterparties, the current credit status based on third party credit reports and known market forces, average age of accounts, collection experience and historical loss experience. The amount and timing of the recorded expenses for any period would differ if the Group made different judgments or utilized different methodologies. An increase in the allowance for impairment losses would increase the recorded operating expenses and decrease current assets.

The allowance for impairment losses on trade and other receivables amounted to P2,451,818 and P1,241,487 as of December 31, 2016 and 2015, respectively. The carrying amount of trade and other receivables amounted to P22,342,846 and P18,473,625 as of December 31, 2016 and 2015, respectively (Note 8).

*Write-down of Inventory.* The Group writes-down the cost of inventory to net realizable value whenever net realizable value becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes.

Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made of the amount the inventories are expected to be realized. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the reporting date to the extent that such events confirm conditions existing at the reporting date.

The Group assessed that no write-down of inventories to net realizable value is necessary as of December 31, 2016 and 2015.

The carrying amount of inventories amounted to P2,272,289 and P1,263,218 as of December 31, 2016 and 2015, respectively (Note 9).

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

In addition, estimation of the useful lives of property, plant and equipment is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of property, plant and equipment would increase the recorded cost and expenses and decrease noncurrent assets.

Property, plant and equipment, net of accumulated depreciation and amortization, amounted to P246,488,027 and P255,452,996 as of December 31, 2016 and 2015, respectively. Accumulated depreciation and amortization of property, plant and equipment amounted to P36,822,438 and P33,916,821 as of December 31, 2016 and 2015, respectively (Note 13).

*Estimating Coal Reserves.* Coal reserve estimates are based on measurements and geological interpretation obtained from natural outcrops, trenches, tunnels and drillholes. In contrast with “coal resource” estimates, profitability of mining the coal during a defined operating period or “mine-life” is a necessary attribute of “coal reserve”. Proven reserves estimates are attributed to future development projects only where there is a significant commitment to project funding and execution and for which applicable governmental and regulatory approvals have been secured or are reasonably certain to be secured. All proven reserve estimates are subject to revision, either upward or downward, based on new information, such as from block grading and production activities or from changes in economic factors, including product prices, contract terms or development plans. Estimates of reserves for undeveloped areas are subject to greater uncertainty over their future life than estimates of reserves for areas that are substantially developed and depleted.

The Philippine Department of Energy (DOE) is the government agency authorized to implement coal operating contracts (COC) and regulate the operation of contractors pursuant to DOE Circular No. 81-11-10: Guidelines for Coal Operations in the Philippines. For the purpose of the 5-year development and production program required for each COC, the agency classifies coal reserves, according to increasing degree of uncertainty, into (i) positive, (ii) probable, and (iii) inferred. The DOE also prescribes the use of "total in-situ reserves" as the sum of positive reserves and 2/3 of probable reserve; and "mineable reserve" as 60% of total in-situ reserve for underground, and 85% for surface (including open-pit) coal mines.

*Recoverability of Deferred Exploration and Development Costs.* A valuation allowance is provided for estimated unrecoverable deferred exploration and development costs based on the Group's assessment of the future prospects of the mining properties, which are primarily dependent on the presence of economically recoverable reserves in those properties.

The Group's mining activities are all in the preparatory stages as of December 31, 2016. All related costs and expenses from the mining activities are currently deferred as exploration and development costs, which will be amortized upon commencement of commercial operations. The Group has not identified any facts and circumstances which suggest that the carrying amount of the deferred exploration and development costs exceeded the recoverable amounts as of December 31, 2016 and 2015.

Deferred exploration and development costs amounted to P693,379 and P689,548 as of December 31, 2016 and 2015, respectively (Note 14).

*Estimated Useful Lives of Intangible Assets.* The useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Intangible assets are regarded to have an indefinite useful life when, based on analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group.

Intangible assets with finite useful lives such as mining rights and computer software amounted to P1,874,279 and P1,896,886 as of December 31, 2016 and 2015, respectively (Note 15).

Intangible assets with indefinite useful life amounted to P8,866 as of December 31, 2016 and 2015 (Note 15).

*Estimated Useful Lives of Intangible Assets - Power Concession Right.* The Group estimates the useful life of power concession right based on the period over which the assets are expected to be available for use. The Group has not included any renewal period on the basis of uncertainty of the probability of securing renewal contract at the end of the original contract term as of the reporting date.

The amortization period and method are reviewed when there are changes in the expected term of the contract or the expected pattern of consumption of future economic benefits embodied in the asset.

The carrying amount of power concession right amounted to P688,974 and P507,497 as of December 31, 2016 and 2015, respectively (Notes 6 and 15).

*Impairment of Goodwill.* The Group determines whether the goodwill acquired in business combination is impaired at least annually. This requires the estimation of value in use of the cash-generating units to which the goodwill is allocated. Estimating value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and to choose a suitable discount rate to calculate the present value of those cash flows.

The carrying amount of goodwill amounted to P8,866 as of December 31, 2016 and 2015 (Note 15).

*Acquisition Accounting.* The Group accounts for acquired businesses using the acquisition method of accounting which requires that the assets acquired and the liabilities assumed be recognized at the date of acquisition based on their respective fair values.

The application of the acquisition method requires certain estimates and assumptions concerning the determination of the fair values of acquired property, plant and equipment and intangible assets as well as liabilities assumed at the acquisition date. Moreover, the useful lives of the acquired property, plant and equipment and intangible assets have to be determined. Accordingly, for significant acquisitions, the Group obtains assistance from valuation specialists. The valuations are based on information available at the acquisition date.

The carrying amount of goodwill and mining rights as a result of the business combination amounted to P8,866 and P1,719,726, respectively, as of December 31, 2016 and 2015 (Note 15).

*Realizability of Deferred Tax Assets.* The Group reviews its deferred tax assets at each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Group's assessment on the recognition of deferred tax assets on deductible temporary difference and carryforward benefits of MCIT and NOLCO is based on the projected taxable income in the following periods.

Deferred tax assets arising from MCIT and NOLCO have not been recognized because the management believes that it is not probable that future taxable income will be available against which the Group can utilize the benefits therefrom (Note 24).

Deferred tax assets from temporary differences amounted to P2,955,570 and P2,745,943 as of December 31, 2016 and 2015, respectively (Note 24).

*Impairment of Non-financial Assets.* PFRS requires that an impairment review be performed on investments and advances, property, plant and equipment, deferred exploration and development costs and intangible assets and goodwill with finite useful lives when events or changes in circumstances indicate that the carrying amounts may not be recoverable. Determining the recoverable amounts of these assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable amounts and any resulting impairment loss could have a material adverse impact on the financial performance.

The Group assessed that its non-financial assets are not impaired as of December 31, 2016 and 2015.

The combined carrying amounts of investments and advances, property, plant and equipment, deferred exploration and development costs and other intangible assets with finite useful lives amounted to P265,990,113 and P269,159,864 as of December 31, 2016 and 2015, respectively (Notes 12, 13, 14 and 15).

*Present Value of Defined Benefit Retirement Obligation.* The present value of the defined benefit retirement obligation depends on a number of factors that are determined on an actuarial basis using a number of assumptions. These assumptions are described in Note 20 to the consolidated financial statements and include discount rate and salary increase rate.

The Group determines the appropriate discount rate at the end of each reporting period. It is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the retirement obligations. In determining the appropriate discount rate, the Group considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid. The terms to maturity of these bonds should approximate the terms of the related retirement obligation.

Other key assumptions for the defined benefit retirement obligation are based in part on current market conditions.

While it is believed that the Group's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Group's defined benefit retirement obligation.

The present value of defined benefit retirement obligation amounted to P69,364 and P45,657 as of December 31, 2016 and 2015, respectively (Note 20).

*Asset Retirement Obligation.* Determining ARO requires estimation of the cost of dismantling, installing and restoring the leased properties to their original condition. The Group determined that there are no ARO as of December 31, 2016 and 2015.

## 5. Segment Information

<u>Operating Segments</u>

The Group's operations are segmented into four businesses: a) power generation, b) retail and other power-related services, c) coal mining and d) others consistent with the reports prepared internally for use by the Group's CODM in reviewing the business performance of the operating segments. The differing economic characteristics and activities of these power plants make it more useful to users of the consolidated financial statements to have information about each component of the Group's profit or loss, assets and liabilities.

The coal mining companies, which were acquired in 2010, have not yet started commercial operations and are in the preparatory stage of mining activities (Note 14). The mining companies' total assets do not exceed 10% of the combined assets of all operating segments. Accordingly, management believes that as of December 31, 2016 and 2015, the information about this component of the Group would not be useful to the users of the consolidated financial statements.

Segment Assets and Liabilities
Segment assets include all operating assets used by a segment except investments and advances, intangible assets and goodwill and deferred tax assets. Segment liabilities include all operating liabilities except long-term debt, deferred tax liabilities and income tax payable. Capital expenditures consist of additions to property, plant and equipment of each reportable segment.

Inter-segment Transactions
The Group's inter-segment sales are accounted for based on contracts entered into by the parties and are eliminated in the consolidation. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transactions are eliminated in consolidation.

The Group operates only in the Philippines which is treated as a single geographical segment.

*Major Customers*
The Group sells, retails and distributes power, through power supply agreements, retail supply agreements, concession agreement and other power-related service agreements (Note 6), either directly to customers (other generators, distribution utilities, electric cooperatives and industrial customers) or through the Philippine Wholesale Electricity Spot Market (WESM). Sale, retail and/or distribution of power to individual external customers that represents 10% or more of the Group's total revenues is as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Manila Electric Company (Meralco) | **P39,565,977** | P40,889,098 | P47,233,747 |
| WESM | **4,153,980** | 6,217,243 | 9,622,839 |

For management reporting purposes, the Group's operating segments are organized and managed separately as follows:

Operating Segments

Financial information about reportable segments follows:

| | For the Years Ended December 31 | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Power Generation | | | Retail and Other Power-related Services | | | Coal Mining | | | Others | | | Eliminations | | | Consolidated | | |
| | **2016** | 2015 | 2014 | **2016** | 2015 | 2014 | **2016** | 2015 | 2014 | **2016** | 2015 | 2014 | **2016** | 2015 | 2014 | **2016** | 2015 | 2014 |
| **Sales** | | | | | | | | | | | | | | | | | | |
| External | **P72,250,309** | P73,849,465 | P80,080,157 | **P5,722,121** | P3,657,226 | P4,213,433 | **P -** | P - | P - | **P -** | P - | P - | **P -** | P - | P - | **P77,972,430** | P77,506,691 | P84,293,590 |
| Inter-segment | **8,964,899** | 6,769,834 | 4,872,675 | **14,629** | - | - | **-** | - | - | **132,000** | - | - | **(9,111,528)** | (6,769,834) | (4,872,675) | **-** | - | - |
| | **81,215,208** | 80,619,299 | 84,952,832 | **5,736,750** | 3,657,226 | 4,213,433 | **-** | - | - | **132,000** | - | - | **(9,111,528)** | (6,769,834) | (4,872,675) | **77,972,430** | 77,506,691 | 84,293,590 |
| **Cost and Expenses** | | | | | | | | | | | | | | | | | | |
| Cost of power sold | **48,198,409** | 51,933,914 | 56,304,969 | **5,711,781** | 3,723,643 | 4,053,848 | **-** | - | - | **-** | - | - | **(8,907,750)** | (6,757,630) | (4,872,675) | **45,002,440** | 48,899,927 | 55,486,142 |
| Operating expenses | **6,111,655** | 4,791,985 | 2,697,961 | **849,499** | 226,397 | 37,204 | **28,495** | 17,831 | 23,919 | **1,599,204** | 1,294,215 | 767,846 | **(2,349,203)** | (1,426,293) | (615,000) | **6,239,650** | 4,904,135 | 2,911,930 |
| | **54,310,064** | 56,725,899 | 59,002,930 | **6,561,280** | 3,950,040 | 4,091,052 | **28,495** | 17,831 | 23,919 | **1,599,204** | 1,294,215 | 767,846 | **(11,256,953)** | (8,183,923) | (5,487,675) | **51,242,090** | 53,804,062 | 58,398,072 |
| **Segment Result** | **P26,905,144** | P23,893,400 | P25,949,902 | **(P824,530)** | (P292,814) | P122,381 | **(P28,495)** | (P17,831) | (P23,919) | **(P1,467,204)** | (P1,294,215) | (P767,846) | **P2,145,425** | P1,414,089 | P615,000 | **P26,730,340** | P23,702,629 | P25,895,518 |
| Interest income | | | | | | | | | | | | | | | | **200,502** | 414,444 | 549,977 |
| Interest expense and other financing charges | | | | | | | | | | | | | | | | **(12,354,229)** | (13,130,252) | (13,168,470) |
| Equity in net losses of associates and joint ventures | | | | | | | | | | | | | | | | **(294,795)** | (528,445) | (22,345) |
| Gain on sale of power plant and other equipment | | | | | | | | | | | | | | | | **116,357** | - | - |
| Other income (charges) - net | | | | | | | | | | | | | | | | **(6,881,754)** | (5,926,050) | 68,225 |
| Income tax expense - net | | | | | | | | | | | | | | | | **(3,365,759)** | (2,703,408) | (2,693,423) |
| **Consolidated Net Income** | | | | | | | | | | | | | | | | **P4,150,662** | P1,828,918 | P10,629,482 |

| | For the Years Ended December 31 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Power Generation | | Retail and Other Power-related Services | | Coal Mining | | Others | | Eliminations | | Consolidated | |
| | **2016** | 2015 | **2016** | 2015 | **2016** | 2015 | **2016** | 2015 | **2016** | 2015 | **2016** | 2015 |
| **Other Information** | | | | | | | | | | | | |
| Segment assets | **P300,511,384** | P297,302,968 | **P2,765,423** | P2,773,437 | **P734,328** | P749,318 | **P34,520,658** | P45,618,031 | **(P26,355,752)** | (P31,006,033) | **P312,176,041** | P315,437,721 |
| Investments and advances - net | **9,832,438** | 4,566,249 | **196,723** | 192,012 | **-** | - | **52,595,284** | 43,451,916 | **(46,378,991)** | (37,597,240) | **16,245,454** | 10,612,937 |
| Intangible assets and goodwill - net | | | | | | | | | | | **2,572,119** | 2,413,249 |
| Deferred tax assets | | | | | | | | | | | **2,955,570** | 2,745,943 |
| **Consolidated Total Assets** | | | | | | | | | | | **P333,949,184** | P331,209,850 |
| Segment liabilities | **P232,894,743** | P240,770,768 | **P3,704,565** | P2,788,300 | **P776,554** | P763,125 | **P751,230** | P1,613,602 | **(P30,084,673)** | (P33,751,269) | **P208,042,419** | P212,184,526 |
| Long-term debt | | | | | | | | | | | **66,323,726** | 58,607,861 |
| Income tax payable | | | | | | | | | | | **127,198** | 99,275 |
| Deferred tax liabilities | | | | | | | | | | | **4,785,217** | 3,882,930 |
| **Consolidated Total Liabilities** | | | | | | | | | | | **P279,278,560** | P274,774,592 |
| Capital expenditures | **P14,849,968** | P31,066,140 | **P -** | P2,893 | **P -** | P48 | **P12,165** | P2,763,740 | | | **P14,862,133** | P33,832,821 |
| Depreciation and amortization of property, plant and equipment and intangible assets | **6,201,578** | 6,469,103 | **25,639** | 21,394 | **15,229** | 15,136 | **99,485** | 34,180 | | | **6,341,931** | 6,539,813 |
| Noncash items other than depreciation* | **7,755,076** | 6,198,795 | **779,891** | 164,633 | **(3)** | - | **769,731** | 2,051,798 | | | **9,304,695** | 8,415,226 |

**Noncash items other than depreciation and amortization include unrealized foreign exchange gain/losses, impairment losses on trade and other receivables and on property, plant and equipment and others, equity in net earnings (losses) of associates and joint ventures and retirement benefit expense.*

## 6. Significant Agreements and Lease Commitments

a. Independent Power Producer (IPP) Administration (IPPA) Agreements

As a result of the biddings conducted by PSALM for the Appointment of the IPP Administrator for the Contracted Capacity of the following power plants, the Group was declared the winning bidder and act as IPP Administrator through the following appointed subsidiaries:

| Subsidiary | Power Plant | Location |
|---|---|---|
| SMEC | Sual Coal - Fired Power Station (Sual Power Plant) | Sual, Pangasinan Province |
| SPDC | San Roque Hydroelectric Multi-purpose Power Plant (San Roque Power Plant) | San Roque, Pangasinan Province |
| SPPC | Ilijan Natural Gas - Fired Combined Cycle Power Plant (Ilijan Power Plant) | Ilijan, Batangas Province |

The IPPA Agreements are with the conformity of National Power Corporation (NPC), a government-owned and controlled corporation created by virtue of Republic Act (RA) No. 6395, as amended, whereby NPC confirms, acknowledges, approves and agrees to the terms of the IPPA Agreements and further confirms that for as long as it remains the counterparty of the IPP, it will comply with its obligations and exercise its rights and remedies under the original agreement with the IPP at the request and instruction of PSALM.

