

# 2005 Annual Report

SOLID GROUP INC.



Life flows from technology.





► Manufacturing  
and Support Services

From a small part  
to a **greater community.**

02 Contents

04 Message to Stockholders

05 Review of Operations

06 Board of Directors and Corporate Officers



► Real Estate

From a strong foundation  
to ample **breathing space.**

From a simple connection  
to a flourishing life.



07 Statement of Management's Responsibility and Financial Statements

07 Report of Independent Auditors

08 Consolidated Balance Sheets

10 Consolidated Statements of Income

11 Consolidated Statements of Changes in Equity

12 Consolidated Statements of Cash Flows

14 Notes to Consolidated Financial Statements



# Dear fellow shareholders

SGI is committed to enabling our Filipino customer to have the quality of life they desire. We are focused on investing in and developing new products and services that are not only relevant to their practical needs but deliver personal enjoyment as well. While we cannot perfectly forecast the future, we are reorganizing our businesses to exploit new technologies to keep pace with our market's ever changing needs.

Building such long-term value means sustaining this vision through short-term difficulties. To win customer loyalty and market leadership in the future, we have not competed purely on price with the dominant industry competitors. Instead we have chosen to constantly innovate and offer new values to our customers. We also have very strong industry and technology partners who continue to support our efforts to expand our reach and strengthen our services to our customers.

SGI's key business value areas are the following:

## Expanding Our Customer Reach

We believe that the value of our businesses is in their accessibility to the customer and the way we efficiently service their requirements. For example, our consumer electronics service operation, Solid Electronics Corporation (SEC), served an average of more than 10,000 customer transactions a month through its nationwide chain of service centers. Through Solid Broadband Corporation (SBC), we grew our broadband cable infrastructure to reach new residential growth areas for a total network coverage of 3,823 strand kilometers covering Metro Manila. Because of our efforts, we continue to be the most far-reaching and integrated broadband network ready for fast developing convergence technologies.

## Deepening Our Customer Relationship

Convergence is here. This means that our significant competitive edge is our capacity for a large commercial scale delivery of cable television video, Internet access and voice communications via a single broadband infrastructure. The claim to be capable of true convergence has been made by many in the industry but we have spent 2005 preparing to make our claim a practical reality. This means that we will be engaging our customers in multiple service transactions, which translates into convenience for them, multiple revenue streams and new efficiencies for our operations and a deeper relationship with our subscriber. Led by strong cable subscriber growth of Global Destiny, we are confident that the customer access through their subscriber base will facilitate the rollout of our "triple-play" service. Working with a great team of technology and business partners, we hope to reach our customers with our new integrated services by the second half of 2006.

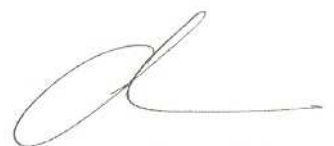
## Delivering "Brick and Mortar" Value

As valuable as our convergence businesses are, we believe that we also need to be firmly rooted in providing our customers with "brick and mortar" services to fulfill their needs. In line with this, we are pursuing with confidence and excitement, our direction to maximize key real estate assets with the first being the Zen Towers tri-tower project along Concepcion Street in Manila. We aim to provide customers with affordable and good quality residential units whose value is further enhanced by its proximity to SM Manila as well as easy access to other major destinations. We are also continuing to explore strategic development of commercial and industrial projects that will further benefit both our customers and our partners in these projects.

Our confidence in our business directions is further strengthened by the strong support we have received from key business partners and technology suppliers who have helped us in extending our network reach to high value market areas and providing new services including low cost Voice Over Internet services. Our real estate development project has already attracted strong market interest as it brings together some of the most respected names in the industry including Mohri and P.A. Associates Inc., Architects, Alden C. Ong and Associates, Structural Consultant and New Golden City Builder & Development Corp, Civil Works Contractor.

We are committed to our direction and confident of the long-term prospects of the businesses we are developing. Most of all, we move forward believing that our efforts will provide our customers with more and better options for achieving the lifestyle they desire.

This is our future and we look forward to sharing it with you.



David S. Lim  
Director, President and  
Chief Executive Officer



# Review of Operations.

## Broadband Services

Our Broadband Services business maintained its positive growth trend despite the challenges of maintaining the largest contiguous broadband cable network in Metro Manila. Our revenue growth, which reached Php 202.5 Million, was supported by subscriber acquisitions in residential cable areas and an increase in high-rise buildings using broadband equipment provided by our technology partnership with Samsung. We also greatly benefited from the successful subscriber acquisition campaign of our cable television operator, Global Destiny Cable with its new program offerings and pay-per-view channel services.

As we steadily grew our subscriber numbers, we also succeeded in our operations efficiency efforts as shown by our significant reductions of 12 percent in operations expenses and 5 percent in cost of services. As a result, we have also been able to improve the EBITDA performance from negative Php 39 Million in 2004 to negative Php 26 Million in 2005. We are confident that our level of efficiency can now support a host of new services that will increase our revenues as well as provide new exciting options for our customers, which will be bundled with our existing Internet and cable television service capabilities.



## Real Estate

Construction of our tri-tower development, Zen Towers, has reached the fifteenth floor and is proceeding steadily. Market studies have indicated that the location and design of the units will make it ideal for current market demand for high-rise residential units in the Manila area. Pre-selling is expected to begin full swing only in the fourth quarter of 2006 pending the fulfillment of regulatory requirements.

Other prime property locations in Metro Manila and in other key cities are also being studied for development as part of objective to maximize real estate values. On the other hand, after a strong showing in the previous year, sales of industrial estates considerably slowed with a general drop in demand.

## Manufacturing and Support Services

The After Sales service operations of Solid Electronics Corporation (SEC) achieved combined sales revenue level only slightly higher from 2004 of Php187 Million to Php 191 Million in 2005 with an increase of Php 4 Million, reflecting the effect of the strong sales of new digital cameras, personal audio players and large projection televisions which requires specialized after sales service. We expect the trend to further improve as the new products sold in the market increasingly require more servicing support.

Omni Logistics posted positive revenue growth as it reached Php 114 Million servicing the warehouse and logistics needs of leading brands such as Sony and TCL, a leading china brand in consumer electronics.

Plastic Injection operations (SLC-Plastics and Kita Corp.) also contributed Php 261 Million even as it had to rebuild one of its operations in the Bicutan plant after an unfortunate fire. Further opportunities to service the needs of consumer product assemblers in the country are also projected in the coming year.

## Trading and Distribution

Solid Video Corporation's (SVC) aggressive sales efforts resulted in an 8 percent growth in revenue from the previous year. Despite a difficult market situation, SVC won significant supply contracts from broadcast and post-production facilities as well as prestigious events such as the International Broadcast Center of the Southeast Asian (SEA) Games.