The IPPA Agreements include, among others, the following common salient rights and obligations:

i. The right and obligation to manage and control the contracted capacity of the power plant for its own account and at its own cost and risks;

ii. The right to trade, sell or otherwise deal with the capacity (whether pursuant to the spot market, bilateral contracts with third parties or otherwise) and contract for or offer related ancillary services, in all cases for its own account and at its own cost and risks. Such rights shall carry the rights to receive revenues arising from such activities without obligation to account therefore to PSALM or any third party;

iii. The right to receive a transfer of the power plant upon termination of the IPPA Agreement at the end of the cooperation period or in case of buy-out;

iv. For SMEC and SPPC, the right to receive an assignment of NPC’s interest to existing short-term bilateral power supply contracts;

v. The obligation to supply and deliver, at its own cost, fuel required by the IPP and necessary for the Sual Power Plant to generate the electricity required to be produced by the IPP;

vi. Maintain the performance bond in full force and effect with a qualified bank; and

vii. The obligation to pay PSALM the monthly payments and energy fees in respect of all electricity generated from the capacity, net of outages.

Relative to the IPPA Agreements, SMEC, SPDC and SPPC have to pay PSALM monthly payments for 15 years until October 1, 2024, 18 years until April 26, 2028 and 12 years until June 26, 2022, respectively. Energy fees amounted to P20,477,903, P23,224,178 and P30,775,896 in 2016, 2015 and 2014, respectively. SMEC and SPDC renewed their performance bonds in United States dollar (US$) amounting to US$58,187 and US$20,305 which will expire on November 3, 2017 and January 25, 2017, respectively. Subsequently, the performance bond of SPDC was renewed up to January 25, 2018.

On June 16, 2015, SPPC renewed its performance bond amounting to US$60,000 with a validity period of one year. This performance bond was subsequently drawn by PSALM on September 4, 2015 which is subject to an ongoing case (Note 29).

The finance lease liabilities are carried at amortized cost using the US dollar and Philippine peso discount rates as follows:

| | US Dollar | Philippine Peso |
|---|---|---|
| SMEC | 3.89% | 8.16% |
| SPPC | 3.85% | 8.05% |
| SPDC | 3.30% | 7.90% |

The discount determined at inception of the agreement is amortized over the period of the IPPA Agreement and recognized as part of “Interest expense and other financing charges” account in the consolidated statements of income. Interest expense amounted to P9,667,662, P10,212,753 and P10,711,071 in 2016, 2015 and 2014, respectively.

The future minimum lease payments for each of the following periods are as follows:

| **2016** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$252,950** | **P12,576,692** | **P12,112,310** | **P24,689,002** |
| More than 1 year and not later than 5 years | **1,117,374** | **55,555,827** | **53,512,338** | **109,068,165** |
| Later than 5 years | **820,263** | **40,783,474** | **39,326,292** | **80,109,766** |
| | **2,190,587** | **108,915,993** | **104,950,940** | **213,866,933** |
| Less: Future finance charges on finance lease liabilities | **310,216** | **15,423,939** | **28,353,458** | **43,777,397** |
| Present values of finance lease liabilities | **US$1,880,371** | **P93,492,054** | **P76,597,482** | **P170,089,536** |

| 2015 | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$250,209 | P11,774,823 | P11,980,712 | P23,755,535 |
| More than 1 year and not later than 5 years | 1,071,953 | 50,446,106 | 51,333,916 | 101,780,022 |
| Later than 5 years | 1,118,634 | 52,642,925 | 53,617,024 | 106,259,949 |
| | 2,440,796 | 114,863,854 | 116,931,652 | 231,795,506 |
| Less: Future finance charges on finance lease liabilities | 383,180 | 18,032,425 | 34,569,888 | 52,602,313 |
| Present values of finance lease liabilities | US$2,057,616 | P96,831,429 | P82,361,764 | P179,193,193 |

The present values of minimum lease payments for each of the following periods are as follows:

| **2016** | **US Dollar** | **Peso Equivalent of US Dollar** | **Peso** | **Total** |
|---|---|---|---|---|
| Not later than 1 year | **US$191,961** | **P9,544,293** | **P6,799,953** | **P16,344,246** |
| More than 1 year and not later than 5 years | **770,562** | **38,312,364** | **24,671,265** | **62,983,629** |
| Later than 5 years | **917,848** | **45,635,397** | **45,126,264** | **90,761,661** |
| | **US$1,880,371** | **P93,492,054** | **P76,597,482** | **P170,089,536** |

| 2015 | US Dollar | Peso Equivalent of US Dollar | Peso | Total |
|---|---|---|---|---|
| Not later than 1 year | US$197,094 | P9,275,262 | P7,271,501 | P16,546,763 |
| More than 1 year and not later than 5 years | 767,797 | 36,132,517 | 25,606,142 | 61,738,659 |
| Later than 5 years | 1,092,725 | 51,423,650 | 49,484,121 | 100,907,771 |
| | US$2,057,616 | P96,831,429 | P82,361,764 | P179,193,193 |

b. Market Participation Agreements (MPA)

SMEC, SPDC, SPPC and SCPC entered into an MPA with the Philippine Electricity Market Corporation (PEMC) to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. Under the WESM Rules, the cost of administering and operating the WESM shall be recovered through a charge imposed on all WESM members or transactions, as approved by the ERC. PEMC's market fees charged to SMEC, SPDC and SPPC recognized in the consolidated statements of income amounted to P160,669, P219,681 and P233,701 in 2016, 2015 and 2014, respectively (Note 22).

Market fees charged to SCPC during its testing and commissioning phase, recognized as part of CPIP under the "Property, plant and equipment" account in the consolidated statements of financial position, amounted to P531 as of December 31, 2016 (Note 13).

In March 2013, SMELC entered into an MPA for Supplier as Direct WESM Member - Customer Trading Participant Category with the PEMC to satisfy the conditions contained in the Philippine WESM Rules on WESM membership and to set forth the rights and obligations of a WESM member. SMELC has a standby letter of credit, expiring on December 26, 2017, to secure the full and prompt performance of obligations for its transactions as a Direct Member and trading participant in the WESM.

c. Power Supply Agreements

SMEC, SPPC, SPDC, SPI, and SMCPC have Power Supply Agreements with various counterparties, including related parties, to sell electricity produced by the power plants. All agreements provide for renewals or extensions subject to mutually agreed terms and conditions by the parties.

Certain customers, particularly electric cooperatives and industrial customers, are billed based on the time-of-use (TOU) per kilowatt hour (kWh) while others are billed at capacity-based rate. As stipulated in the contracts, each TOU-based customer has to pay the minimum charge based on the contracted power using the basic energy charge and/or adjustments if customer has not fully taken or failed to consume the contracted power. For capacity-based contracts, the customers are charged with the capacity fees based on the contracted capacity plus the energy fees for the associated energy taken during the month.

SMEC, SPPC and SPDC can also purchase power from WESM and other power generation companies during periods when the power generated from the power plants is not sufficient to meet customers' power requirements. Power purchases amounted to P7,836,564, P8,330,550 and P6,045,468 in 2016, 2015 and 2014, respectively.

d. Memorandum of Agreement (MOA) with San Roque Power Corporation (SRPC)

On December 6, 2012, SPDC entered into a 5-year MOA with SRPC to sell a portion of the capacity of the San Roque Power Plant. Under the MOA, i) SRPC shall purchase a portion of the capacity sourced from the San Roque Power Plant; ii) SRPC shall pay a settlement amount to SPDC for the capacity; and iii) the MOA may be earlier terminated or extended subject to terms and mutual agreement of the parties.

Revenue from sale of capacity of the San Roque Power Plant amounted to P758,134, P1,274,893 and P1,488,437 in 2016, 2015 and 2014, respectively, and was recognized as part of "Sale of power" account in the consolidated statements of income.

e. Coal Supply Agreements

SMEC has supply agreements with various coal suppliers for the Sual Power Plant's coal requirements.

f. Operations and Maintenance (O&M) Services Agreement

In exchange for the O&M services rendered by Petron Corporation (Petron), an entity under common control, SPI pays for all the documented costs and expenses incurred in relation to the operation, maintenance and repair of its 4 x 35 MW Limay Co-generation Solid Fuel-fired Power Plant (Limay Co-gen Power Plant). The agreement is effective for 25 years from September 2013 until 2038 and was terminated upon sale of SPI's power plant to Petron on December 23, 2016.

g. Retail Supply Agreements

SMELC has retail supply agreements with customers to supply or sell electricity purchased from WESM, SMEC or other generators. All agreements provide for renewals or extensions subject to terms and conditions mutually agreed by the parties.

The customers are billed based on the capacity charge and associated energy charge. As stipulated in the contracts, each customer has to pay the capacity charge based on the contracted capacity using the capacity fee and associated energy fee with adjustments if customer has not fully taken or failed to consume the contracted capacity.

h. Distribution Wheeling Service (DWS) Agreements

SMELC and SCPC, related to its Retail Electricity Supplier (RES) licenses, entered into DWS Agreements with certain Distribution Utilities (DU) for the conveyance of electricity through its distribution systems in order to meet the demand of the Contestable Customers. The agreements are valid and binding upon execution unless terminated by either party.

The DWS charges from the DUs are passed on to its customers as mandated by ERC thru the "Single-Billing Policy".

i. Lease Agreements

*Group as Lessee*

i. The Group has operating lease agreements with San Miguel Properties, Inc., an entity under common control, for a period of 1 to 6 years which is renewable annually or upon agreement between parties.

ii. SPI subleases its plant premises from New Ventures Realty Corporation (NVRC), an entity under common control. The existing lease agreement is for a 25-year period up to September 30, 2038, subject to renewal. The yearly rental is subject to an automatic 3.0% per annum escalation rate for the 4 years following the negotiation under the lease terms. Pursuant to the sale of power plant to Petron, all agreements between SPI and Petron and its subsidiaries were terminated effective December 23, 2016.

iii. SMEC entered into a lease agreement with Challenger Aero Air Corporation (Challenger), an entity under common control, for the lease of certain aircrafts for a period of 1 year from October 1, 2014 to September 30, 2015. The lease agreement was pre-terminated on April 30, 2015.

   Subsequently, SMEC entered into a new lease agreement with Challenger for the lease of the same aircrafts for a period of 1 year from May 1, 2015 to April 30, 2016. The lease agreement was renewed from May 1, 2016 to April 30, 2017.

iv. In November 2015, SCPC leased parcels of land from NVRC for the construction of 2 x 150 MW Coal-fired Power Plant (Limay Coal-fired Power Plant - Phase I) and ash dump facility. This is covered by two lease agreements, each having an initial term of 25 years with an option to renew for a further 25 years. The agreements contain a clause allowing the annual escalation adjustments of rental rates starting on certain anniversary dates.

v. On December 7, 2015, LPPC leased a parcel of land from NVRC for the construction of its 2 x 150 MW Coal-fired Power Plant (Limay Coal-fired Power Plant - Phase II) for a period of 25 years from the effective date. LPPC has the option to renew this lease for another 25 years. The rent shall be increased annually by 6.0% starting from the second anniversary of the lease execution.

vi. DAMI leases a parcel of land in General Santos City with SMC. The existing lease agreement is for a 10-year period up to June 30, 2023, subject to renewal. The rent is subject to an automatic 10.0% per annum escalation rate. Rent for the year, capitalized in "Deferred exploration and development costs" account in the consolidated statements of financial position, amounted to P402 and P405 as of December 31, 2016 and 2015, respectively (Note 14).

vii. In 2016, SMCPC entered into an agreement with Kyron Landholdings Inc. for the sub-lease of a parcel of land for the construction, erection and installation of its 2 x 150 MW Coal-fired Power Plant in Malita, Davao (Malita Coal-fired Power Plant). The initial term of the lease is for a period of 25 years with the option to renew for a further 25 years. Beginning January 1, 2018 until the end of the term, the rental shall be increased by 5.1% per annum.

Relative to the lease agreements, the Group was required to pay advance rental and security deposits which are included under "Trade and other receivables - net" or "Prepaid expenses and other current assets" accounts in the consolidated statements of financial position (Notes 8 and 10).

Future minimum lease payments under the non-cancellable operating lease agreements are as follows:

| | **2016** | 2015 |
|---|---|---|
| Not later than 1 year | **P119,335** | P63,593 |
| More than 1 year and not later than 5 years | **244,067** | 138,776 |
| Later than 5 years | **1,871,061** | 1,381,648 |
| | **P2,234,463** | P1,584,017 |

Rent expense recognized in the consolidated statements of income amounted to P351,091, P360,091 and P115,849 in 2016, 2015 and 2014, respectively (Note 22).

*Group as Lessor*

i. In 2014, the Parent Company has an operating sub-lease agreement with Clariden Holdings, Inc., an entity under common control, for a period of 2 years which is renewable upon agreement between the parties. The agreement expired on December 31, 2016.

ii. In May 2011, GPII entered into an agreement with Limay Energen Corporation (LEC), an entity under common control, to lease certain portions of 3 parcels of land located in Limay, Bataan. The lease term is for a period of 10 years up to May 2021, with an option to renew not later than 6 months prior to expiration and a 3.0% escalation rate of the rental every year from signing of the contract. LEC executed a deed of assignment on July 19, 2012, assigning all rights and obligations to the leased area to Petron. Petron is the assignee for the remaining period of the lease effective June 1, 2012. The agreement was terminated effective June 1, 2015.

iii. In May 2011, GPII entered into an agreement with NVRC, for the lease of certain parcels of land located in Limay, Bataan with a total area of 612,193 square meters. The lease term is for a period of 10 years up to May 2021, with an option to renew not later than 6 months prior to expiration and a 3.0% escalation rate of the rental every year from signing of the contract. This Agreement was subsequently amended, reducing the leased area to 340,646 square meters effective October 1, 2013. This was further amended reducing the leased area to 130,980 square meters and with a corresponding reduction in the monthly rental effective December 1, 2016.

There are no restrictions imposed on these lease agreements such as those concerning dividends, additional debt and further leasing.

Future minimum lease receivables under the non-cancellable operating lease agreements are as follows:

| | 2016 | 2015 |
|---|---|---|
| Not later than 1 year | **P6,007** | P46,517 |
| More than 1 year and not later than 5 years | **21,892** | 183,394 |
| Later than 5 years | **-** | 20,204 |
| | **P27,899** | P250,115 |

Rent income recognized under the "Miscellaneous income (charges)" account in "Other Income (Charges)" account in the consolidated statements of income amounted to P21,147, P28,104, and P18,434 in 2016, 2015 and 2014, respectively (Note 23).

j. Concession Agreement

The Parent Company entered into a 25-year Concession Agreement with ALECO on October 29, 2013. It became effective upon confirmation of the National Electrification Administration on November 7, 2013.