Even as local plastics product manufacturers restrained production plans in 2005, AA Plastics still achieved revenue of Php 141.7 Million primarily in trading and supply of plastic resins.

## Financing, Investments & Others

Revenues from investment activities only reached Php164 Million because of the pressure from a declining US dollar despite our diversification into bond investments with higher interest yields.





Elena S. Lim  
Chairman Emeritus



Gabriel V. Manalac  
Director



Joseph Lim  
Director



Susan L. Tan  
Director  
Chairman of the Board



Quintin Chua  
Director

## Board of Directors



Vincent S. Lim  
Director  
Senior Vice President  
and Chief Financial Officer



David S. Lim  
Director  
President  
and Chief Executive Officer



Jason S. Lim  
Director  
Senior Vice President  
and  
Chief Operating Officer

## Corporate Officers



James H. Uy  
Senior Vice President  
and Chief Operating Officer,  
Solid Broadband Corporation



Lita L. Joaquin  
Treasurer



Enrique L. Ligeralde  
Senior Vice President for  
Administration and Control



Ireneo D. Tubio, Jr.  
Senior Vice-President and  
Chief Accounting Officer,

(Not in picture)  
Roberto V. San Jose  
Corporate Secretary



# Statement of Management's Responsibility and Financial Statements

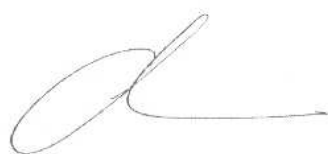
The management of Solid Group, Inc. is responsible for all information and representations contained in the financial statements for the years ended December 31, 2005 and 2004. The financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

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

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

Punongbayan and Araullo, the independent auditors appointed by the stockholders, has examined the financial statements of the Company in accordance with generally accepted auditing standards in the Philippines and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to the Board of Directors and stockholders.

Signed under oath by the following:



David S. Lim  
President and Chief Executive Officer



Susan L. Tan  
Chairman of the Board



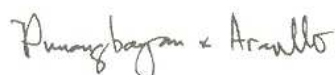
Vincent S. Lim  
Chief Financial Officer

## Report of Independent Auditors

The Board of Directors and Stockholders  
Solid Group Inc. and Subsidiaries  
2285 Don Chino Roces Avenue Extension  
Makati City

Punongbayan & Araullo 

We have audited the consolidated financial statements of Solid Group Inc. and subsidiaries for the year ended December 31, 2005, on which we have rendered our report dated May 8, 2006. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The applicable supplementary schedules (see table contents) of the Company and subsidiaries as of December 31, 2005 and for the year then ended, required by the Securities and Exchange Commission, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The information in such supplementary schedules has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



May 8, 2006



**Consolidated Balance Sheets**  
**December 31, 2005 and 2004**  
(Amounts in Philippine Pesos)

	Notes	2005	2004
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	6	<b>P 1,382,850,803</b>	P 1,619,213,573
Financial assets at fair value through profit or loss	7	<b>488,291,583</b>	328,302,566
Trade and other receivables - net	8	<b>489,546,651</b>	330,270,538
Advances to related parties	26	<b>52,724,220</b>	78,384,763
Available-for-sale financial assets	9	<b>499,411,952</b>	422,620,365
Inventories - net	10	<b>95,558,427</b>	120,438,048
Real estate inventories - net	11	<b>525,065,741</b>	318,462,630
Other current assets	14	<b>99,091,146</b>	82,383,187
Total Current Assets		<b>3,632,540,523</b>	3,300,075,670
<b>NON-CURRENT ASSETS</b>			
Trade and other receivables - net	8	<b>587,657,761</b>	500,496,966
Available-for-sale financial assets	9	<b>22,237,451</b>	21,159,989
Property, plant and equipment - net	12	<b>742,740,864</b>	749,382,605
Investment property - net	13	<b>2,576,007,985</b>	2,710,044,059
Retirement benefit assets	22	<b>43,766,077</b>	38,276,561
Deferred tax assets - net	23	<b>14,497,152</b>	4,399,438
Other non-current assets - net	14	<b>41,186,647</b>	45,186,074
Total Non-current Assets		<b>4,028,093,937</b>	4,068,945,692
<b>TOTAL ASSETS</b>		<b>P 7,660,634,460</b>	P 7,369,021,362

Forward

	Notes	2005	2004
<b>LIABILITIES AND EQUITY</b>			
<b>CURRENT LIABILITIES</b>			
Interest-bearing loans	15	P 596,583,614	P 262,412,605
Trade and other payables	16	333,152,506	383,967,592
Estimated liability for land and land development costs		19,934,298	19,816,448
Advances from related parties	26	98,093,656	96,697,485
Income tax payable		3,279,417	7,357,197
Total Current Liabilities		1,051,043,491	770,251,327
<b>NON-CURRENT LIABILITIES</b>			
Refundable deposits	17	5,495,516	4,753,433
Retirement benefit obligation	22	3,336,728	2,667,422
Deferred tax liabilities - net	23	1,429,716	16,544,482
Total Non-current Liabilities		10,261,960	23,965,337
Total Liabilities		1,061,305,451	794,216,664
<b>EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF PARENT COMPANY</b>			
Capital stock	24	2,030,975,000	2,030,975,000
Additional paid-in capital	24	4,641,701,922	4,641,701,922
Treasury shares		( 115,614,380 )	( 115,614,380 )
Revaluation reserves	24	( 4,099,860 )	14,425,419
Deficit		( 211,400,057 )	( 260,116,387 )
Total Equity Attributable to Equity Holders of Parent		6,341,562,625	6,311,371,574
MINORITY INTERST		257,766,384	263,433,124
Total Equity		6,599,329,009	6,574,804,698
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>P 7,660,634,460</b>	<b>P 7,369,021,362</b>

See Notes to Consolidated Financial Statements.