On January 24, 2014, the Parent Company and APEC entered into an Assignment Agreement whereby APEC assumed all the rights, interests and obligations of the Parent Company under the Concession Agreement effective January 2, 2014.

The Concession Agreement include, among others, the following rights and obligations: i) as Concession Fee, APEC shall pay to ALECO: (1) separation pay of ALECO employees in accordance with the Concession Agreement; (2) the amount of P2,100 every quarter for the upkeep of residual ALECO (fixed concession fees); ii) if the net cash flow of APEC is positive within 5 years or earlier from date of signing of the Concession Agreement, 50% of the Net Cash Flow each month shall be deposited in an escrow account until the cumulative nominal sum reaches P4,048,529; iii) on the 20th anniversary of the Concession Agreement, the concession period may be extended by mutual agreement between ALECO and APEC; and iv) at the end of the concession period, all assets and system, as defined in the Concession Agreement, shall be returned by APEC to ALECO in good and usable condition. Additions and improvements to the system shall likewise be transferred to ALECO. In this regard, APEC shall provide services within the franchise area and shall be allowed to collect fees and charges, as approved by the ERC. ALECO formally turned over the operations to APEC on February 26, 2014.

The Group recognized as intangible assets all costs directly related to the Concession Agreement. The intangible assets consist of: a) concession rights, which include fixed concession fees and separation pay of ALECO employees amounting to P384,317. Fixed concession fees are recognized at present value using the discount rate at the inception date with a corresponding concession payable recognized; and b) infrastructure, which includes the costs of structures and improvements, distribution system and equipment. Cost of infrastructure amounted to P386,083, and P159,086 as of December 31, 2016 and 2015, respectively. Interest expense on concession payable is included as part of "Interest expense and other financing charges" account in the consolidated statements of income amounted to P6,127, P6,254 and P4,769 in 2016, 2015 and 2014, respectively. Amortization of concession assets recognized in the "Depreciation and amortization" account in the consolidated statements of income amounted to P45,520, P21,296 and P14,610 in 2016, 2015 and 2014, respectively.

Maturities of the carrying amount of concession payable are as follows:

| | **2016** | 2015 |
|---|---:|---:|
| Not later than 1 year | **P2,407** | P2,273 |
| More than 1 year and not later than 5 years | **11,136** | 10,515 |
| Later than 5 years | **91,083** | 94,110 |
| | **P104,626** | P106,898 |

Power concession assets consist of:

| | **Concession Fee** | **Completed Projects/Others** | **Asset Under Construction** | **Total** |
|---|---:|---:|---:|---:|
| **Cost** | | | | |
| January 1, 2015 | P384,317 | P111,995 | P - | P496,312 |
| Additions | - | 47,091 | - | 47,091 |
| December 31, 2015 | 384,317 | 159,086 | - | 543,403 |
| Additions | - | 72,824 | 154,173 | 226,997 |
| **December 31, 2016** | **384,317** | **231,910** | **154,173** | **770,400** |
| **Accumulated Depreciation and Amortization** | | | | |
| January 1, 2015 | 12,811 | 1,799 | - | 14,610 |
| Additions | 15,373 | 5,923 | - | 21,296 |
| December 31, 2015 | 28,184 | 7,722 | - | 35,906 |
| Additions | 15,373 | 30,147 | - | 45,520 |
| **December 31, 2016** | **43,557** | **37,869** | **-** | **81,426** |
| **Carrying Amount** | | | | |
| December 31, 2015 | P356,133 | P151,364 | P - | P507,497 |
| **December 31, 2016** | **P340,760** | **P194,041** | **P154,173** | **P688,974** |

The Group accounted for revenue and costs relating to construction or upgrade services in accordance with PAS 11 based on the stage of completion of work performed. The fair value of the construction and upgrade services provided is equal to the recorded cost of the intangible asset built up from day one until the construction activity ceases. Construction revenue and construction cost amounted to P226,997, P47,091 and P111,995 in 2016, 2015 and 2014, respectively (Note 23).

## 7. Cash and Cash Equivalents

Cash and cash equivalents consist of:

| | ***Note*** | **2016** | 2015 |
|---|---:|---:|---:|
| Cash in banks and on hand | | **P2,089,297** | P4,390,785 |
| Short-term investments | | **19,402,088** | 17,850,576 |
| | *27, 28* | **P21,491,385** | P22,241,361 |

Cash in banks earn interest at the respective bank deposit rates. Short-term investments include demand deposits which can be withdrawn at anytime depending on the immediate cash requirements of the Group and earn interest at the respective short-term investment rates. Interest income from cash and cash equivalents amounted to P176,681, P261,338 and P356,852 in 2016, 2015 and 2014, respectively.

## 8. Trade and Other Receivables

Trade and other receivables consist of:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| Trade | | **P12,269,984** | P12,415,742 |
| Non-trade | | **6,613,459** | 5,664,269 |
| Amounts owed by related parties | *6, 19* | **5,911,221** | 1,635,101 |
| | | **24,794,664** | 19,715,112 |
| Allowance for impairment losses | *4* | **2,451,818** | 1,241,487 |
| | *27, 28* | **P22,342,846** | P18,473,625 |

Trade and other receivables are non-interest bearing, unsecured and are generally on a 30-day term or an agreed collection period. The balance of trade receivables is inclusive of VAT on the sale of power collectible from customers.

The movements in the allowance for impairment losses are as follows:

| | **2016** | 2015 |
|---|---|---|
| Balance at beginning of year | **P1,241,487** | P866,686 |
| Impairment losses during the year | **1,210,451** | 374,801 |
| Amounts written-off | **(120)** | - |
| Balance at end of year | **P2,451,818** | P1,241,487 |

Impairment losses are recognized in profit or loss as follows:

| | *Note* | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| Operating expenses | *22* | **P958,784** | P142,658 | P144,393 |
| Other income (charges) - net | *23* | **251,667** | 232,143 | - |
| | | **P1,210,451** | P374,801 | P144,393 |

The aging of trade and other receivables as of December 31 are as follows:

| | **2016** | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Trade** | **Non-trade** | **Amounts Owed by Related Parties** | **Total** | Trade | Non-trade | Amounts Owed by Related Parties | Total |
| Current | **P5,576,247** | **P1,031,133** | **P5,282,075** | **P11,889,455** | P5,361,249 | P76,388 | P1,560,903 | P6,998,540 |
| Past due: | | | | | | | | |
| 1-30 days | **671,466** | **73,200** | **8,900** | **753,566** | 561,693 | 50,077 | 16,717 | 628,487 |
| 31-60 days | **505,682** | **62,467** | **27,134** | **595,283** | 372,998 | 57,261 | 4,994 | 435,253 |
| 61-90 days | **201,448** | **10,207** | **31,563** | **243,218** | 201,639 | 2,929,235 | - | 3,130,874 |
| Over 90 days | **5,315,141** | **5,436,452** | **561,549** | **11,313,142** | 5,918,163 | 2,551,308 | 52,487 | 8,521,958 |
| | **P12,269,984** | **P6,613,459** | **P5,911,221** | **P24,794,664** | P12,415,742 | P5,664,269 | P1,635,101 | P19,715,112 |

Past due trade receivables by more than 30 days pertain mainly to output VAT. The Group believes that the unimpaired amounts that are past due are still collectible based on historical payment behavior and analyses of the underlying customer credit ratings. There are no significant changes in their credit quality.

Non-trade receivables include the following:

a. Due from PSALM amounting to US$60,000 which pertains to SPPC's performance bond pursuant to the Ilijan IPPA Agreement that was drawn by PSALM in September 2015. The validity of PSALM's action is the subject of an ongoing case filed by SPPC with the Regional Trial Court (RTC) of Mandaluyong City (Note 29).

b. As of December 31, 2016 and 2015, SMEC has receivables for the cost of fuel, market fees, coal and other charges related to the dispatch of the excess capacity of the Sual Power Plant amounting to P32,409 and P33,658. Likewise, SMEC has receivables arising from WESM transactions related to the excess capacity amounting to P1,258,519 and P1,083,353 as of December 31, 2016 and 2015, respectively. The issue on excess capacity is subject of ongoing cases (Note 29).

c. On June 16, 2011, SMEC entered into a MOA with Hardrock Coal Mining Pty Ltd. (HCML) and Caason Investments Pty Ltd. (Caason), companies registered in Australia, for the acquisition of shares in HCML. SMEC paid Caason Australian dollars 12,000 (equivalent to P550,000), for an option to subscribe to the shares in HCML (the Deposit) with further option for SMEC to decide not to pursue its investment in HCML, which will result in the return of the Deposit to SMEC plus interest. In a letter dated July 15, 2011, SMEC notified Caason and HCML that it shall not pursue the said investment and therefore asked Caason and HCML for the return of the Deposit with corresponding interest (the Amount Due), pursuant to the terms of the MOA.

   On September 2, 2014, SMEC, HCML and Caason agreed to a schedule of payment of the outstanding Amount Due to SMEC. For the years ended December 31, 2015 and 2014, HCML and Caason paid a total amount of P107,086 and P119,841, respectively, inclusive of interest and other payments, such as legal costs and expenses. Interest income amounted to nil, P105,735, and P118,824 in 2016, 2015 and 2014, respectively. As of December 31, 2016 and 2015, total outstanding receivables from HCML (net of allowance for impairment losses) amounted to P7,145 and P203,099, respectively.

d. The balance mainly pertains to receivables from customers which will be remitted to the Government upon collection.

## 9. Inventories

Inventories at cost consist of:

| | *Note* | 2016 | 2015 |
|---|---|---|---|
| Coal | *6* | **P2,120,657** | P1,079,086 |
| Fuel oil | *19* | **84,885** | 67,599 |
| Materials and supplies | | **53,322** | 109,820 |
| Other consumables | | **13,425** | 6,713 |
| | | **P2,272,289** | P1,263,218 |

There were no inventory write-downs to net realizable value for the years ended December 31, 2016 and 2015. Inventories charged to cost of power sold amounted to P10,046,687, P10,376,590 and P11,945,280 in 2016, 2015 and 2014, respectively.

## 10. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| Input VAT | | **P12,398,635** | P10,960,202 |
| Prepaid tax | | **3,735,642** | 2,253,885 |
| Prepaid rent and others | *6, 18* | **1,548,743** | 1,854,660 |
| | | **P17,683,020** | P15,068,747 |

Input VAT consists of input VAT on purchases of goods and services which can be offset against the output VAT payable (Note 17).

Prepaid tax consists of creditable withholding taxes and excess tax credits of the Group which can be used as a deduction against future income tax payable.

Prepaid rent and others pertain to the following:

a. Prepaid rent of the Group from various operating lease agreements amounted to P39,044 and P61,961 as of December 31, 2016 and 2015, respectively (Note 6).

b. PSALM monthly fee outage credits pertain to the approved reduction in future monthly fees payable to PSALM resulting from the outages of the Sual Power Plant in 2016 and 2015.

c. Professional services related to project financing of SCPC (Note 18).

## 11. Assets Held For Sale

On September 15, 2016, the BOD of SPI approved the plan to sell certain machinery and equipment. Accordingly, the carrying amount, which is the fair value, of the other equipment amounting to P184,324 was reclassified as “Assets held for sale” account in the consolidated statements of financial position (Note 13). Efforts to sell the machinery and equipment have started and the sale is expected to be completed in 2017.

## 12. Investments and Advances

Investments and advances consist of:

| | **2016** | 2015 |
|---|---|---|
| **Investments in Shares of Stock of Associates and Joint Ventures** | | |
| **Cost** | | |
| Balance at beginning of year | **P2,074,052** | P2,074,051 |
| Additions/Reclassifications | **6,509,410** | 1 |
| Balance at end of year | **8,583,462** | 2,074,052 |
| **Accumulated Equity in Net Losses** | | |
| Balance at beginning of year | **(592,164)** | (63,719) |
| Equity in net losses during the year | **(293,113)** | (526,463) |
| Adjustment to equity in net losses in prior year | **(1,682)** | (1,982) |
| Balance at end of year | **(886,959)** | (592,164) |
| | **7,696,503** | 1,481,888 |
| Advances | **8,548,951** | 9,131,049 |
| | **P16,245,454** | P10,612,937 |

Advances pertain to deposits made for future investment in land holding companies and power-related expansion projects.

The following are the developments relating to the Group's investments in shares of stock of associates and joint ventures:

a. Investment in shares of stock of associates

   i. Olongapo Electricity Distribution Company, Inc. (OEDC)

      In April 2013, SPGC and San Miguel Equity Investments, Inc. (SMEII), an entity under common control, entered into a Deed of Assignment of Subscription Rights whereby SMEII agreed to assign 35% ownership interest in OEDC to SPGC for a consideration of P8,750.

      Subscriptions payable amounted to P28,101 as of December 31, 2016 and 2015 (Note 19).

   ii. Mariveles Power Generation Corp. (MPGC)

      On June 16, 2016, Meralco Powergen Corporation (MGen), a subsidiary of Meralco, and Zygnet Prime Holdings, Inc. (Zygnet) subscribed to 2,500 and 102 common shares of MPGC, respectively. As a result, the Parent Company now holds 49% of the outstanding capital stock of MPGC while MGen and Zygnet holds 49% and 2%, respectively. MPGC was a wholly-owned subsidiary of the Parent Company prior to the subscription of MGen and Zygnet. MPGC shall develop, construct, finance, own, operate and maintain a 4 x 150 MW Circulating Fluidized Bed Coal-fired Power Plant and associated facilities in Mariveles, Bataan.

      On July 13, 2016, the Parent Company subscribed to 9,643,200 shares, representing 49% of the total shares subscribed by all shareholders out of the increase in the authorized capital stock of MPGC, at the subscription price of P100 per share.

On January 9, 2017, the SEC approved the increase in the authorized capital stock of MPGC.

The table below summarizes the financial information of investment in shares of stock of associates which is accounted for using the equity method:

**December 31, 2016 (Unaudited)**

| | **OEDC** | **MPGC** |
|---|---|---|
| **Country of Incorporation** | **Philippines** | **Philippines** |
| Current assets | **P331,180** | **P123,163** |
| Noncurrent assets | **1,191,043** | **1,841,417** |
| Current liabilities | **(639,298)** | **(445)** |
| Noncurrent liabilities | **(353,812)** | **-** |
| Net assets | **P529,113** | **P1,964,135** |
| Revenue | **P1,329,636** | **P -** |
| Net income (losses)/total comprehensive income (losses) | **P18,267** | **(P12,009)** |
| Share in net income (losses)/total comprehensive income (losses) | **P6,393** | **(P5,851)*** |
| Carrying amount of investment | **P196,723** | **P958,719** |

**The Group's share in net losses/ total comprehensive losses for the period from June 16, 2016 to December 31, 2016 of MPGC.*

December 31, 2015 (Audited)

| | OEDC |
|---|---|
| Country of Incorporation | Philippines |
| Current assets | P367,191 |
| Noncurrent assets | 1,157,037 |
| Current liabilities | (901,666) |
| Noncurrent liabilities | (114,199) |
| Net assets | P508,363 |
| Revenue | P1,288,435 |
| Net income/total comprehensive income | P2,940 |
| Share in net income/total comprehensive income | P1,029 |
| Carrying amount of investment | P192,012 |

b. Investments in shares of stock of joint ventures

i. Angat Hydropower Corporation (Angat Hydro) and KWPP Holdings Corporation (KWPP)

The Parent Company, through PVEI, and Korea Water Resources Corporation (K-Water) entered into a joint venture partnership for the acquisition, rehabilitation, operation and maintenance of the 218 MW Angat Hydroelectric Power Plant (Angat Power Plant) awarded by PSALM to K-Water.

On November 18, 2014, PVEI acquired from the individual stockholders and K-Water, 2,817,270 shares or 60% of the outstanding capital stock of Angat Hydro and from the individual stockholders, 75 shares representing 60% of KWPP outstanding capital stock.

Subsequently, Angat Hydro and KWPP each issued shares in favor of nominee directors of PVEI and K-Water to complete their respective shareholding interest.