Consolidated Statements of Income  
For the Years Ended December 31, 2005 and 2004  
(Amounts in Philippine Pesos)

	Notes	2005	2004
<b>REVENUES</b>			
Rendering of services		P 506,272,144	P 441,830,145
Sale of goods		489,899,827	500,893,736
Rentals		117,194,101	110,354,171
Sale of land		6,459,750	220,857,086
		<b>1,119,825,822</b>	<b>1,273,935,138</b>
<b>COST OF SALES, SERVICES AND RENTALS</b>			
Cost of services	18, 20	482,367,187	485,100,862
Cost of sales	18, 20	433,661,630	425,079,125
Cost of rentals	18, 20	65,717,411	61,531,059
Cost of land sold	20	5,925,376	170,139,677
		<b>987,671,604</b>	<b>1,141,850,723</b>
<b>GROSS PROFIT</b>		<b>132,154,218</b>	<b>132,084,415</b>
<b>OTHER OPERATING EXPENSES (INCOME)</b>			
Other operating income	19	( 225,214,223 )	( 263,271,870 )
General and administrative expenses	20	293,451,028	238,305,278
Selling and distribution costs	20	27,070,089	19,649,221
		<b>95,306,894</b>	<b>( 5,317,371 )</b>
<b>OPERATING PROFIT</b>		<b>36,847,324</b>	<b>137,401,786</b>
<b>OTHER INCOME (CHARGES)</b>			
Finance costs	15	( 20,257,994 )	( 8,833,348 )
Other gains-net	21	36,351,692	39,112,006
		<b>16,093,698</b>	<b>30,278,658</b>
<b>INCOME BEFORE TAX FROM CONTINUING OPERATIONS</b>		<b>52,941,022</b>	<b>167,680,444</b>
<b>TAX EXPENSE</b>	23	<b>9,891,432</b>	<b>46,520,878</b>
<b>INCOME FROM CONTINUING OPERATIONS</b>		<b>43,049,590</b>	<b>121,159,566</b>
<b>LOSS FROM DISCONTINUED OPERATIONS</b>	4	<b>—</b>	<b>( 5,020,074 )</b>
<b>NET INCOME</b>		<b>P 43,049,590</b>	<b>P 116,139,492</b>
<b>Attributable to:</b>			
Equity holders of parent company		P 48,716,330	P 101,046,964
Minority interest		( 5,666,740 )	15,092,528
		<b>P 43,049,590</b>	<b>P 116,139,492</b>
<b>Earnings Per Share</b>	25	<b>P 0.03</b>	<b>P 0.06</b>

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Changes In Equity**  
**For the Years Ended December 31, 2005 and 2004**  
(Amounts in Philippine Pesos)

	Notes	2005	2004
<b>CAPITAL STOCK</b> - P1 par value			
Authorized - 5,000,000,000 shares			
Balance at beginning of year		P 2,030,975,000	P 2,255,436,752
Effects of revaluation of Destiny, Inc.'s net assets	1, 24	—	( 224,461,752 )
Balance at end of year		2,030,975,000	2,030,975,000
<b>ADDITIONAL PAID-IN CAPITAL</b>			
Balance at beginning of year		4,641,701,922	4,664,902,932
Effects of revaluation of Destiny, Inc.'s net assets	1, 24	—	( 23,201,010 )
Balance at end of year		4,641,701,922	4,641,701,922
<b>TREASURY SHARES</b> - At cost		( 115,614,380 )	( 115,614,380 )
<b>REVALUATION RESERVES</b>	24		
Balance at beginning of year			
As previously reported		—	—
Effects of transition to PFRS, net of taxes	2	14,425,419	11,052,500
As restated		14,425,419	11,052,500
Exchange differences on remeasuring balances of foreign operations		( 18,329,519 )	3,368,934
Fair value gains (loss) on available-for-sale financial assets, net of tax		( 195,760 )	3,985
Balance at end of year		( 4,099,860 )	14,425,419
<b>DEFICIT</b>			
Balance at beginning of year			
As previously reported		( 315,307,469 )	( 403,544,625 )
Effects of transition to PFRS, net of taxes	2	55,191,082	42,381,274
As restated		( 260,116,387 )	( 361,163,351 )
Net income attributable to equity holders of parent company		48,716,330	101,046,964
Balance at end of year		( 211,400,057 )	( 260,116,387 )
Total Equity Attributable to Equity Holders of Parent Company		6,341,562,625	6,311,371,574
<b>MINORITY INTEREST</b>			
Balance at beginning of year	2	263,433,124	264,045,089
Purchase by the Group of minority interest	1	—	( 15,704,493 )
Net income (loss) attributable to minority interest		( 5,666,740 )	15,092,528
Total Equity of Attributable to Minority Interest		257,766,384	263,433,124
<b>TOTAL EQUITY</b>		P 6,599,329,009	6,574,804,698
Net Income (Loss) Recognized Directly in Equity	2	( P 18,525,279 )	P 3,372,919

See Notes to Consolidated Financial Statements.



**Consolidated Statements of Cash Flows**  
**For the Years Ended December 31, 2005 and 2004**  
(Amounts in Philippine Pesos)

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income before tax from continuing operations	P 52,941,022	P 167,680,444
Adjustments for:		
Depreciation and amortization	129,054,878	151,410,835
Unrealized foreign currency losses (gains) - net	50,667,757	( 4,372,750 )
Finance costs	20,257,994	( 8,833,348 )
Gain on sale of property and equipment	( 663,779 )	( 8,647,523 )
Gain on sale of investment property	( 4,953,667 )	—
Fair value gains on financial assets at fair value through profit or loss	( 32,691,738 )	( 20,447,356 )
Gain from insurance proceeds	( 45,448,725 )	—
Interest income	( 103,603,700 )	( 144,876,587 )
Gain on return of investment in an associate	—	( 26,730,000 )
Negative goodwill recognized in income	—	( 19,298,410 )
Reversal of impairment loss on investment property	—	( 16,807,098 )
Operating income before working capital changes	65,560,042	86,744,903
Decrease (increase) in trade and other receivables	( 249,999,079 )	( 76,843,326 )
Decrease (increase) in inventories	24,879,621	( 3,165,016 )
Increase in financial assets at fair value through profit or loss	( 127,297,279 )	( 114,191,524 )
Decrease (increase) in available-for-sale financial assets	( 96,345,328 )	31,475,522
Decrease (increase) in real estate inventories	( 103,013,949 )	170,179,989
Decrease (increase) in other current assets	( 16,707,959 )	30,949,522
Increase in retirement benefit asset	( 5,489,516 )	( 8,140,916 )
Decrease in other non-current asset	3,999,427	34,703,481
Decrease in trade and other payables	( 58,723,555 )	( 39,719,657 )
Increase (decrease) in estimated liability for land and land development costs	117,850	( 8,369,145 )
Increase in refundable deposits	742,083	641,857
Increase (decrease) in retirement benefit obligation	669,306	( 2,451,722 )
Cash generated from (used in) operations	( 561,608,336 )	101,813,968
Interest received	103,603,700	144,876,587
Cash paid for taxes	( 39,230,692 )	( 43,015,258 )
Net Cash From (Used in) Continuing Operating Activities	( 497,235,328 )	203,675,297
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from insurance policies	48,321,580	—
Decrease in advances to related parties	25,660,543	110,809,203
Proceeds from sale of investment property	6,795,455	—
Proceeds from sale of property, plant and equipment	1,465,880	18,813,246
Acquisitions of investment property	( 2,585,175 )	( 55,375,256 )
Acquisitions of property, plant and equipment	( 92,535,636 )	( 76,131,406 )
Proceeds from return of investment in an associate	—	26,730,000
Net cash from acquired division	—	21,342,086
Purchase of equity interest from minority shareholders	—	( 6,525,072 )
Net Cash From (Used in) Investing Activities	( 12,877,353 )	39,662,801

Consolidated Statements of Cash Flows  
For the Years Ended December 31, 2005 and 2004  
(Amounts in Philippine Pesos)

	2005	2004
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Interest paid	( 12,349,525 )	( 7,606,775 )
Net proceeds from (payments of) bank borrowings	334,171,009	( 29,221,885 )
Net increase (decrease) in advances from related parties	1,396,171	( 137,454,437 )
Net Cash From (Used in) Financing Activities	323,217,655	( 174,283,097 )
Effect of Exchange Rate Changes on Cash and Cash Equivalents	( 49,467,744 )	3,829,201
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS	( 236,362,770 )	72,884,202
NET CASH FLOWS FROM DISCONTINUED OPERATIONS	—	( 2,047,173 )
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	( 236,362,770 )	70,837,029
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,619,213,573	1,548,376,544
CASH AND CASH EQUIVALENTS AT END OF YEAR	P 1,382,850,803	P 1,619,213,573

**Supplemental Information on Noncash Investing and Financing Activities:**

In 2005 and 2004, Solid Laguna Corporation wrote-off property and equipment that were destroyed by fire. The related costs and accumulated depreciation of these property and equipment amounted to P1,093,373 and P582,676 in 2005, respectively, and P13,627,503 and P11,265,345 in 2004, respectively. The net amount written-off were recorded as receivables from an insurance company (see Note 12).

In 2004, Destiny, Inc. (DI) (now merged with Solid Broadband Corporation) acquired certain assets and assumed certain liabilities of the Data Division of a related party. Total non-cash assets and liabilities transferred as a result of the acquisition amounted to P171,347,210 and P192,689,296, respectively.

In 2004, the Group, thru Solid Corporation (SC), acquired interest held by minority shareholders in SSEC, Inc. (now SolidGroup Technologies Corporation). The acquisition price of P33.5 million was recorded as part of Trade and Other Payables account in the 2004 consolidated balance sheet and was fully paid in 2005.

In 2003, SGI acquired the entire issued and outstanding shares of DI. As part of the transfer of ownership of DI, the Company recognized the constructive issuance of 224,461,752 shares of stock, and recorded additional paid-in capital of P75,826,336 for the excess of the total paid-in capital acquired over the total par value of the shares issued. In 2004, SGI and DCI agreed that certain receivables from and payables to related parties with a total net amount of P247,662,762 were to be excluded from the valuation of DI's net assets. The revaluation of the net assets of DI were effected in 2004 as a reduction in trade and other receivables and advances to related parties and reversal of the previously recognized capital stock issuance and the related additional paid-in capital.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004  
(Amounts in Philippine Pesos)

## 1. CORPORATE INFORMATION

## 1.1 Company Background

Solid Group Inc. (SGI or the Company) and its subsidiaries (collectively referred to herein as the Group), are incorporated in the Philippines, except for Brilliant Reach Limited (BRL), which was incorporated in the British Virgin Islands (BVI).

The Company holds interests in the following companies:

Investee Company	Percentage of Ownership	
	2005	2004
<b>Subsidiaries:</b>		
Brilliant Reach Limited (BRL)	100%	100%
Kita Corporation (Kita)	100	100
Omni Logistics Corporation (OLC)	100	100
Solid Broadband Corporation (SBC)	100	100
Solid Corporation (SC) and Subsidiaries	100	100
Solid Electronics Corporation (SE Corp.)	100	100
Solid Laguna Corporation (SLC)	100	100
Solid Manila Corporation (SMC) and Subsidiaries	100	100
Solid Manila Finance, Inc. (SMFI)	100	100
Solid Video Corporation (SVC)	100	100
Zen Towers Corporation (Zen)	100	—
Destiny, Inc. (DI) and Subsidiaries	—	100
<b>Associate:</b>		
Sony Philippines, Inc. (SPH)	—	33%

The subsidiaries of SC are as follows:

Investee Company	Percentage of Ownership	
	2005	2004
SolidGroup Technologies Corporation (SGTC) (formerly SSEC, Inc.)	100%	100%
Precos, Inc (Precos)	100	100
Interstar Holdings Company, Inc. (Interstar)	60	60
Laguna International Industrial Park, Inc. (LIIP)	45*	45*

\* LIIP is 22.5% owned by SC and 37.5% owned by Interstar.

The subsidiaries of SMC are as follows:

Investee Company	Percentage of Ownership	
	2005	2004
Skyworld Corporation (Skyworld)	75%	75%
Starworld Corporation (Starworld)	45*	45*

\* Starworld is 20.0% owned by SMC and 40.0% by Skyworld.

The subsidiaries of DI in 2004 are as follows:

Investee Company	Percentage of Ownership	
	2005	2004
Destiny Communication Corporation (DCC)	100%	100
Destiny Multimedia Corporation (DMC)	100	100
Destiny On-line Corporation (DOC)	100	100
Omni Distribution Services, Inc. (ODSI)	100	100

The Group's main business activities are broadband cable and satellite services, manufacturing of injected plastics and assembly of colored television, repair services for audio and video products, real estate, trading of plastic resins and professional audio/video equipment and peripherals, financing, and investing.

SBC's application with the National Telecommunications Commission for a provisional authority to use its legislative franchise under Republic Act No. 9116 entitled "An Act Granting Solid Broadband Corporation a Franchise to Construct, Install, Establish, Operate and Maintain Telecommunications Systems throughout the Philippines" which took effect on April 14, 2001, was approved on April 23, 2002.

SMFI is subject to the rules and regulations provided under Republic Act 8556 (RA 8556), *The Financing Company Act of 1998*.

## 1.2 Changes in Corporate Structure

The Company has initiated a structural reorganization of its various units to sustain operational efficiency through mergers. The results of the said mergers are discussed below:

## a. SBC and DI and its subsidiaries

On November 5, 2003, the stockholders of SBC and DI and its subsidiaries approved the merger of the companies. The merger dissolved DI and its subsidiaries and transferred all their operations,

assets and liabilities to SBC, the surviving company. The SEC approved the merger on August 26, 2005. Prior to the merger, the companies were wholly-owned subsidiaries of SGI. The merger was accounted for at historical cost in a manner similar to that of pooling of interest method. The combined net assets of SBC and DI after the merger amounted to P724,252,155 and P733,234,499 as of December 31, 2005 and 2004, respectively. In 2005 and 2004, combined net loss of SBC and DI amounted to P87,174,539 and P130,627,948, respectively.