In accordance with the entry of PVEI into Angat Hydro and KWPP, K-Water and PVEI are jointly in control of the management and operation of Angat Hydro and KWPP.

Further, PVEI agreed to pay K-Water a support fee amounting to 3.0% of the total amount of the bridge loan facility which was obtained for the acquisition by Angat Hydro of the Angat Power Plant. This was subsequently reduced to 1.5% of the total amount of the bridge loan facility effective August 4, 2015. The obligation to pay support fee terminated on July 15, 2016 with the refinancing of the bridge loan facility.

On July 11, 2016, PVEI, subscribed to 27,724,200 shares, out of the increase in the authorized capital stock of Angat Hydro, at the subscription price of P200 per share. Total subscription amounting to P5,544,840 represents PVEI's 60% share in the additional equity infusion required by Angat Hydro from its existing stockholders as of date pursuant to Angat Hydro's project financing requirements.

<u>Angat Hydro</u>
Angat Hydro was incorporated on November 15, 2013 and was created to engage in the operations and maintenance of the Angat Power Plant and to supply power generated to power corporations and to electric utilities, to import hydro-electric facilities and equipment, and to do all acts necessary and incidental thereto, in accordance with RA No. 9136 or otherwise known as the Electric Power Industry Reform Act of 2001 (EPIRA).

<u>KWPP</u>
KWPP was incorporated on November 27, 2013 and was established for the purpose of acquiring, holding or leasing water and flowage rights.

The table below summarizes the financial information of investments in shares of stock of joint ventures which is accounted for using the equity method:

**December 31, 2016 (Unaudited)**

| | **Angat Hydro** | **KWPP** |
|---|---|---|
| **Country of Incorporation** | **Philippines** | **Philippines** |
| Current assets | **P2,784,190** | **P3,762** |
| Noncurrent assets | **19,302,522** | **20,684** |
| Current liabilities | **(13,339,970)** | **(8,274)** |
| Noncurrent liabilities | **(13,601)** | **(17,583)** |
| Net assets (liabilities) | **P8,733,141** | **(P1,411)** |
| Revenue | **P1,231,068** | **P -** |
| Net losses/total comprehensive losses | **(P489,425)** | **(P572)** |
| Share in net losses/total comprehensive losses | **(P293,655)** | **(P343)** |
| Carrying amount of investment | **P6,541,061** | **P -** |

December 31, 2015 (Audited)

| | Angat Hydro | KWPP |
|---|---|---|
| Country of Incorporation | Philippines | Philippines |
| Current assets | P1,144,068 | P2,049 |
| Noncurrent assets | 19,717,161 | 19,651 |
| Current liabilities | (20,862,372) | (5,023) |
| Noncurrent liabilities | (17,693) | (17,583) |
| Net liabilities | (P18,836) | (P906) |
| Revenue | P1,248,800 | P - |
| Net losses/total comprehensive losses | (P881,958) | (P352) |
| Share in net losses/total comprehensive losses | (P529,174) | (P211) |
| Carrying amount of investment | P1,289,876 | P - |

Unrecognized shares in net losses in excess of the Group's interest in KWPP amounted to P343 and P211 on December 31, 2016 and 2015, respectively.

<u>Investment in shares of stock of subsidiaries</u>

i. *Acquisition of OHC and GPII*
On February 10, 2015, the Parent Company acquired 100% outstanding capital stock of OHC for a total consideration amount of P588,050, inclusive of transaction costs. OHC is engaged in the business of acquiring by purchase, lease, donation or otherwise, and to own, use, improve, develop, subdivide, sell, mortgage, exchange, lease, develop and hold for investment or otherwise, real estate of all kinds; to improve, manage or otherwise deal with or dispose of buildings, houses, apartments, and other structures of whatever kind, together with their appurtenances; and to carry on, provide support and manage the general business of any corporation, entity or joint venture.

On September 4, 2015, the Parent Company acquired 100% outstanding capital stock of GPII for a total consideration amount of P1,820,972, inclusive of transaction costs. GPII's primary purpose is to carry on and engage in the business of developing and converting the properties in Limay, Bataan into a multi-use industrial park with all the necessary amenities, in joint venture with any person or entity.

The following summarizes the acquired net assets from OHC and GPII at the acquisition date:

| | OHC | GPII |
|---|---|---|
| Current assets | P37,609 | P126,317 |
| Noncurrent assets | 550,441 | 2,071,882 |
| Current liabilities | - | (5,940) |
| Noncurrent liabilities | - | (371,287) |
| Net assets | P588,050 | P1,820,972 |

In accordance with criteria set out in paragraph 2 of PFRS 3 and based on PIC Question and Answer No. 2011 - 06 PFRS 3 (2008), and PAS 40, Investment Property - *Acquisition of Investment Properties - Asset Acquisition or Business Combination,* the Parent Company is exempt from applying acquisition method and should be accounted for as an asset acquisition based on the principles described in other PFRS. The acquired set of assets and activities does not constitute a business as defined in PFRS 3.

ii. SCPC

In 2013, SCPC started the construction of its 2 x 150 MW Limay Coal-fired Power Plant Phase I. On November 4, 2016, SCPC started the testing and commissioning phase of Unit 1 of the power plant.

iii. SMCPC

In 2013, SMCPC started the construction of its 2 x 150 MW Malita Coal-fired Power Plant. On December 26, 2016 SMCPC started its commercial operations following the completion of Unit 1 of the power plant.

iv. SPI

SPI acquired from Petron in 2013 the 2 x 35 MW Limay Co-gen Power Plant and all other pertinent machineries, equipment, facilities and structures being constructed and installed which comprise the additional 2 x 35 MW Limay Co-gen Power Plant in Bataan.

On September 15, 2016, the BOD of the Parent Company and SPI approved the sale of its 4 x 35 MW Limay Co-gen Power Plant in favor of Petron.

SPI closed the sale of the power plant and all pertinent assets to Petron effective December 23, 2016.

v. PVEI

In January 2017, PVEI and K-Water granted short-term loans amounting to US$31,800 and US$21,200, respectively, to Angat Hydro, collectible in full plus a 4.50% interest on April 30, 2017 or at a certain date in accordance with the Terms and Conditions of the Loan Agreement dated January 3, 2017.

## 13. Property, Plant and Equipment

Property, plant and equipment consists of:

| | Power Plants (Note 6) | Land and Leasehold Improvements | Other Equipment | Building | Capital Projects in Progress | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| January 1, 2015 | P226,788,832 | P346,648 | P1,158,076 | P5,831,097 | P21,413,097 | P255,537,750 |
| Additions | - | 2,649,691 | 159,223 | 10,346 | 31,013,561 | 33,832,821 |
| Disposals | - | - | (754) | - | - | (754) |
| December 31, 2015 | 226,788,832 | 2,996,339 | 1,316,545 | 5,841,443 | 52,426,658 | 289,369,817 |
| Additions | 10,654,500 | 1,054,299 | 730,036 | 31,311 | 2,391,987 | 14,862,133 |
| Disposals/Reclassifications | (12,469,072) | (332,055) | (978,469) | (5,831,097) | (1,126,468) | (20,737,161) |
| Transfers to Assets Held for Sale | - | - | - | - | (184,324) | (184,324) |
| **December 31, 2016** | **224,974,260** | **3,718,583** | **1,068,112** | **41,657** | **53,507,853** | **283,310,465** |
| **Accumulated Depreciation and Amortization** | | | | | | |
| January 1, 2015 | 26,930,663 | 46,231 | 161,702 | 265,831 | - | 27,404,427 |
| Additions | 6,030,650 | 44,848 | 135,629 | 301,958 | - | 6,513,085 |
| Disposals | - | - | (691) | - | - | (691) |
| December 31, 2015 | 32,961,313 | 91,079 | 296,640 | 567,789 | - | 33,916,821 |
| Additions | 5,826,594 | 51,000 | 141,779 | 229,897 | - | 6,249,270 |
| Disposals/Reclassifications | (2,221,036) | (99,617) | (231,534) | (791,466) | - | (3,343,653) |
| **December 31, 2016** | **36,566,871** | **42,462** | **206,885** | **6,220** | **-** | **36,822,438** |
| **Carrying Amount** | | | | | | |
| December 31, 2015 | P193,827,519 | P2,905,260 | P1,019,905 | P5,273,654 | P52,426,658 | P255,452,996 |
| **December 31, 2016** | **P188,407,389** | **P3,676,121** | **P861,227** | **P35,437** | **P53,507,853** | **P246,488,027** |

a. The combined carrying amounts of power plants under finance lease amounted to P177,759,894 and P182,946,297 as of December 31, 2016 and 2015, respectively (Note 4).

b. On September 15, 2016, the BOD of the Parent Company and SPI approved the sale of its 4 x 35 MW Limay Co-gen Power Plant located in Petron Bataan Refinery in favor of Petron. Accordingly, the carrying amount of certain property, plant and equipment, amounting to P18,093,254 as of September 30, 2016 were reclassified to "Assets held for sale" account (Note 11). SPI recognized impairment loss of P323,788 at initial classification to measure its assets held for sale at lower of their carrying amount and fair value less costs to sell (Note 23).

   On October 28, 2016, SPI signed an agreement with Petron for the sale of the power plant and all pertinent assets, assignment of contracts to Petron, and the transfer of all remaining inventories, tools, supplies and other working capital necessary for the operation and maintenance of the power plant, among others.

   Effective December 23, 2016, SPI closed the sale of the power plant to Petron for a total consideration of P20,029,983 (inclusive of tax), payable based on the terms of the agreement. Consequently, gain of P114,447 was recognized on the sale and presented as part of "Gain on sale of property, plant and equipment" account in the consolidated statements of income.

   As of December 31, 2016, SPI received P15,966,458 as initial payment, and the balance of the receivable of P4,063,525 was included under "Trade and other receivables" account in the consolidated statements of financial position (Notes 8 and 19).

   Pursuant to the sale of the power plant, all SPI agreements mentioned in Note 6 were terminated effective December 23, 2016.

   As of December 31, 2016, the remaining assets held for sale consist of machineries and equipment to be sold to related parties (Note 11).

c. Additions to building, land and leasehold improvements and other equipment include acquisition of assets of OHC and GPII for the Group's power plant expansion projects.

d. Other equipment includes machinery and equipment, transportation equipment, mining equipment, office equipment and furniture and fixtures.

e. Capital projects in progress pertains to the following:

   i. Project of SMCPC for the construction of 2 x 150 MW (Units 1 and 2) Malita Coal-fired Power Plant.

      Following the completion of Unit 1 and the ERC grant of a Provisional Authority to Operate in favor of SMCPC in October 2016, all CPIP costs pertaining to Unit 1 were reclassified to the appropriate property, plant and equipment account.

   ii. Projects of SCPC and LPPC for the construction of the Limay Coal-fired Power Plants Phase I and II.

   iii. Plant optimization and pumped-storage hydropower projects of SPDC.

Depreciation and amortization related to property, plant and equipment are recognized in profit or loss as follows:

| | *Note* | 2016 | 2015 | 2014 |
|---|---|---|---|---|
| Cost of power sold | | **P6,139,882** | P6,445,102 | P6,129,256 |
| Operating expenses | *22* | **109,388** | 67,983 | 43,774 |
| | | **P6,249,270** | P6,513,085 | P6,173,030 |

Total depreciation and amortization recognized in the consolidated statements of income include annual amortization of capitalized interest amounting to P10,020, P13,360 and P4,453 in 2016, 2015 and 2014, respectively.

The Group has interest amounting to P610,707, P105,549 and P254,539 which were capitalized in 2016, 2015 and 2014, respectively. The capitalization rates used to determine the amount of interest eligible for capitalization range from 3.88% to 6.29% and from 6.06% to 6.29% in 2016 and 2015, respectively. The unamortized capitalized borrowing costs amounted to P627,126 and P446,789 as of December 31, 2016 and 2015, respectively (Note 18).

## 14. Deferred Exploration and Development Costs

The movement in deferred exploration and development costs is as follows:

| | 2016 | 2015 |
|---|---|---|
| Balance at beginning of year | **P689,548** | P671,783 |
| Additions | **3,831** | 17,765 |
| Balance at end of year | **P693,379** | P689,548 |

In 2010, SMEC acquired DAMI, SEPC and BERI resulting in the recognition of mining rights of P1,719,726 (Notes 4 and 15).

DAMI's coal property covered by COC No. 126, issued by the DOE, is located in South Cotabato and consists of 2 coal blocks with a total area of 2,000 hectares, more or less, and has an In-situ coal resources (measured plus indicated coal resources) of about 93 million metric tons as of December 31, 2016.

SEPC has a coal property and right over an aggregate area of 7,000 hectares, more or less, composed of 7 coal blocks located in South Cotabato and Sultan Kudarat. As of December 31, 2016, COC No. 134 has an In-situ coal resources (measured plus indicated coal resources) of about 35 million metric tons.

BERI's COC No. 138, issued by the DOE is located in Sarangani and South Cotabato consisting of 8 coal blocks with a total area of 8,000 hectares, more or less, and has an In-situ coal resources (measured plus indicated coal resources) of about 24 million metric tons as of December 31, 2016.

Status of Operations

In 2008 and 2009, the DOE approved the conversion of the COC for Exploration to COC for Development and Production of DAMI, SEPC and BERI, respectively, effective on the following dates:

| Subsidiary | COC No. | Effective Date | Term* |
|---|---|---|---|
| DAMI | 126 | November 19, 2008 | 10 years |
| SEPC | 134 | February 23, 2009 | 10 years |
| BERI | 138 | May 26, 2009 | 10 years |

* *The term is followed by another 10-year extension, and thereafter, renewable for a series of 3 year periods not exceeding 12 years under such terms and conditions as may be agreed upon with the DOE.*

On January 26, 2015, DOE granted the request by DAMI, SEPC and BERI for further extension of the moratorium of their work commitments under their respective COCs. The request is in connection with a resolution passed by South Cotabato in 2010 prohibiting open-pit mining activities in the area. The moratorium is retrospectively effective from January 1, 2013 and is valid until December 31, 2016 or until the ban on open-pit mining pursuant to the Environment Code of South Cotabato has been lifted, whichever comes first. On December 5, 2016, DAMI, SEPC and BERI requested for moratorium extension of work commitments. DOE in return required the 3 mining companies to submit supplemental information which the latter complied on December 27, 2016.

As of December 31, 2016, DAMI, SEPC and BERI are in the preparatory stages of its mining activities. All related costs and expenses from exploration are currently deferred as exploration and development costs and will be amortized upon commencement of their commercial operations.

Based on management's assessment, mining rights is not impaired since the recoverable amount of mining rights still exceeds its carrying amount as of December 31, 2016 and 2015.

## 15. Intangible Assets and Goodwill

Intangible assets and goodwill consist of:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| Mining rights | *14* | **P1,719,726** | P1,719,726 |
| Power concession assets - net | *4, 6* | **688,974** | 507,497 |
| Computer software - net | | **154,553** | 177,160 |
| Goodwill | | **8,866** | 8,866 |
| | | **P2,572,119** | P2,413,249 |

Goodwill

In November 2009 and March 2010, the Parent Company acquired 60% ownership interest in SMEC and SPDC. As a result of these transactions, the Parent Company recognized goodwill amounting to P8,349 and P517, respectively.

Based on management's assessment, goodwill is not impaired since the recoverable amount of the related net assets of SMEC and SPDC for which the goodwill was attributed still exceeds its carrying amount as of December 31, 2016 and 2015.