## b. SE Corp., Solid Electronic Services, Inc. (SESI) and AA Electronics Corporation (AAEC)

On December 2, 2003, the stockholders of SE Corp., SESI and AAEC approved the merger of the three companies. The merger dissolved SESI and AAEC and transferred all their operations, assets and liabilities to SE Corp., the surviving company. The SEC approved the merger on April 12, 2004. Prior to the merger, SESI and AAEC were wholly owned subsidiaries of SC and SGI, respectively. The merger was accounted for at historical cost in a manner similar to that of a pooling of interest method. The combined net assets of the SE Corp, SESI and AAEC after the merger amounted to P72,083,706 in December 31, 2004. In 2004, combined net income of SE Corp., SESI and AAEC amounted to P10,653,691.

## c. Kita and CPM

On December 2, 2003, the stockholders of Kita and CPM approved the merger of these two companies. The merger dissolved CPM, a company engaged in the business of manufacturing, importing, exporting, buying, selling, or otherwise dealing in, at wholesale, plastic injection molding parts, and transferred all its operations, assets and liabilities to Kita, the surviving company. SEC approved the merger on April 12, 2004. Prior to the merger, CPM was a wholly owned subsidiary of SGI. The merger was accounted for at historical cost in a manner similar to that of a pooling of interest method. The combined net liabilities of Kita and CPM after the merger amounted to P522,816,668 as of December 31, 2004. In 2004, the combined net income of Kita and CPM amounted to P19,947,360.

## 1.3 Acquisition/Incorporation of Subsidiaries and a Subsidiary's Division

## a. In 2005, Zen, a wholly-owned subsidiary, was incorporated. Zen took over the development of a Tri-Tower Condominium Project of SMC.

b. SC increased its interest in the then SSEC, Inc. (now SGTC) to 100% in 2004, from 67.50% in 2003, by acquiring the 32.50% minority interest for a consideration of P33.5 million. As of December 31, 2004, the amount remains unpaid and forms part of the Trade and Other Payables account in the 2004 consolidated balance sheet (see Note 16). The amount was fully paid in 2005.

c. In 2003 and prior years, SC holds 60% interest in Precos, a company in preoperating stage. The investment was previously accounted for using the cost method because SC has no control or significant influence over the operating and financial policies of Precos. In 2004, SC increased its interest in Precos to 100% by acquiring the remaining 40% interest for a consideration of P6.5 million thereby making Precos a wholly-owned subsidiary of SC. The acquisition is accounted for using the purchase method and the excess of the fair value of the net assets acquired over total purchase price amounting to P19,298,410 is recognized as negative goodwill and is directly recognized as income and included as part of Other Income account in the 2004 consolidated statement of income. The investment, which initially formed part of the Other Non-current Assets account, was reclassified to the Investments in and Advances to Subsidiaries account in SC's financial statements. Moreover, Precos is consolidated in the Group's financial statements starting in 2004 when the Group obtained control over the subsidiary.

d. In May 2003, the Company acquired from Destiny Cable, Inc. (DCI) the entire issued and outstanding shares of DI, a company engaged in broadband cable and satellite services, in exchange for the proposed issuance of 224,461,752 shares of the Company's common stock. The acquisition was in accordance with the stockholders' approval in November 2002. The acquisition was approved by the Bureau of Internal Revenue (BIR) on May 15, 2003. A notice of exemption for the issuance of shares under the Revised Securities Act was filed with the Securities and Exchange Commission (SEC) on November 6, 2003. The acquisition of DI was accounted for similar to the pooling of interest method of accounting.

Upon further review of the assets and liabilities of DI, certain receivables from and payables to related parties were removed from the valuation of DI's net assets. The revaluation resulted in a change in its financial position from a net asset to a net liability of P23,201,010. The Company and DCI agreed that the Company would no longer issue shares of stock to DCI as payment for its acquisition of DI but instead assume DI's net liability representing the excess of the estimated fair value of DI's broadband cable infrastructure and its existing cable internet subscriber base over their aggregate book value which, in accordance with the pooling of interest accounting applied to this transaction, was charged to additional paid-in capital in 2004 (see Note 24).

## 1.4 Quasi-Reorganization

a. On August 2, 2004, DI's Board of Directors approved the conversion of a portion of DI's advances to DOC amounting to P3 million to equity in relation to DOC's quasi-reorganization. This transaction was approved by SEC on August 20, 2004.

b. On August 20, 2004, the SEC approved the conversion of P440 million advances from SGI to additional paid-in capital and the application of the resulting balance against DI's deficit as of December 31, 2003. The quasi-reorganization eliminated the entire deficit of DI as of December 31, 2003 amounting to P577 million. The remaining amount of Additional Paid-in Capital in the books of DI after quasi-reorganization is not allowed to be used to wipe out losses that may be incurred in the future without prior approval of SEC.

## 1.5 Return of Investment in an Associate

In August 2004, the common shareholders of SPH, an associate in 2004, including the Company, received a partial return of their investment in SPH. The Company's investment in SPH has zero net book value and the Company has stopped recognizing equity share in net loss after the recognized accumulated share in net losses already equalled the acquisition cost of the investment. The amount received of P26,730,000 was taken up as a gain and included as part of Gain from Return of Investment in an Associate under the Other Ventures account in the 2004 consolidated statement of income (see Note 21). The Joint Venture Agreement (JVA) executed in 1997 with Sony Corporation of Japan (Sony) covering the Company's investment in SPH expired on May 8, 2005. On April 11, 2005, the



Company received a formal notice from Sony Holding (Asia) B.V. of the expiry of the JVA. The Company and Sony have agreed to pursue negotiations for an equitable settlement of all matters relating to the JVA and its expiration.

In 2005, the Company has determined that it no longer has significant influence over SPH and has classified the cost of the remaining investment in SPH and the related accumulated impairment loss to Available-for-Sale Financial Assets (see Notes 2.3 and 11).

#### 1.6 Other Corporate Information

The registered office and principal place of business of the Company and its subsidiaries, except those listed below, is located at Solid House, 2285 Don Chino Roces Avenue Extension, Makati City. The registered offices and principal places of business of the other subsidiaries are as follows:

BRL	-	2nd Floor, Abbott Building, P.O. Box 933, Road Town, Tortola, British Virgin Islands (registered office and principal place of business)
Kita	-	7170 Clark Special Economic Zone, Clark Field, Pampanga (registered office and principal place of business)
Precos	-	26F Tower I, The Enterprise Center, 6766 Ayala Avenue corner Paseo de Roxas, Makati City (registered office)
	-	2285 Don Chino Roces Avenue Extension, Makati City (principal place of business)
SC	-	17 A. Fernando St., Marulas, Valenzuela, Metro Manila (registered office and principal place of business)
SMC	-	1000 J. Bocobo St., Ermita, Manila (registered office and principal place of business)
SGTC	-	1172 E delos Santos Avenue, Balintawak, Quezon City (registered office)
	-	2285 Don Chino Roces Avenue Extension, Makati City (principal place of business)
SE Corp.	-	1172 E. delos Santos Avenue, Balintawak, Quezon City (registered office and principal place of business)
Starworld	-	Bo. Prinza, Calamba City (registered office and principal place of business)

The Group mainly operates within the Philippines, except BRL which operates in BVI.

#### 1.7 Approval for Release of Financial Statements

The consolidated financial statements of the Group for the year ended December 31, 2005 (including the comparatives for the year ended December 31, 2004) were authorized for issue by the Board of Directors on May 8, 2006.

## 2. TRANSITIONING TO PHILIPPINE FINANCIAL REPORTING STANDARDS

The Accounting Standards Council (ASC), the accounting standards-setting body in the Philippines, started a program in 1997 to move fully to the International Accounting Standards (IASs) issued by the then International Accounting Standards Committee (IASC). In April 2001, IASC was succeeded by the International Accounting Standards Board (IASB) which since then has issued revised IASs and new International Financial Reporting Standards (IFRSs).

To correspond better with the issuances of the IASB, the ASC renamed the Standards it issues as Philippine Financial Reporting Standards or PFRSs (previously referred to as Statements of Financial Accounting Standards or SFASs). PFRSs consist of:

- PFRSs (corresponding to IFRSs);
- Philippine Accounting Standards or PASs (corresponding to IASs); and,
- Interpretations (corresponding to IFRICs and SICs).

In compliance with the pronouncements of the ASC and the regulations of SEC, the Group has adopted all the relevant PFRSs for the first time in its financial statements for the year ended December 31, 2005, with January 1, 2004 as its transition date. The transition from previous generally accepted accounting principles (GAAP) in the Philippines to PFRS has been made in accordance with PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*. As a first-time adopter, however, the Company elected not to apply PFRS 3, *Business Combinations*, retrospectively as allowed under PFRS 1.

The Group's financial statements for 2005 and the comparatives presented for 2004 comply with all presentation and disclosure requirements of the relevant PFRSs applicable for accounting periods commencing on or after January 1, 2005.

Due to the transition to PFRS, the 2004 comparatives contained in these financial statements differ from those published in the financial statements for the year ended December 31, 2004.

The reconciliations and explanatory notes thereto presented in the following pages describe the effects of the transition on the Group's opening PFRS balance sheet as of January 1, 2004 and for the year ended December 31, 2004. All explanations should be read in conjunction with the PFRSs accounting policies of the Company as disclosed in Note 3.

No adjustments to capital stock, additional paid-in capital and treasury shares were necessary in the opening PFRS balance sheet as of January 1, 2004 and the comparatives prepared for the year ended December 31, 2004.

#### 2.1 Reconciliations

- a. The reconciliation of the Group's equity reported under previous Philippine GAAP to equity under PFRS are summarized as follows:

	Notes	December 31, 2004	January 1, 2004
<b>Revaluation reserves under previous GAAP</b>		P —	P —
Remeasurement of available-for-sale financial assets	2.3	11,056,485	11,052,500
Accumulated remeasurement adjustments	2.7	3,368,934	—
Total adjustments to revaluation reserves		14,425,419	11,052,500
<b>Revaluation reserves under PFRS</b>		<b>P 14,425,419</b>	<b>P 11,052,500</b>
<b>Deficit under previous GAAP</b>		<b>(P 315,307,469)</b>	<b>(P 403,544,625)</b>
Remeasurement of available-for-sale financial assets	2.3	5,801,637	( 1,780,000)
Remeasurement of refundable deposits	2.6	6,886,663	7,528,520
Recognition of transitional liability and increase in defined benefit expense	2.5	( 2,667,422)	( 2,862,835)
Recognition of transitional asset and reduction in defined benefit expense	2.5	50,047,206	40,639,497
Accumulated remeasurement adjustments	2.7	( 3,368,934)	—
Deferred tax adjustments	2.8	( 1,508,068)	( 1,143,908)
Total adjustments to deficit		55,191,082	42,381,274
<b>Deficit under PFRS</b>		<b>(P 260,116,387)</b>	<b>(P 361,163,351)</b>
<b>Minority interest presented as part of equity under previous GAAP</b>		P —	P —
Reclassification of minority interest to equity	2.2f	263,433,124	264,045,089
<b>Minority interest presented as part of equity under PFRS</b>		<b>P 263,433,124</b>	<b>P 264,045,089</b>
<b>Equity under previous GAAP</b>		<b>P 6,241,755,073</b>	<b>P 6,401,180,679</b>
Total adjustments to equity		333,049,625	317,478,863
<b>Equity under PFRS</b>		<b>P 6,574,804,698</b>	<b>P 6,718,659,542</b>

- b. The remeasurement of balance sheet items at the opening PFRS balance sheet as of January 1, 2004 and comparative financial year as of December 31, 2004 are summarized as follows:

	Notes	Previous GAAP	Effect of Transition	PFRS
<b>January 1, 2004</b>				
<b>Change in assets:</b>				
Short-term investments	2.2a, 2.3	P 618,129,555	(P 618,129,555)	P —
Financial assets at fair value through profit or loss	2.2a, 2.3	—	193,663,686	193,663,686
Trade and other receivables - current	2.3	564,743,383	( 5,122,963)	559,620,420
Other current assets	2.5	91,882,119	( 526,153)	91,355,966
Trade and other receivables - non-current	2.2c, 2.4	—	363,217,321	363,217,321
Available-for-sale financial assets	2.2a	—	—	—
Property, plant and equipment - net	2.2b, 2.3	—	471,882,957	471,882,957
Investment property	2.2d	3,437,215,396	( 2,669,020,384)	768,195,012
Retirement benefit assets	2.2d	—	2,669,020,384	2,669,020,384
Other non-current assets	2.5	—	30,135,645	30,135,645
	2.2b, 2.2c, 2.3, 2.4	474,348,448	( 396,238,946)	78,109,502
		<b>P 5,186,318,901</b>	<b>P 38,881,992</b>	<b>P 5,225,200,893</b>



	Notes		Previous GAAP	Effect of Transition	PFRS
<b>Change in liabilities</b>					
Trade and other payables	2.5, 2.6	P	401,663,438	( 24,926,410)	P 376,737,028
Refundable deposits	2.6		—	4,111,576	4,111,576
Retirement benefit obligation	2.5		—	5,119,144	5,119,144
Deferred tax liabilities - net	2.8		9,922,769	1,143,908	11,066,677
			411,586,207	( 14,551,782)	397,034,425
<b>Minority interest</b>	2.2f		264,045,089	( 264,045,089)	—
		P	<b>4,510,687,605</b>		<b>P 4,828,166,468</b>
<b>Total adjustment to equity</b>				<b>P 317,478,863</b>	