Computer Software

The movements in computer software are as follows:

| | *Note* | 2016 | 2015 |
|---|---|---|---|
| **Cost** | | | |
| Balance at beginning of year | | **P184,377** | P113,733 |
| Additions | | **44,994** | 70,644 |
| Balance at end of year | | **229,371** | 184,377 |
| **Accumulated Amortization** | | | |
| Balance at beginning of year | | **7,217** | 1,786 |
| Amortization | *22* | **67,601** | 5,431 |
| Balance at end of year | | **74,818** | 7,217 |
| | | **P154,553** | P177,160 |

## 16. Other Noncurrent Assets

Other noncurrent assets consist of:

| | *Note* | 2016 | 2015 |
|---|---|---|---|
| Restricted cash | *27, 28* | **P663,820** | P1,311,740 |
| Amounts owed by related parties | *19, 27, 28* | **227,394** | 253,812 |
| Deferred input VAT - net of current portion | | **84,876** | 682,674 |
| Noncurrent receivables | *27, 28* | **44,681** | - |
| | | **P1,020,771** | P2,248,226 |

Restricted cash comprises: (a) the amount received from PEMC totaling to P475,057 representing the proceeds of sale on WESM for a specific period in 2016, for the electricity generated from the excess capacity of the Sual Power Plant, which SMEC consigned with the RTC of Pasig City (Note 29); (b) APEC's reinvestment fund for sustainable capital expenditures and contributions collected from customers for membership fees and bill deposits which are refundable amounting to P188,763 and P102,870 as of December 31, 2016 and 2015, respectively; and (c) SPI's Cash Flow Waterfall accounts (Trust Fund) with a local bank, as part of the provisions in SPI's Facility Agreement (Note 18) totaling to P1,208,870 as of December 31, 2015. As of December 31, 2016, the remaining balance of SPI's restricted cash amounting to P4,088 was reclassified under "Cash and cash equivalents," due to the prepayment of its outstanding long-term debt in December 2016.

Amounts owed by related parties mainly pertains to loan granted by SPGC to OEDC which is collectible in equal monthly payments of principal and interest, initially pegged at 4.73% and subject to change every 6 months. The equal monthly payments of OEDC shall be made on the first day of each month commencing in January 2017 until December 2024 (Note 19).

The deferred input VAT as of December 31, 2015 mainly pertains to the remaining input VAT on the purchase of power plant from Petron in 2013, which was claimed against output VAT in 2016 (Note 17).

## 17. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| Trade | *6* | **P11,914,211** | P12,552,148 |
| Non-trade | | **19,125,230** | 14,840,406 |
| Output VAT | | **5,569,399** | 4,057,706 |
| Amounts owed to related parties | *19* | **633,436** | 653,900 |
| Accrued interest | *6, 18* | **283,724** | 493,897 |
| Withholding taxes | | **203,415** | 242,993 |
| | *27, 28* | **P37,729,415** | P32,841,050 |

Trade payables consist of payable related to energy fees, inventories and power purchases. These are generally on a 30-day term and are non-interest bearing.

Non-trade payables include liability relating to power rate adjustments, payables to contractors and other payables to the Government except output VAT and withholding taxes. Power rate adjustments include the adjustments in November and December 2013 sale of power to WESM amounting to nil and P563,587 as of December 31, 2016 and 2015, respectively (Note 29).

Output VAT consists of current and deferred output VAT payable. Deferred output VAT represents the VAT on sale of power which will be remitted to the Government only upon collection from the customers (Note 8).

## 18. Long-term Debt

Long-term debt consists of:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| Bonds payable *(a)* | | **P15,000,000** | P14,118,000 |
| Less debt issue costs | | **157,437** | 4,512 |
| | | **14,842,563** | 14,113,488 |
| Loans payable *(b)* | | **52,670,304** | 45,175,700 |
| Less debt issue costs | | **1,189,141** | 681,327 |
| | | **51,481,163** | 44,494,373 |
| | *27, 28* | **66,323,726** | 58,607,861 |
| Less current maturities | | **1,040,690** | 15,647,244 |
| | | **P65,283,036** | P42,960,617 |

a. Bonds Payable

i. <u>US Dollar-denominated Bonds</u>
On January 28, 2011, the Parent Company carried out a US$300,000, 7%, 5-year note (the "Bonds Payable") issued under Regulations of the U.S. Securities Act of 1933, as amended. The unsecured Bonds Payable is listed in the Singapore Exchange Securities Trading Limited. The terms and conditions of the Bonds Payable contain a negative pledge provision with certain limitations on the ability of Parent Company and its material subsidiaries to create or have outstanding any security interest upon, or with respect to, any of the present or future business, undertaking, assets or revenue (including any uncalled capital) of the Parent Company or any of its material subsidiaries to secure any indebtedness, subject to certain exceptions. Upon the occurrence of a change of control, each bondholder has the right, at its option, to require the Parent Company to repurchase all (but not some only) of its bonds, at a redemption price equal to 101% of the principal amount thereof plus accrued interest on the change of control put date.

The Parent Company has agreed to observe certain covenants, including, among other things, maintaining a leverage ratio, limitation on guarantees and loans, limitation on indebtedness, limitation on restricted payments, limitation on dividends and other restrictions affecting material subsidiaries, limitation on transactions with shareholders and affiliates, limitation of asset sales, consolidation, merger and sales of assets and certain other covenants. Interest is payable semi-annually in arrears on January 28 and July 28 of each year, with first interest payment on July 28, 2011.

On December 5, 2013, the BOD was informed of the need to amend certain provisions of the Bonds Payable, including but not limited to, the definitions of "Asset Sale", "Material Subsidiary", "Non-Recourse Project Level Indebtedness", "Permitted Security Interest" and "Project Subsidiaries" and the leverage and cross-default thresholds in order to align the provisions of the Bonds Payable with the US$700,000 Loan Facility of the Parent Company, thereby providing flexibility to enable the Parent Company to divest its non-core assets and raise funds in line with its long term growth strategy.

On January 14, 2016, the Parent Company availed of a US$300,000 six-month term loan (the "Short-Term Loan") as bridge financing with a local bank for the redemption of the Bonds Payable that matured on January 26, 2016.

ii. <u>Peso-denominated Bonds</u>
On July 11, 2016, the Parent Company issued and listed in the Philippine Dealing and Exchange Corp. (PDEX) fixed rate Philippine peso-denominated bonds (the "Bonds" or "Offer") with an aggregate principal amount of P15,000,000. The Bonds were issued at the issue price of 100% of face value in three series: Series A Bonds, Series B Bonds and Series C Bonds.

The terms and interest rate of the bonds are as follows:

| | Term | Interest Rate Per Annum |
|---|---|---|
| Series A Bonds | five (5) years, due 2021 | 4.3458% |
| Series B Bonds | seven (7) years, due 2023 | 4.7575% |
| Series C Bonds | ten (10) years, due 2026 | 5.1792% |

Interest on the Bonds shall be payable quarterly in arrears starting on October 11, 2016, for the first Interest Payment Date, and January 11, April 11, July 11 and October 11 of each year thereafter.

The net proceeds of the Offer was utilized primarily by the Parent Company to refinance the Short-Term Loan that matured on July 25, 2016.

*Valuation Technique*
The market value was determined using the market comparison technique. The fair values are based on PDEX. The bonds are traded in an active market and the quotes reflect the actual transactions in similar instruments.

The fair value of the long-term debt amounting to P15,129,886 as of December 31, 2016 has been categorized as Level 1 in the fair value hierarchy based on the inputs used in the valuation techniques (Note 28).

Bonds payable amounted to P14,842,563 and P14,113,488 while accrued interest amounted to P159,379 and P411,775 as of December 31, 2016 and 2015, respectively. Interest expense amounted to P435,166, P1,147,860, and P1,123,679 in 2016, 2015 and 2014, respectively.

b. Loans Payable

i. Parent Company

On September 9, 2013, the Parent Company signed a US$650,000, 5-year term loan with a syndicate of banks. The amount of the loan will bear interest at the rate of the London Interbank Offered Rate (LIBOR) plus a margin, payable in arrears on the last day of the agreed interest period. Subsequently, on November 15, 2013, the US$650,000 Facility Agreement was amended extending the loan facility from US$650,000 to US$700,000.

The Facility Agreement imposes a number of covenants on the part of the Parent Company including, but not limited to, maintaining a leverage ratio throughout the duration of the term of the Facility Agreement. The terms and conditions of the Facility Agreement contains a negative pledge provision with certain limitations on the ability of the Parent Company and its material subsidiaries to create or have outstanding any security interest upon or with respect to, any of the present or future business, undertaking, assets or revenue (including any uncalled capital) of the Parent Company or any of its material subsidiaries to secure any indebtedness, subject to certain exceptions.

In March 2015, the remaining US$200,000 was drawn by the Parent Company from the US$700,000, 5-year term loan, which will mature in September 2018. The drawn amount from the Facility Agreement amounted to US$700,000 in both years (equivalent to P34,804,000 and P32,942,000, as of December 31, 2016 and 2015, respectively).

ii. SCPC

On December 29, 2015, SCPC signed a US$400,000, 7-year term loan with a syndicate of banks. Pursuant to the Facility Agreement, the amount of the loan will bear interest at the rate of the LIBOR plus a margin, payable in arrears on the last day of the agreed interest period.

The Facility Agreements impose a number of covenants on the part of SCPC including, but not limited to, maintaining a leverage ratio throughout the duration of the Facility Agreements' term. The terms and conditions of the Facility Agreement include a negative pledge provision with certain limitations on the ability of SCPC to create or have outstanding any security interest upon or with respect to any of its assets or revenues and to secure any indebtedness, subject to certain exceptions.

The loan is secured by real estate and chattel mortgages on all present and future assets and reserves of SCPC as well as a pledge by the Parent Company of all its outstanding shares of stock in SCPC.

As of December 31, 2016, total drawn amount from the Facility Agreement is US$359,339 (equivalent to P17,866,304). Repayment of the loan principal shall commence on October 31, 2017, and every 3 months thereafter. The loan includes amount owed to a related party amounting to P2,687,451 as of December 31, 2016 (Note 19).

iii. SPI

On September 27, 2013, SPI has entered into a P13,800,000, 10-year term loan with a syndicate of banks, for the acquisition of the initial 2 x 35 MW Limay Co-gen Power Plant and all other pertinent machinery, equipment, facilities and structures for the expansion of the capacity. Of this amount, P12,300,000 and P1,500,000 were drawn on September 30, 2013 and 2014, respectively. The loan includes amount owed to a related party amounting to P3,102,750 as of December 31, 2015 (Note 19).

Effective interest rate ranges from 6.06% to 6.29% in 2016 and 2015, respectively. The Facility Agreement has a final maturity date of September 2023.

Facility Agreement imposes a number of covenants on the part of SPI, including, but not limited to, maintaining a debt-to-equity ratio and a specified debt service coverage ratio throughout the duration specified under the Facility Agreement. The terms and conditions of the Facility Agreement contains certain limitations on the ability of SPI to declare or pay any dividend, distribution or other return of capital in respect of any ownership interest to SPI and any other payment to the Parent Company or its affiliates, subject to certain exceptions.

On December 23, 2016, the Parent Company pre-settled the entire loan with accrued interest amounting to P11,270,930 using the proceeds from the sale of power plant to Petron (Notes 11, 13 and 19).

Loans payable amounted to P51,481,163 and P44,494,373 while accrued interest amounted to P55,164 and P7,544 as of December 31, 2016 and 2015, respectively. Total interest expense and financing charges on loans payable amounted to P2,726,143, P1,756,754, and P1,475,532 (inclusive of P723,306, P111,147 and P266,655 capitalized in CPIP in 2016, 2015 and 2014, respectively; Note 13) in 2016, 2015 and 2014, respectively.

The amortization of debt issue costs of P369,403, P262,428 and P173,978 is included as part of "Interest expense and other financing charges" account in the consolidated statements of income in 2016, 2015 and 2014, respectively.

As of December 31, 2016 and 2015, the Group is in compliance with the covenants of the debt agreements.

The movements in debt issue costs are as follows:

| | ***Note*** | **2016** | 2015 |
|---|---|---|---|
| Balance at beginning of year | | **P685,839** | P669,555 |
| Additions | | **1,142,741** | 284,310 |
| Amortization | | **(369,403)** | (262,428) |
| Capitalized amount | *13* | **(112,599)** | (5,598) |
| Balance at end of year | | **P1,346,578** | P685,839 |

The annual maturities of the long-term debt are as follows:

| | Gross Amount | | | | |
|---|---|---|---|---|---|
| Year | Dollar Amount | Peso Equivalent of US Dollar | Peso | Debt Issue Costs | Net |
| 2017 | $24,507 | P1,218,482 | P - | P177,792 | P1,040,690 |
| 2018 | 731,945 | 36,392,314 | - | 486,317 | 35,905,997 |
| 2019 | 33,814 | 1,681,219 | - | 152,939 | 1,528,280 |
| 2020 | 35,575 | 1,768,764 | - | 139,999 | 1,628,765 |
| 2021 | 38,054 | 1,892,042 | 6,153,250 | 187,014 | 7,858,278 |
| 2022 and thereafter | 195,444 | 9,717,483 | 8,846,750 | 202,517 | 18,361,716 |
| | $1,059,339 | P52,670,304 | P15,000,000 | P1,346,578 | P66,323,726 |

Contractual terms of the Group's interest bearing loans and borrowings and exposure to interest rate, foreign currency and liquidity risks are discussed in Note 27.

## 19. Related Party Disclosures

The Group, in the normal course of business, purchases products and services from and sells products and renders services to related parties. Transactions with related parties are made at normal market prices and terms. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

The following are the transactions with related parties and the outstanding balances as of December 31:

| | *Note* | Year | Revenues from Related Parties | Purchases from Related Parties | Amounts Owed by Related Parties | Amounts Owed to Related Parties | Terms | Conditions |
|---|---|---|---|---|---|---|---|---|
| SMC | *22* | **2016** | **P -** | **P660,590** | **P252** | **P6,201** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | - | 1,177,187 | 252 | 106,573 | | |
| Entities Under Common Control | *6, 8, 9, 17, 22* | **2016** | **10,248,500** | **3,300,854** | **1,589,923** | **562,408** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | 8,817,828 | 2,835,155 | 1,461,602 | 358,842 | | |
| | *8, 13* | **2016** | **17,883,913** | **-** | **4,063,525** | **-** | 180 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | - | - | - | - | | |
| Associate | *8, 17* | **2016** | **1,004,967** | **198,445** | **90,767** | **36,040** | 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | 958,043 | - | 92,621 | 28,101 | | |
| | *16* | **2016** | **12,929** | - | **254,827** | - | 9 years; interest bearing | Unsecured; no impairment |
| | | 2015 | - | - | 253,812 | - | | |
| Associates of Entities Under Common Control | *6, 8, 9* | **2016** | **763,309** | **199,635** | **102,256** | **28,787** | 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | 735,355 | 118,896 | 78,952 | 6 | | |
| | *18* | **2016** | **-** | **-** | **-** | **2,687,451** | 7 or 10 years; Interest bearing | Secured |
| | | 2015 | - | - | - | 3,102,750 | | |
| Others | *8, 17* | **2016** | **84,493** | **-** | **37,065** | **-** | On demand or 30 days; non-interest bearing | Unsecured; no impairment |
| | | 2015 | 7,419 | 321,143 | 1,674 | 160,378 | | |
| | | **2016** | **P29,998,111** | **P4,359,524** | **P6,138,615** | **P3,320,887** | | |
| | | 2015 | P10,518,645 | P4,452,381 | P1,888,913 | P3,756,650 | | |

All current outstanding balances with related parties are settled in cash within twelve months from the reporting date.

a. Amounts owed by related parties consist of trade and other receivables and security deposits (Notes 8).

b. Amounts owed to related parties consist of trade and non-trade payables, management fees, purchases of fuel, reimbursement of expenses, rent, insurance and services rendered by related parties.

c. Amounts owed by an associate consists of interest bearing loan granted to OEDC included as part of "Trade and other receivables" and "Other noncurrent assets" accounts in the consolidated statements of financial position and management fees charged to Angat Hydro by PVEI (Notes 8, 16 and 23).

d. The amount owed to associate of an entity under common control consists of interest bearing loan obtained from Bank of Commerce included as part of “Long-term debt” account in the consolidated statements of financial position (Note 18).

e. The compensation of key management personnel of the Group amounted to P39,712, P37,509 and P32,604 for the years ended December 31, 2016, 2015 and 2014, respectively.