#### December 31, 2004

##### Change in assets:

Short-term investments	2.2a	P	704,264,491	(P 704,264,491)	P —
Financial assets at fair value through profit or loss	2.2a		—	328,302,566	328,302,566
Trade and other receivables - current	2.3		355,840,857	( 25,570,319)	330,270,538
Other current assets	2.5		82,616,060	( 232,873)	82,383,187
Trade and other receivables - non-current	2.2c		—	500,496,966	500,496,966
Available-for-sale financial assets	2.2a		—	443,780,354	443,780,354
Property, plant and equipment - net	2.2d		3,459,426,664	( 2,710,044,059)	749,382,605
Investment property	2.2d		—	2,710,044,059	2,710,044,059
Retirement benefit assets	2.5		—	38,276,561	38,276,561
Other non-current assets	2.2b, 2.2c, 2.3, 2.4		571,073,028	( 525,886,954)	45,186,074
			5,173,221,100	54,901,810	5,228,122,910

##### Change in liabilities

Trade and other payables	2.5, 2.6		407,611,206	( 23,643,614)	383,967,592
Refundable deposits	2.6		—	4,753,433	4,753,433
Retirement benefit obligation	2.5		—	2,667,422	2,667,422
Deferred tax liabilities - net	2.8		15,036,414	1,508,068	16,544,482
			422,647,620	( 14,714,691)	407,932,929
<b>Minority interest</b>	2.2f		263,433,124	( 263,433,124)	—
		P	<b>4,487,140,356</b>		<b>P 4,820,189,981</b>
<b>Total adjustment to equity</b>				<b>P 333,049,625</b>	

c. Profit and loss reported under previous GAAP is reconciled to profit and loss reported under PFRS for the year ended December 31, 2004 as follows:

	Notes		Previous GAAP	Effect of Transition	PFRS
Revenues		P	1,273,935,138	P —	P 1,273,935,138
Cost of sales, services and rentals	2.5		1,145,964,473	( 4,113,750)	1,141,850,723
Gross profit			127,970,665	4,113,750	132,084,415
Other operating income-net	2.3, 2.5		469,856	4,847,515	5,317,371
Operating profit			128,440,521	( 8,961,265)	137,401,786
Other income-net	2.3, 2.7		26,065,955	4,212,703	30,278,658
Income on continuing operations before tax and minority interest			154,506,476	13,173,968	167,680,444
Tax expense	2.8		46,156,718	364,160	46,520,878
Income from continuing operations before minority interest			108,349,758	12,809,808	121,159,566
Loss from discontinued operations			5,020,074	—	5,020,074
Income before minority interest			103,329,684	12,809,808	116,139,492
Share of minority interest in net earnings	2.2g		15,092,528	( 15,092,528)	—
<b>Net income</b>		P	<b>88,237,156</b>	<b>P 27,902,336</b>	<b>P 116,139,492</b>

## 2.2 Revised Structure of Consolidated Balance Sheet and Statement of Income

The Group has modified its previous consolidated balance sheet and consolidated statement of income structure on transition to PFRS. The main changes are summarized as follows:

- Assets classified as Short-term Investments in the current asset section of the consolidated balance sheet under the previous GAAP are now presented under separate consolidated balance sheet line items Financial Assets at Fair Value Through Profit or Loss and Available-for-Sale Financial Assets under the current and non-current asset sections, respectively;
- Investments in club shares and shares of stock presented as part of Other Noncurrent Assets under the previous GAAP are now presented as part of Available-for sale Financial Assets;
- Investment in cash surrender value of life insurance, non-current portion of finance receivables and receivables from sale of land presented as part of Other Non-current Assets under the previous GAAP are now presented as a separate consolidated balance sheet line item Non-current Trade and Other Receivables;
- Land and buildings held for rentals or unspecified purposes by the Group were reclassified from Property, Plant and Equipment as presented under previous GAAP to the separate consolidated balance sheet line item Investment Property;
- Advances to related parties, previously presented as part of Investments and Advances in the non-current asset section of the consolidated balance sheets under previous GAAP are now presented as a separate line item Advances to Related Parties in the current asset section of the consolidated balance sheets. Also, advances from related parties previously presented in the non-current liability section of the consolidated balance sheets are now presented as current liability in the consolidated balance sheets.
- Minority interest presented separately from liabilities and equity under previous GAAP is now presented as a separate component of equity;
- Net income, presented net of share of minority interest under previous GAAP, is now presented in total under PFRS, with additional information on net income attributable to equity holders of parent and minority interest; and,
- Costs and other operating expenses presented by function and nature in the consolidated statements of income under the previous GAAP are now presented by function in the consolidated statements of income and breakdown of expenses by nature is disclosed in the notes to the financial statements.

In addition, some consolidated balance sheet items that were previously classified as noncurrent in accordance with previous GAAP requirements are now presented as current under PFRS.

Individual notes to the consolidated balance sheet items and the accounting policies provide further details on this and other changes.

## 2.3 Reclassification and Fair Value Measurement of Financial Assets

Under previous GAAP, the Group classified its investment in mutual funds and foreign currency bonds as Short-term Investments. On its transition to PFRS, the Group elected to classify its investments in mutual funds and foreign currency bonds as Financial Assets at Fair Value Through Profit or Loss and Available-for-Sale Financial Assets, respectively. Consequently, the investments were presented under separate line items in the Group's consolidated balance sheets. In addition, investment in shares of stock and club shares presented as part of Other Non-current Assets under previous GAAP were reclassified to Available-for-Sale Financial Assets. Also, investment in shares of stock of SPH with zero carrying amount as of December 31, 2004 were reclassified to Available-for-Sale Financial Assets from Investment and Advances account (see Notes 1.5 and 11).

Investments in mutual funds amounting to P188,540,723 and P302,732,247 as of January 1, 2004 and December 31, 2004, respectively, were already measured at fair value under previous GAAP, hence, no adjustment to equity was necessary. However, the accumulated, fair value gains on these investments amounting to P5,122,963 and P25,570,319 as of January 1, 2004 and December 31, 2004, respectively, presented as part of Trade and Other Receivables under previous GAAP, were reclassified and now presented as part of the Financial Assets at Fair Value Through Profit or Loss. This also resulted in the reclassification of the increase in fair value of the assets amounting to P20,447,356 from Interest Income account to Fair Value Gains on Financial Assets account. Both accounts are presented under Other Operating Expenses (Income) in the consolidated statement of income.