## 20. Retirement Plan

The Parent Company and SMEC have unfunded, noncontributory, defined benefit retirement plans covering all of their permanent employees. Retirement benefits expense pertains to accrual of expected retirement benefits of active employees in accordance with RA No. 7641, *The Philippine Retirement Law*. Retirement benefits expense and liability is determined using the projected unit credit method. The Group’s latest actuarial valuation date is December 31, 2016. Valuations are obtained on a periodic basis.

The following table shows reconciliation of the net defined benefit retirement obligation and its component:

| | **2016** | 2015 |
|---|---|---|
| **Balance at beginning of year** | **P45,657** | P16,692 |
| **Recognized in Profit or Loss** | | |
| Current service cost | **6,174** | 5,866 |
| Interest cost | **2,214** | 745 |
| | **8,388** | 6,611 |
| **Recognized in Other Comprehensive Income** | | |
| Remeasurements: | | |
| Actuarial (gains) losses arising from: | | |
| Experience adjustments | **17,502** | 22,354 |
| Changes in financial assumptions | **(2,183)** | - |
| | **15,319** | 22,354 |
| **Balance at the end of year** | **P69,364** | P45,657 |

Defined benefit retirement obligation included as part of “Other noncurrent liabilities” account in the consolidated statements of financial position amounted to P69,364 and P45,657 as of December 31, 2016 and 2015, respectively.

The retirement costs amounting to P8,388, P6,611 and P8,978 in 2016, 2015 and 2014, respectively, are recognized as part of “Salaries, wages and benefits” under “Operating expenses” account in the consolidated statements of income (Note 22).

The reserve for retirement plan as of December 31, 2016 and 2015 comprises of net actuarial loss recognized in other comprehensive income during the year amounting to P15,319 and P22,354, respectively.

The principal actuarial assumptions used to determine retirement benefits are as follows:

| | **2016** | 2015 |
|---|---|---|
| Discount rate | **4.93% - 5.38%** | 4.43% - 4.89% |
| Salary increase rate | **7.00%** | 7.00% |

Assumptions for mortality and disability rates are based on published statistics and mortality and disability tables.

The weighted average duration of the defined benefit retirement obligation ranges from 8.0 to 9.0 years and 8.9 to 9.2 years as of December 31, 2016 and 2015, respectively.

Sensitivity Analysis

As of December 31, 2016 and 2015, the reasonably possible changes to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit retirement obligation by the amounts shown below:

| | **Defined Benefit Retirement Obligation** | | | |
|---|---|---|---|---|
| | **2016** | | 2015 | |
| | **1% Increase** | **1% Decrease** | 1% Increase | 1% Decrease |
| Discount rate | **(P4,151)** | **P4,558** | (P3,060) | P3,370 |
| Salary increase rate | **4,063** | **(3,793)** | 2,991 | (2,785) |

Risks and Management of Risks

The defined benefit retirement obligation expose the Group to actuarial risks, such as longevity risk and interest rate risk.

The defined benefit retirement obligation is calculated using a discount rate set with reference to government bond yields as such is exposed to market factors including inflation. Higher inflation will lead to higher liability. Also, the defined benefit retirement obligations are to provide benefits for the life of members, so increase in life expectancy will result in an increase in the plan's liability. These risks are managed with the objective of reducing the impact of these risks to the cash flows of the Group.

The Group does not have a formal retirement plan and therefore has no plan assets to match against the liability under the defined benefit retirement obligation. Also, benefit claims under the defined benefit retirement obligation are paid directly by the Group when they become due.

## 21. Equity

Capital Stock

As of December 31, 2016 and 2015, the Parent Company's authorized capital stock is P2,000,000, divided into 2,000,000,000 common shares with par value of P1 per share.

Capital stock consists of:

| | **2016** | 2015 |
|---|---|---|
| Subscribed capital stock | **P1,250,004** | P1,250,004 |
| Less subscription receivable | **187,500** | 187,500 |
| | **P1,062,504** | P1,062,504 |

The number of shares subscribed is 1,250,003,500 common shares as of December 31, 2016 and 2015.

Equity Reserves
In September 2010, the Parent Company acquired the remaining 40% non-controlling ownership interest of SMC in SMEC and SPDC. The difference between the price paid and carrying amount of net assets transferred was recognized in equity.

Retained Earnings
The Parent Company's retained earnings available for dividend declaration, calculated based on the regulatory requirements of the Philippine SEC, amounted to P508,785 and P1,186,479 as at December 31, 2016 and 2015, respectively. The difference between the consolidated retained earnings and the Parent Company's retained earnings available for dividend declaration primarily consist of undistributed earnings of subsidiaries and equity method investees. Stand-alone earnings of the subsidiaries and share in net earnings of equity method investees are not available for dividend declaration by the Parent Company until declared by the subsidiaries and equity investees as dividends.

The Parent Company's BOD declared cash dividends as follows:

**December 31, 2016**

| **Date of Declaration** | **Stockholders of Record** | **Date Payable** | **Dividend Per Share** | **Amount** |
|---:|---:|---:|---:|---:|
| **June 7, 2016** | **June 7, 2016** | **June 14, 2016** | **P1.20** | **P1,500,000** |
| **August 11, 2016** | **August 11, 2016** | **August 18, 2016** | **1.20** | **1,500,000** |
| | | | | **P3,000,000** |

December 31, 2015

| Date of Declaration | Stockholders of Record | Date Payable | Dividend Per Share | Amount |
|---:|---:|---:|---:|---:|
| March 25, 2015 | March 25, 2015 | March 31, 2015 | P1.20 | P1,500,000 |
| July 2, 2015 | July 2, 2015 | July 9, 2015 | 1.20 | 1,500,000 |
| November 5, 2015 | November 5, 2015 | November 10, 2015 | 1.20 | 1,500,000 |
| | | | | P4,500,000 |

December 31, 2014

| Date of Declaration | Stockholders of Record | Date Payable | Dividend Per Share | Amount |
|---:|---:|---:|---:|---:|
| March 25, 2014 | March 25, 2014 | April 8, 2014 | P1.20 | P1,500,000 |
| June 3, 2014 | June 3, 2014 | June 10, 2014 | 2.80 | 3,500,000 |
| August 19, 2014 | August 19, 2014 | August 29, 2014 | 2.00 | 2,500,000 |
| November 4, 2014 | November 4, 2014 | November 11, 2014 | 2.00 | 2,500,000 |
| | | | | P10,000,000 |

*Parent Company*
On December 22, 2014, the BOD approved the appropriation of retained earnings amounting to P9,128,000 for additional funding requirements on its expansion projects.

On December 23, 2015, the BOD approved the appropriation amounting to P7,700,000 for the payment of the US$700,000, 5-year term loan that will mature in September 2018 (Note 18). Reversals during 2015 pertain to: (a) construction of power plant amounting to P2,092,750; (b) interest on bonds payable amounting to P446,250; (c) interest on loans payable amounting to P104,000; and (d) expansion projects amounting to P9,128,000.

In 2016, reversals amounted to P2,966,000 for the debt servicing of the $700,000 loan, as intended.

Total appropriated retained earnings of the Parent Company amounted to P4,734,000, P7,700,000 and P11,771,000 as at December 31, 2016, 2015, and 2014 respectively.

*SMEC, SPPC and SPDC*
On December 22, 2014, the BOD of SMEC, SPPC and SPDC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P6,375,000, P4,370,500, and P2,604,600, respectively, pursuant to the IPPA Agreements and additional funding requirements on their expansion project.

On December 23, 2015, the BOD of SMEC, SPPC and SPDC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P4,990,000, P1,806,300 and P352,400, respectively, pursuant to the IPPA Agreements and additional funding requirements on their expansion project.

On December 21, 2016, the BOD of SMEC and SPPC approved the appropriation of retained earnings for fixed monthly payments to PSALM amounting to P1,099,300 and P2,990,300, respectively, pursuant to the IPPA Agreements and additional funding requirements on their expansion project.

The appropriations reversed in 2016, 2015 and 2014 were used for the required capital expenditures and fixed monthly payments of SMEC, SPPC and SPDC to PSALM, as intended.

Total combined appropriated retained earnings of SMEC, SPPC and SPDC amounted to P20,507,200, P17,455,600 and P17,631,900 as at December 31, 2016, 2015 and 2014, respectively.

Undated Subordinated Capital Securities
The Parent Company issued and listed on the Singapore Stock Exchange the following USCS at an issue price of 100%:

| Date of Issuance | Distribution Payment Date | Initial Rate of Distribution | Step-Up Date | Amount of USCS Issued | Amount in Philippine Peso |
|---|---|---|---|---|---|
| August 26, 2015 | August 26 and February 26 of each year | 6.75% per annum | February 26, 2021 | US$300,000 | P13,823,499 |
| May 7, 2014 | May 7 and November 7 of each year | 7.5% per annum | November 7, 2019 | 300,000 | 13,110,066 |
| | | | | **US$600,000** | **P26,933,565** |

The holders of the USCS have conferred a right to receive distributions on a semi-annual basis from their issuance dates at the initial rate of distribution, subject to the step-up rate. The Parent Company has a right to defer this distribution under certain conditions.

The USCS have no fixed redemption date and are redeemable in whole, but not in part, at the Parent Company's option on step-up date, or any distribution payment date thereafter or upon the occurrence of certain other events at the principal amounts of the USCS plus any accrued, unpaid or deferred distribution.

The proceeds were used by the Parent Company to finance investments in power-related assets and other general corporate purposes.

Details of distributions paid to USCS holders are as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| February | **P689,223** | P - | P - |
| May | **756,804** | 714,616 | - |
| August | **681,412** | - | - |
| November | **777,134** | 736,072 | 723,214 |
| | **P2,904,573** | P1,450,688 | P723,214 |

On February 24, 2017, the Parent Company paid distributions to holders of the \$300,000 USCS issued in August 2015, amounting to P720,611.

On March 13, 2017, the Parent Company's BOD approved the payment of distribution in the total amount of \$11,250, plus applicable taxes, on May 7, 2017 to the holders of the \$300,000 USCS issued in May 2014.

## 22. Plant Operations and Maintenance Fees and Operating Expenses

Plant operations and maintenance consist of:

| | ***Note*** | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| Plant operations and maintenance fees | *6, 19* | **P379,231** | P440,897 | P499,850 |
| Supplies and metering | | **59,410** | 47,865 | 22,510 |
| Salaries, wages and benefits | | **17,514** | 13,326 | 41,720 |
| Others | | **20,189** | 123 | 11,552 |
| | | **P476,344** | P502,211 | P575,632 |

Operating expenses consist of:

| | Note | 2016 | 2015 | 2014 |
|---|---|---|---|---|
| Taxes and licenses | | **P982,855** | P946,801 | P406,979 |
| Impairment losses on trade receivables | *8* | **958,784** | 142,658 | 144,393 |
| Donations | | **738,980** | 59,781 | 662,752 |
| Management fees | *19* | **652,167** | 1,196,789 | 456,727 |
| Corporate special program | | **384,166** | 245,736 | 134,607 |
| Salaries, wages and benefits | *19, 20* | **361,854** | 222,994 | 149,113 |
| Rent | *4, 6, 19* | **351,091** | 360,091 | 115,849 |
| Repairs and maintenance | | **308,335** | 138,067 | 65,952 |
| Supplies | | **250,200** | 105,617 | 46,444 |
| Outside services | | **212,975** | 749,207 | 152,512 |
| Depreciation and amortization | *13, 15* | **176,989** | 73,414 | 43,774 |
| Market fees | *6* | **160,669** | 219,681 | 233,701 |
| Travel and transportation | | **141,463** | 57,544 | 37,233 |
| Professional fees | | **137,303** | 124,221 | 130,019 |
| Advertising and promotions | | **119,874** | 59,653 | 40,998 |
| Insurance | | **63,827** | 65,434 | 38,238 |
| Miscellaneous | | **238,118** | 136,447 | 52,639 |
| | | **P6,239,650** | P4,904,135 | P2,911,930 |

Donations represent contributions to registered donee institutions for their programs on education, environment and disaster-related projects. Corporate special program pertains to the Group's corporate social responsibility projects.

On September 9, 2014, SMEC agreed to provide an additional coal unloader (the Third Unloader) to the Sual Power Plant while Team Sual Corporation (TSC) agreed to install, operate and maintain the same during the life of the Sual IPPA Agreement or until 2024. Considering, however, that TSC is not allowed to accept and install any equipment in the Sual Power Plant that it does not own, SMEC agreed to donate the same in order to implement the intention of both parties to improve the unloading capability and increase coal shipment deliveries. The Third Unloader will be part of the assets to be turned over to SMEC at the end of the Sual IPPA Agreement or until 2024.

## 23. Other Income (Charges)

Other income (charges) consists of:

| | Note | 2016 | 2015 | 2014 |
|---|---|---|---|---|
| PSALM monthly fees reduction | *6* | **P1,509,225** | P1,858,506 | P814,565 |
| Construction revenue | *4, 6* | **226,997** | 47,091 | 111,995 |
| Construction cost | *4, 6* | **(226,997)** | (47,091) | (111,995) |
| Foreign exchange losses - net | *27* | **(8,075,159)** | (7,582,548) | (813,621) |
| Miscellaneous income (charges) - net | *4, 6, 19* | **(315,820)** | (202,008) | 67,281 |
| | | **(P6,881,754)** | (P5,926,050) | P68,225 |

Miscellaneous income (charges) pertain to impairment losses on non-trade receivables and property, plant and equipment, management fees and rental income charged to related parties (Notes 6, 8, 13 and 19).

## 24. Income Taxes

The components of income tax expense are as follows:

| | *Note* | **2016** | 2015 | 2014 |
|---|---|---|---|---|
| Current | *25* | **P2,668,503** | P2,181,771 | P1,608,293 |
| Deferred | | **697,256** | 521,637 | 1,085,130 |
| | | **P3,365,759** | P2,703,408 | P2,693,423 |

Current income tax expense in 2016, 2015 and 2014 represents regular corporate income tax of 30% on taxable income, MCIT on gross income and final tax paid on interest income.

Deferred tax assets (liabilities) arise from the following:

| | *Note* | **2016** | 2015 |
|---|---|---|---|
| **Items Recognized in Profit or Loss** | | | |
| Allowance for impairment losses on trade and other receivables | *8* | **P458,043** | P170,443 |
| Defined benefit retirement obligation | *20* | **9,507** | 6,991 |
| Difference of amortization of borrowing costs over payments and others | | **(624,000)** | (472,095) |
| Difference of depreciation and other related expenses over monthly payments | *6* | **(1,684,499)** | (849,032) |
| **Item Recognized in Other Comprehensive Income** | | | |
| Equity reserve for retirement plan | *20* | **11,302** | 6,706 |
| | | **(P1,829,647)** | (P1,136,987) |

The difference of depreciation and other related expenses over monthly payments represents timing difference between tax and accounting recognition of expenses.

The deferred taxes are reported in the consolidated statements of financial position as follows:

| | **2016** | 2015 |
|---|---|---|
| Deferred tax assets | **P2,955,570** | P2,745,943 |
| Deferred tax liabilities | **(4,785,217)** | (3,882,930) |
| | **(P1,829,647)** | (P1,136,987) |

The movements in deferred tax assets (liabilities) are as follows:

| **December 31, 2016** | **Balance at Beginning of Year** | **Recognized in Profit or Loss** | **Recognized in Other Comprehensive Income** | **Balance at End of Year** |
|---|---|---|---|---|
| **Allowance for impairment losses on trade and other receivables** | **P170,443** | **P287,600** | **P -** | **P458,043** |
| **Defined benefit retirement obligation** | **6,991** | **2,516** | **-** | **9,507** |
| **Difference of amortization of borrowing costs over payments and others** | **(472,095)** | **(151,905)** | **-** | **(624,000)** |
| **Difference of depreciation and other related expenses over monthly payments** | **(849,032)** | **(835,467)** | **-** | **(1,684,499)** |
| **Equity reserve for retirement plan** | **6,706** | **-** | **4,596** | **11,302** |
| **Net liabilities** | **(P1,136,987)** | **(P697,256)** | **P4,596** | **(P1,829,647)** |

| December 31, 2015 | Balance at Beginning of Year | Recognized in Profit or Loss | Recognized in Other Comprehensive Income | Balance at End of Year |
|---|---|---|---|---|
| Allowance for impairment losses on trade and other receivables | P60,005 | P110,438 | P - | P170,443 |
| Defined benefit retirement obligation | - | 6,991 | - | 6,991 |
| Difference of amortization of borrowing costs over payments and others | (71,912) | (42,217) | (357,966) | (472,095) |
| Difference of depreciation and other related expenses over monthly payments | (252,183) | (596,849) | - | (849,032) |
| Equity reserve for retirement plan | - | - | 6,706 | 6,706 |
| Net liabilities | (P264,090) | (P521,637) | (P351,260) | (P1,136,987) |

As of December 31, 2016, the NOLCO and MCIT of the Group that can be claimed as deduction from future taxable income and deduction from corporate income tax due, respectively, are as follows:

| **Year Incurred/Paid** | **Carryforward Benefits Up To** | **NOLCO** | **MCIT** |
|---|---|---|---|
| Year 2016 | December 31, 2019 | P3,137,496 | P19,932 |
| Year 2015 | December 31, 2018 | 2,938,533 | 10,195 |
| Year 2014 | December 31, 2017 | 2,074,956 | 3,824 |
| | | P8,150,985 | P33,951 |

The reconciliation between the statutory income tax rate on income before income tax and the Group's effective income tax rate is as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Statutory income tax rate | **30.00%** | 30.00% | 30.00% |
| Increase (decrease) in the income tax rate resulting from: | | | |
| Unrecognized deferred tax assets | **17.85%** | 30.43% | - |
| Availment of optional standard deduction and others | **(3.07%)** | (0.78%) | (1.91%) |
| Income subject to ITH | **-** | - | (7.87%) |
| Effective income tax rate | **44.78%** | 59.65% | 20.22% |

## 25. Registrations and License

Registrations with the Board of Investments (BOI)

i. In 2013, SMCPC and SCPC were granted incentives by the BOI on a pioneer status for 6 years subject to the representations and commitments set forth in the application for registration, the provisions of Omnibus Investments Code of 1987, the rules and regulations of the BOI and the terms and conditions prescribed. On October 5, 2016, BOI granted SCPC's request to move the start of its commercial operation and Income Tax Holiday (ITH) reckoning date from February 2016 to September 2017 or when the first kWh of energy was transmitted after commissioning or testing, or 1 month from the date of such commissioning or testing, whichever comes earlier as certified by the National Grid Corporation of the Philippines. Subsequently, on December 21, 2016, BOI granted a similar request of SMCPC to move the start of its commercial operation and ITH reckoning date from December 2015 to July 2016, or the actual date of commercial operations subject to compliance with the Specific Terms and Conditions, due to delay in the implementation of the project for reasons beyond its control. The ITH incentives shall be limited only to the revenues generated from the sale of the electricity from the power plants.

ii. On September 20, 2016, LPPC was registered with the BOI under the Omnibus Investment Code of 1987 as expanding operator of 2 x 150 MW Circulating Fluidized Bed Coal-fired Power Plant on a non-pioneer status. The BOI categorized LPPC as an "Expansion" based on the 2014 to 2016 IPP's Specific Guidelines for "Energy" in relation to SCPC's 2 x 150 MW Coal-fired Power Plant. As a registered entity, LPPC is entitled to certain incentives that include, among others, an ITH for 3 years from January 2018 or date of actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration. The ITH incentives shall be limited only to the revenues generated from the sale of the electricity from the power plant.

iii. On August 26, 2015, February 11, 2016 and October 26, 2016, the BOI issued a Certificate of Authority to SMCPC, SCPC and LPPC, respectively, subject to provisions and implementing rules and regulations of Executive Order No. 70, entitled "Reducing the Rates of Duty on Capital Equipment, Spare Parts and Accessories imported by BOI Registered New and Expanding Enterprises." Authority shall be valid for 1 year from the date of issuance.

iv. SMEC, SPDC and SPPC are registered with the BOI as administrator/operator of their respective power plants on a pioneer status with non-pioneer incentives and were granted ITH for 4 years without extension beginning August 1, 2010 up to July 31, 2014, subject to compliance with certain requirements under their registrations. The ITH incentive availed was limited only to the sale of power generated from the power plants.

v. On August 21, 2007, SEPC was registered with the BOI under the Omnibus Investment Code of 1987 (Executive Order No. 226), as New Domestic Producer of Coal on a Non-pioneer Status.

License Granted by the ERC
On August 22, 2011 and August 24, 2016, SMELC and SCPC, respectively, were granted a RES License by the ERC pursuant to Section 29 of the EPIRA which requires all suppliers of electricity to the contestable market to secure a license from the ERC. The term of the RES License is for a period of 5 years from the time it was granted and renewable thereafter.

On August 19, 2016, the ERC approved the renewal of SMELC's RES License for another 5 years from August 22, 2016 up to August 21, 2021.

## 26. Basic and Diluted Earnings (Loss) Per Share

Basic and diluted EPS is computed as follows:

| | **2016** | 2015 | 2014 |
|---|---|---|---|
| Net income attributable to equity holders of the Parent Company | **P4,150,662** | P1,828,918 | P10,629,482 |
| Distributions to USCS holders for the year | **(2,938,623)** | (1,918,382) | (962,786) |
| Net income (loss) attributable to common shareholders of the Parent Company (a) | **1,212,039** | (89,464) | 9,666,696 |
| Weighted average number of common shares outstanding (in thousands) (b) | **1,250,004** | 1,250,004 | 1,250,004 |
| Basic/Diluted Earnings (Loss) Per Share (a/b) | **P0.97** | (P0.07) | P7.73 |

As of December 31, 2016, 2015 and 2014, the Group has no dilutive debt or equity instruments.

## 27. Financial Risk and Capital Management Objectives and Policies

Objectives and Policies
The Group has significant exposure to the following financial risks primarily from its use of financial instruments:

- Interest Rate Risk
- Foreign Currency Risk
- Liquidity Risk
- Credit Risk

This note presents information about the exposure to each of the foregoing risks, the objectives, policies and processes for measuring and managing these risks, and for management of capital.

The principal non-trade related financial instruments of the Group include cash and cash equivalents, restricted cash, and long-term debt. These financial instruments are used mainly for working capital management and investment purposes. The trade-related financial assets and financial liabilities of the Group such as trade and other receivables, noncurrent receivables, accounts payable and accrued expenses, finance lease liabilities and other noncurrent liabilities arise directly from, and are used to facilitate, its daily operations.

The BOD has the overall responsibility for the establishment and oversight of the risk management framework of the Group.

The risk management policies of the Group are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The BOD constituted the Audit Committee to assist the BOD in fulfilling its oversight responsibility of the Group's corporate governance process relating to the: a) quality and integrity of the consolidated financial statements and financial reporting process and the systems of internal accounting and financial controls; b) performance of the internal auditors; c) annual independent audit of the consolidated financial statements, the engagement of the independent auditors and the evaluation of the independent auditors' qualifications, independence and performance; d) compliance with legal and regulatory requirements, including the disclosure control and procedures; e) evaluation of management's process to assess and manage the enterprise risk issues; and f) fulfillment of the other responsibilities set out by the BOD.

The Audit Committee also oversees how management monitors compliance with the risk management policies and procedures of the Group and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Audit Committee is assisted in its oversight role by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

Interest Rate Risk

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group’s exposure to changes in interest rates relates primarily to the long-term borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, borrowings issued at variable rates expose the Group to cash flow interest rate risk.

Management is responsible for monitoring the prevailing market-based interest rate and ensures that the mark-up rates charged on its borrowings are optimal and benchmarked against the rates charged by other creditor banks.

On the other hand, the investment policy of the Group is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the operations and working capital management. However, the Group invests only in high-quality short-term investments while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term fluctuations on the earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P14,127, P2,092 and P6,388 in 2016, 2015 and 2014, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. These changes are considered to be reasonably possible given the observation of prevailing market conditions in those periods. There is no impact on the Group's other comprehensive income.

The Group does not account for any fixed-rate financial assets or financial liabilities at FVPL and the Group does not designate derivatives as hedging instruments under a fair value hedge accounting model. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

Interest Rate Risk Table

The terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

| **December 31, 2016** | **1 Year or Less** | **>1-2 Years** | **>2-3 Years** | **>3-4 Years** | **>4-5 Years** | **>5 Years** | **Total** |
|---|---|---|---|---|---|---|---|
| **Fixed Rate** | | | | | | | |
| Philippine peso-denominated | **P -** | **P -** | **P -** | **P -** | **P6,153,250** | **P8,846,750** | **P15,000,000** |
| Interest rate | | | | | | | |
| Series A Bonds | | | | | 4.3458% | | |
| Series B Bonds | | | | | | 4.7575% | |
| Series C Bonds | | | | | | 5.1792% | |
| **Floating Rate** | | | | | | | |
| Foreign currency-denominated | | | | | | | |
| (expressed in Philippine peso) | **1,218,482** | **36,392,314** | **1,681,219** | **1,768,764** | **1,892,042** | **9,717,483** | **52,670,304** |
| Interest rate | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | LIBOR + Margin | |
| | **P1,218,482** | **P36,392,314** | **P1,681,219** | **P1,768,764** | **P8,045,292** | **P18,564,233** | **P67,670,304** |

| December 31, 2015 | 1 Year or Less | >1-2 Years | >2-3 Years | >3-4 Years | >4-5 Years | >5 Years | Total |
|---|---|---|---|---|---|---|---|
| Fixed Rate | | | | | | | |
| Philippine peso-denominated | P1,402,200 | P1,402,200 | P1,402,200 | P1,402,200 | P1,402,200 | P3,892,950 | P10,903,950 |
| Step-down interest rate | 6.0606% | 6.0606% | 6.0606% | 6.0606% | 6.0606% | 6.0606% | |
| Philippine peso-denominated | 171,000 | 171,000 | 171,000 | 171,000 | 171,000 | 474,750 | 1,329,750 |
| Step-down interest rate | 6.2921% | 6.2921% | 6.2921% | 6.2921% | 6.2921% | 6.2921% | |
| Foreign currency-denominated | | | | | | | |
| (expressed in Philippine peso) | 14,118,000 | - | - | - | - | - | 14,118,000 |
| Interest rate | 7% | | | | | | |
| Floating Rate | | | | | | | |
| Foreign currency-denominated | | | | | | | |
| (expressed in Philippine peso) | - | - | 32,942,000 | - | - | - | 32,942,000 |
| Interest rate | | | LIBOR + Margin | | | | |
| | P15,691,200 | P1,573,200 | P34,515,200 | P1,573,200 | P1,573,200 | P4,367,700 | P59,293,700 |

Foreign Currency Risk
The exposure to foreign currency risk results from significant movements in foreign exchange rates that adversely affect the foreign currency-denominated transactions of the Group. The risk management objective with respect to foreign currency risk is to reduce or eliminate earnings volatility and any adverse impact on equity.

Information on the Group's foreign currency-denominated monetary assets and monetary liabilities and their Philippine peso equivalents as of December 31 are as follows:

| | | **2016** | | 2015 | |
|---|---|---|---|---|---|
| | ***Note*** | **US Dollar** | **Peso Equivalent** | US Dollar | Peso Equivalent |
| **Assets** | | | | | |
| Cash and cash equivalents | *7* | **US$108,229** | **P5,381,123** | US$210,578 | P9,909,822 |
| Trade and other receivables | *8* | **80,301** | **3,992,573** | 81,746 | 3,846,983 |
| | | **188,530** | **9,373,696** | 292,324 | 13,756,805 |
| **Liabilities** | | | | | |
| Accounts payable and accrued expenses | *17* | **312,823** | **15,553,551** | 278,830 | 13,121,735 |
| Finance lease liabilities | *6* | **1,880,371** | **93,492,054** | 2,057,616 | 96,831,429 |
| Long-term debt | *18* | **1,059,339** | **52,670,304** | 1,000,000 | 47,060,000 |
| | | **3,252,533** | **161,715,909** | 3,336,446 | 157,013,164 |
| **Net Foreign Currency-Denominated Monetary Liabilities** | | **US$3,064,003** | **P152,342,213** | US$3,044,122 | P143,256,359 |

The Group reported net losses on foreign exchange amounting to P8,075,159, P7,582,548 and P813,621 in 2016, 2015 and 2014, respectively, with the translation of its foreign currency-denominated assets and liabilities (Note 23). These mainly resulted from the movement of the Philippine peso against US dollar as shown in the following table:

| | **US Dollar to Philippine Peso** |
|---|---|
| **December 31, 2016** | **49.72** |
| December 31, 2015 | 47.06 |
| December 31, 2014 | 44.72 |

The management of foreign currency risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various foreign currency exchange rate scenarios.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) for the years ended December 31:

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **P1 Decrease in the US Dollar Exchange Rate** | **P1 Increase in the US Dollar Exchange Rate** | P1 Decrease in the US Dollar Exchange Rate | P1 Increase in the US Dollar Exchange Rate |
| Cash and cash equivalents | **(P108,229)** | **P108,229** | (P210,578) | P210,578 |
| Trade and other receivables | **(80,301)** | **80,301** | (81,746) | 81,746 |
| | **(188,530)** | **188,530** | (292,324) | 292,324 |
| Accounts payable and accrued expenses | **312,823** | **(312,823)** | 278,830 | (278,830) |
| Finance lease liabilities | **1,880,371** | **(1,880,371)** | 2,057,616 | (2,057,616) |
| Long-term debt | **1,059,339** | **(1,059,339)** | 1,000,000 | (1,000,000) |
| | **3,252,533** | **(3,252,533)** | 3,336,446 | (3,336,446) |
| | **P3,064,003** | **(P3,064,003)** | P3,044,122 | (P3,044,122) |

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

Liquidity Risk

Liquidity risk pertains to the risk that the Group will encounter difficulty to meet payment obligations when they fall under normal and stress circumstances.

The Group's objectives to manage its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps and surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary.

The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted receipts and payments used for liquidity management as of December 31:

| **2016** | **Carrying Amount** | **Contractual Cash Flow** | **1 Year or Less** | **>1 Year - 2 Years** | **>2 Years - 5 Years** | **Over 5 Years** |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | **P21,491,385** | **P21,491,385** | **P21,491,385** | **P -** | **P -** | **P -** |
| Trade and other receivables - net* | **22,342,743** | **22,342,743** | **22,342,743** | **-** | **-** | **-** |
| Noncurrent receivables (included under "Other noncurrent assets - net" account) | **272,019** | **315,066** | **-** | **77,195** | **116,640** | **121,231** |
| **Financial Liabilities** | | | | | | |
| Accounts payable and accrued expenses* | **31,095,490** | **31,095,490** | **31,095,490** | **-** | **-** | **-** |
| Finance lease liabilities (including current portion) | **170,089,536** | **213,866,933** | **24,689,002** | **24,966,835** | **84,101,330** | **80,109,766** |
| Long-term debt - net (including current maturities) | **66,323,726** | **77,424,824** | **3,618,010** | **38,428,920** | **15,077,705** | **20,300,189** |

**Excluding statutory receivables and payables*

| 2015 | Carrying Amount | Contractual Cash Flow | 1 Year or Less | >1 Year - 2 Years | >2 Years - 5 Years | Over 5 Years |
|---|---|---|---|---|---|---|
| Financial Assets | | | | | | |
| Cash and cash equivalents | P22,241,361 | P22,241,361 | P22,241,361 | P - | P - | P - |
| Trade and other receivables - net* | 18,473,455 | 18,486,278 | 18,486,278 | - | - | - |
| Restricted cash (included under "Other noncurrent assets" account - net) | 1,311,740 | 1,311,740 | 1,311,740 | - | - | - |
| Noncurrent receivables (included under "Other noncurrent assets - net" account) | 253,812 | 309,075 | - | 38,634 | 115,903 | 154,538 |
| Financial Liabilities | | | | | | |
| Accounts payable and accrued expenses* | 27,707,659 | 27,707,659 | 27,707,659 | - | - | - |
| Finance lease liabilities (including current portion) | 179,193,193 | 231,795,506 | 23,755,535 | 24,016,154 | 77,763,868 | 106,259,949 |
| Long-term debt - net (including current maturities) | 58,607,861 | 64,490,903 | 17,262,779 | 2,969,354 | 39,484,150 | 4,774,620 |

Credit Risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the trade and other receivables. The Group manages its credit risk mainly through the application of transaction limits and close risk monitoring. It is the Group's policy to enter into transactions with a wide diversity of creditworthy counterparties to mitigate any significant concentration of credit risk.

The Group has regular internal control reviews to monitor the granting of credit and management of credit exposures.

*Trade and Other Receivables*

The exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, management also considers the demographics of the Group's customer base, including the default risk of the industry in which customers operate, as these factors may have an influence on the credit risk.

The Group has established a credit policy under which each new customer is analyzed individually for creditworthiness before the standard payment and delivery terms and conditions are offered. The Group ensures that sales on account are made to customers with appropriate credit history. The Group has detailed credit criteria and several layers of credit approval requirements before engaging a particular customer or counterparty. The review includes external ratings, when available, and in some cases bank references. Purchase limits are established for each customer and are reviewed on a regular basis. Customers that fail to meet the benchmark creditworthiness may transact with the Group only on a prepayment basis.

The Group establishes an allowance for impairment losses that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance include a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets in respect of losses that have been incurred but not yet identified. The collective loss allowance is determined based on historical data of payment statistics for similar financial assets.

Financial information on the Group's maximum exposure to credit risk as of December 31, without considering the effects of other risk mitigation techniques, is presented below.

| | **2016** | 2015 |
|---|---|---|
| Cash and cash equivalents (excluding cash on hand) | **P21,490,065** | P22,240,755 |
| Trade and other receivables - net* | **22,342,743** | 18,473,455 |
| Restricted Cash | **-** | 1,311,740 |
| Noncurrent receivables (included under "Other noncurrent assets" account) | **272,019** | 253,812 |
| | **P44,104,827** | P42,279,762 |

**Excluding statutory receivables*

The credit risk for cash and cash equivalents and restricted cash is considered negligible, since the counterparties are reputable entities with high quality external credit ratings.

The Group has significant concentration of credit risk. Sale of power to Meralco accounts for 51%, 53% and 56% of the Group's total revenues for the years ended December 31, 2016, 2015 and 2014, respectively. The Group does not execute any credit guarantee in favor of any counterparty.

Capital Management

The Group maintains a sound capital base to ensure its ability to continue as a going concern, thereby continue to provide returns to stockholders and benefits to other stockholders and to maintain an optimal capital structure to reduce cost of capital.

The Group manages its capital structure and makes adjustments in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, distribution payment, pay-off existing debts, return capital to shareholders or issue new shares, subject to compliance with certain covenants of its long-term debt and USCS (Notes 18 and 21).

The Group defines capital as capital stock, additional paid-in capital, USCS and retained earnings, both appropriated and unappropriated.

The BOD has overall responsibility for monitoring capital in proportion to risk. Profiles for capital ratios are set in the light of changes in the external environment and the risks underlying the Group's business, operation and industry.

The Group monitors capital on the basis of debt-to-equity ratio, which is calculated as total debt divided by total equity. Total debt is defined as total current liabilities and total noncurrent liabilities, while equity is total equity as shown in the consolidated statements of financial position.

There were no changes in the Group's approach to capital management during the year.

## 28. Financial Assets and Financial Liabilities

The table below presents a comparison by category of the carrying amounts and fair values of the Group's financial instruments as of December 31:

| | **2016** | | 2015 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Fair Value** | Carrying Amount | Fair Value |
| **Financial Assets** | | | | |
| Cash and cash equivalents | **P21,491,385** | **P21,491,385** | P22,241,361 | P22,241,361 |
| Trade and other receivables - net* | **22,342,743** | **22,342,743** | 18,473,455 | 18,473,455 |
| Restricted cash (included under "Other noncurrent assets - net" account) | **-** | **-** | 1,311,740 | 1,311,740 |
| Noncurrent receivables (included under "Other noncurrent assets - net" account) | **272,019** | **272,019** | 253,812 | 253,812 |
| | **P44,106,147** | **P44,106,147** | P42,280,368 | P42,280,368 |
| **Financial Liabilities** | | | | |
| Accounts payable and accrued expenses* | **P31,095,490** | **P31,095,490** | P27,707,659 | P27,707,659 |
| Finance lease liabilities (including current portion) | **170,089,536** | **170,089,536** | 179,193,193 | 179,193,193 |
| Long-term debt - net (including current maturities) | **66,323,726** | **66,611,049** | 58,607,861 | 59,760,982 |
| | **P267,508,752** | **P267,796,075** | P265,508,713 | P266,661,834 |

**Excluding statutory receivables and payables*

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

*Cash and Cash Equivalents, Trade and Other Receivables (excluding statutory receivables), Restricted Cash, and Noncurrent Receivable.* The carrying amounts of these financial assets approximate their fair values primarily due to the relatively short-term nature/maturities of these financial instruments. The fair value of noncurrent receivable is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

*Accounts Payable and Accrued Expenses (excluding statutory payables).* The carrying amount of accounts payable and accrued expenses approximates fair value due to the relatively short-term maturities of these financial instruments.

*Long-term Debt, Finance Lease Liabilities and Other Noncurrent Liabilities.* The fair value of interest-bearing fixed-rate loans is based on the discounted value of expected future cash flows using the applicable market rates for similar types of instruments as of reporting date. Discount rates used for Philippine peso-denominated loans range from 2.18% to 4.88% and 2.39% to 4.57% as of December 31, 2016 and 2015, respectively. The discount rates used for foreign currency-denominated loans is nil and 0.43% as of December 31, 2016 and 2015, respectively. The carrying amounts of floating rate loans with quarterly interest rate repricing approximate their fair values.

## 29. Other Matters

a. Electric Power Industry Reform Act of 2001

The EPIRA sets forth the following: (a) Section 49 created PSALM to take ownership and manage the orderly sale, disposition and privatization of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets; (b) Section 31(c) requires the transfer of the management and control of at least 70% of the total energy output of power plants under contract with NPC to the IPP Administrators as one of the conditions for retail competition and open access; and (c) Pursuant to Section 51(c), PSALM has the power to take title to and possession of the IPP contracts and to appoint, after a competitive, transparent and public bidding, qualified independent entities who shall act as the IPP Administrators in accordance with the EPIRA. In accordance with the bidding procedures and supplemented bid bulletins thereto to appoint an IPP Administrator relative to the capacity of the IPP contracts, PSALM has conducted a competitive, transparent and open public bidding process following which the Group was selected winning bidder of the IPPA Agreements discussed in Note 6.

The EPIRA requires generation and distribution utility (DU) companies to undergo public offering within 5 years from the effective date, and provides cross ownership restrictions between transmission and generation companies. If the holding company of generation and DU companies is already listed with the PSE, the generation company or the DU need not comply with the requirement since such listing of the holding company is deemed already as compliance with the EPIRA.

A DU is allowed to source from an associated company engaged in generation up to 50% of its demand except for contracts entered into prior to the effective date of the EPIRA. Generation companies are restricted from owning more than 30% of the installed generating capacity of a grid and/or 25% of the national installed generating capacity. The Group is in compliance with the restrictions as of December 31, 2016.

b. Contingencies

The Group is a party to certain cases or claims which are either pending decision by the court/regulators or are subject to settlement agreements. The outcome of these cases or claims cannot be presently determined (Note 4).

i. *Generation Payments to PSALM*

SPPC and PSALM are parties to the Ilijan IPPA Agreement covering the appointment of SPPC as the IPP Administrator of the Ilijan Power Plant.

SPPC and PSALM have an ongoing dispute arising from differing interpretations of certain provisions related to generation payments under the Ilijan IPPA Agreement. As a result of such dispute, the parties have arrived at different computations regarding the subject payments. In a letter dated August 6, 2015, PSALM has demanded payment of the difference between the generation payments calculated based on its interpretation and the amount which has already been paid by SPPC, plus interest, covering the period December 26, 2012 to April 25, 2015.

On August 12, 2015, SPPC initiated a dispute resolution process with PSALM as provided under the terms of the Ilijan IPPA Agreement, while continuing to maintain that it has fully paid all of its obligations to PSALM. Notwithstanding the bona fide dispute, PSALM issued a notice terminating the Ilijan IPPA Agreement on September 4, 2015. On the same day, PSALM also called on the Performance Bond posted by SPPC pursuant the Ilijan IPPA Agreement.

On September 8, 2015, SPPC filed a Complaint with the RTC of Mandaluyong City. In its Complaint, SPPC requested the RTC that its interpretation of the relevant provisions of the Ilijan IPPA Agreement be upheld. The Complaint also asked that a 72-hour Temporary Restraining Order (TRO) be issued against PSALM for illegally terminating the Ilijan IPPA Agreement and drawing on the Performance Bond. On even date, the RTC issued a 72-hour TRO which prohibited PSALM from treating SPPC as being in Administrator Default and from performing other acts that would change the status quo ante between the parties before PSALM issued the termination notice and drew on the Performance Bond. The TRO was extended for until September 28, 2015.

On September 28, 2015, the RTC issued an Order granting a Preliminary Injunction enjoining PSALM from proceeding with the termination of the Ilijan IPPA Agreement while the main case is pending.

On October 22, 2015, the RTC also issued an Order granting the Motion for Intervention and Motion to Admit Complaint-in-intervention by Meralco.

In an Order dated June 27, 2016, the RTC denied PSALM's: (1) Motion for Reconsideration of the Order dated September 28, 2015, which issued a writ of preliminary injunction enjoining PSALM from further proceedings with the termination of the IPPA Agreement while the case is pending; (2) Motion for Reconsideration of the Order, which allowed Meralco to intervene in the case; and (3) Motion to Dismiss. In response to this Order, PSALM filed a petition for certiorari with the Court of Appeals (CA) seeking to annul the RTC's Orders granting the writ of preliminary injunction, allowing Meralco's intervention, and the Orders denying PSALM's motions for reconsideration of said injunction and intervention orders. PSALM also prayed for the issuance of a TRO and/or writ of preliminary injunction "against public respondent RTC and its assailed Orders." SPPC shall file the appropriate pleading and opposition to the TRO and injunction applications of PSALM.

The preliminary conference on the RTC case was suspended to pave way for mediation between the parties. During the last mediation conference on January 6, 2017, mediation between the parties was terminated. The case has been referred to Judicial Dispute Resolution process at the trial court level.

Meanwhile, there are no restrictions or limitations on the ability of SPPC to supply power from the Ilijan Power Plant to Meralco under its Power Supply Agreement with the latter.

By virtue of the Preliminary Injunction issued by the RTC, SPPC continues to be the IPP Administrator for the Ilijan Power Plant.

*ii. Criminal Cases*

SPPC

On September 29, 2015, SPPC filed a criminal complaint for estafa and for violation of Section 3(e) of RA No. 3019, otherwise known as the Anti-Graft and Corrupt Practices Act, before the Department of Justice (DOJ), against certain officers of PSALM, in connection with the termination of SPPC's IPPA Agreement, which was made by PSALM with manifest partiality and evident bad faith. PSALM fraudulently misrepresented its entitlement to draw on the Performance Bond posted by SPPC, resulting in actual injury to SPPC in the amount of US$60,000. The case is still pending with the DOJ as of December 31, 2016.

SMEC

On October 21, 2015, SMEC filed a criminal complaint for Plunder and violation of Section 3(e) and 3(f) of RA 3019, before the DOJ against a certain officer of PSALM, and certain officers of Team Philippines Energy Corp. (TPEC) and TSC, relating to the illegal grant of the so-called "excess capacity" of the Sual Power Plant in favor of TPEC which enabled it to receive a certain amount at the expense of the Government and SMEC.

In a Resolution dated July 29, 2016, the DOJ found probable cause to file Information against the respondents for (a) Plunder; (b) Violation of Sec. 3(e) of the Anti-Graft and Corrupt Practices Act; and (c) Violation of Sec. 3(f) of the Anti-Graft and Corrupt Practices Act. The DOJ further resolved to forward the entire records of the case to the Office of the Ombudsman for their proper action. Respondents have respectively appealed said DOJ's Resolution of July 29, 2016 with the Secretary of Justice.

On June 17, 2016, SMEC filed with the RTC Pasig a civil complaint for consignation against PSALM arising from PSALM's refusal to accept SMEC's remittances corresponding to the proceeds of the sale on the WESM of electricity generated from capacity in excess of the 1000 MW of the Sual Power Plant ("Sale of the Excess Capacity"). With the filing of the complaint, SMEC also consigned with the RTC Pasig, the amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods December 26, 2015 to April 25, 2016.

On October 3, 2016, SMEC filed an Omnibus Motion (To Admit Supplemental Complaint and To Allow Future Consignation without Tender). Together with this Omnibus Motion, SMEC consigned with the RTC Pasig an additional amount corresponding to the proceeds of the Sale of the Excess Capacity for the billing periods from April 26, 2016 to July 25, 2016.

Pending for resolution are (a) PSALM's Motion for Preliminary Hearing and Special and Affirmative Defenses and (b) SMEC's Omnibus Motion (to Admit Supplemental Complaint and to Allow Future Consignations without Tender).

Further related thereto, on December 1, 2016, SMEC received a copy of a Complaint filed by TPEC and TSC with the ERC against SMEC and PSALM in relation to the Excess Capacity issues, which issues have already been raised in the abovementioned cases. SMEC filed a Motion to Dismiss and Motion to Suspend Proceeding of the instant case.

iii. *Temporary Restraining Order Issued to Meralco*

On December 23, 2013, the Supreme Court (SC) issued a TRO, effective immediately, preventing Meralco from collecting from its customers the power rate increase pertaining to November 2013 billing. As a result, Meralco was constrained to fix its generation rate to its October 2013 level of P5.67/kWh. Claiming that since the power supplied by generators, including SMEC and SPPC is billed to Meralco's customers on a pass-through basis, Meralco deferred a portion of its payment on the ground that it was not able to collect the full amount of its generation cost. Further, on December 27, 2013, the DOE, the ERC and PEMC, acting as a tripartite committee, issued a joint resolution setting a reduced price cap on the WESM of P32/kWh. The price will be effective for 90 days until a new cap is decided upon.

On January 16, 2014, the SC granted Meralco's plea to include other power supplier and generation companies, including SMEC and SPPC, as respondents to an inquiry. On February 18, 2014, the SC extended the period of the TRO until April 22, 2014 and enjoined the respondents (PEMC and the generators) from demanding and collecting the deferred amounts.

On March 3, 2014, the ERC issued an order declaring the November and December 2013 Luzon WESM prices void and imposed the application of regulated prices. Accordingly, SMEC, SPPC and SPDC recognized a reduction in the sale of power while SMELC recognized a reduction in its power purchases. Consequently, a payable and receivable were also recognized for the portion of over-collection or over-payment, the settlement of which have been covered by a 24-month Special Payment Arrangement with PEMC which was already completed on May 25, 2016. On June 26, 2014, SMEC, SPPC, SPDC and SPI filed with the CA a Petition for Review of these orders.

In a resolution dated October 11, 2016, the CA directed the parties to file their respective memoranda. SPPC, SMEC SPDC and SPI filed their memoranda on December 21, 2016. The case is still pending resolution with the CA as of December 31, 2016.

c. Commitments

The outstanding purchase commitments of the Group amounted to P1,588,516 and P2,577,051 as of December 31, 2016 and 2015, respectively.

Amount authorized but not yet disbursed for capital projects as of December 31, 2016 and 2015 is approximately P23,038,949 and P32,704,535, respectively.