Investment in foreign currency bonds under the previous GAAP was measured at lower of cost and net realizable value. Under PFRS, these financial assets, which the Company elected to classify as available-for-sale, are required to be measured at fair value. This resulted in the recognition of net fair value gains amounting to P13,552,500 in the January 1, 2004 opening PFRS balance sheet and P21,088,122 in December 31, 2004. The gains on changes in fair value are recorded under the Revaluation Reserves in the equity section of the consolidated balance sheets.

Investment in shares of stock and club shares were measured at cost less accumulated impairment losses under the previous GAAP. Under PFRS these financial assets are classified as available-for-sale and are required to be measured at fair value. This resulted in the recognition of losses on changes in fair value loss amounting to P4,280,000 in the January 1, 2004 opening PFRS balance sheet and P11,811,637 as of December 31, 2004. Of these amounts, loss on changes in fair value amounting to P1,780,000 as of January 1, 2004 and December 31, 2004 was deemed to be other than temporary, hence, were charged directly to Deficit. Losses from changes in fair values amounting to P2,500,000 and P10,031,637 as of January 1, 2004 and December 31, 2004, respectively, were recorded as adjustments to Revaluation Reserves as of those dates.



The remeasurement of available-for-sale financial assets are summarized below:

	December 31, 2004	January 1, 2004
Revaluation Reserves:		
Fair value gains on investment in foreign-currency bonds	P 21,088,122	P 13,552,500
Fair value losses on investment in shares of stock and club shares	( 10,031,637)	( 2,500,000)
	P 11,056,485	P 11,052,500
Deficit:		
Reversal of impairment loss previously recognized in profit or loss	P 7,831,637	P —
Permanent decline in value of investment in club shares	( 1,780,000)	( 1,780,000)
	P 5,801,637	(P 1,780,000)

## 2.4 Reclassification of Non-current Loans and Receivables

The following items, presented as part of Other Non-current Assets under previous GAAP and are classified as loans and receivables under PFRS, were reclassified and presented as a separate line item Trade and Other Receivables under the non-current assets section of the consolidated balance sheets (see Note 8):

	December 31, 2004	January 1, 2004
Investment in cash surrender value of life insurance	P 230,750,766	P 224,975,892
Finance receivables - net of current portion	194,521,262	138,241,429
Receivables from sale of land -net of current portion	75,224,938	—
	P 500,496,966	P 363,217,321

## 2.5 Full Recognition of Defined Benefit Obligation and Asset

Under PFRS, the Company's obligation under post-employment defined benefit plan should be actuarially determined using the projected unit credit method. The adoption of the new standard resulted in the recognition of transitional asset for the subsidiaries and transitional liability for the Company amounting to P40,639,497 and P2,862,835, respectively, on transition. The transitional liability and asset were fully recognized retrospectively in the Company's opening PFRS balance sheet. The adoption of the new standard also resulted in the recognition of retirement benefit asset for the subsidiaries amounting to P30,135,645 and P38,276,561 as of January 1, 2004 and December 31, 2004, respectively, and retirement benefit liability for the Company and a subsidiary amounting to P5,119,144 and P2,667,422 as of January 1, 2004 and December 31, 2004, respectively. These also resulted in the net reduction in the defined benefit expense in 2004 amounting to P9,603,122, of which P4,113,750 was deducted from Cost of Sales, Services and Rentals while the remaining P5,489,372 was deducted from Other Operating Expenses. The total net adjustments to deficit as of January 1, 2005 and 2004 amounted to P47,379,784 and P37,776,662, respectively.

The adoption of PAS 19 also resulted in the reversal and transfer of previously recorded accrued retirement liability and pension contribution overpayments to the retirement benefit accounts. Previously accrued retirement liabilities amounted to P12,003,518 and P12,431,412 as of January 1, 2004 and December 31, 2004, respectively, and were presented as part Trade and Other Payables account. Pension contribution overpayments amounted to P526,153 and P232,873 as of January 1, 2004 and December 31, 2004, respectively, and were presented as part of Other Current Assets.

## 2.6 Reclassification and Remeasurement of Security Deposit at Amortized Cost

Refundable security deposit arising from the lease of various investment properties to third parties was measured under the previous GAAP at the amount of consideration given to the lessor amounting to P11,640,096. Under PFRS, the refundable deposit is considered as financial liabilities measured at amortized cost using the effective interest rate method. The discount rates used, 15.24% to 15.77%, were determined by reference to the market interest rate of comparable financial instrument at the date of the inception of the lease. This resulted in the recognition of day-one gain amounting to P8,083,691 and interest expense of P555,171 in the Deficit as of January 1, 2004. The related interest expense recognized in 2004 amounted to P641,857 which resulted in the decrease in net income for that year. The net adjustment to the beginning deficit as of December 31, 2004 amounted to P6,866,663.

In the previous consolidated balance sheets, such refundable deposits were presented as part of Trade and Other Payables account. Under the revised consolidated balance sheet, the full amount of P11,640,096 was removed from the Trade and Other Payables account and was transferred to a separate consolidated balance sheet line item Refundable Deposits under the non-current liability section at its amortized cost of P4,111,576 and P4,753,433 as of January 1, 2004 and December 31, 2004, respectively.

## 2.7 Remeasurement of Results and Financial Position of Foreign Subsidiary

The Company's transition to PFRS and adoption of PAS 21, *The Effects of Changes in Foreign Exchange Rates*, require remeasurement of results and financial position of the Company's foreign subsidiary using the Group's functional currency with the resulting difference arising from remeasurement to be taken to equity. Under the previous GAAP, the Group recorded differences arising from remeasurement as part of Foreign Currency Gains account in the consolidated statements of income. The Company's transition to PFRS resulted in the transfer of the remeasurement difference in 2004 amounting to P3,368,934 from Foreign Currency Gains in the 2004 consolidated statement of income to Revaluation Reserve in the 2004 consolidated balance sheet and statement of changes in equity.

## 2.8 Deferred Tax Adjustments

The deferred tax expense recognized by the Company which relates to the temporary differences arising from PFRSs adjustments amounted to P364,160 in 2004. The deferred tax adjusted to the beginning deficit amounted to P1,508,068 and P1,143,908 on January 1, 2005 and 2004, respectively.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

### 3.1 Basis of Preparation

The consolidated financial statements of Solid Group Inc. and its subsidiaries have been prepared in accordance with GAAP in the Philippines as set forth in PFRSs. The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of certain financial assets. The measurement bases are more fully described in the accounting policies in the succeeding paragraphs.

Accounting estimates and assumptions are used in preparing the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

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

### 3.2 Impact of New and Revised Accounting Standards Effective Subsequent to 2005

There are new and revised accounting standards, amendments and interpretations to existing standards that have been published by IASB and adopted by the ASC which are mandatory for accounting periods beginning on or after January 1, 2006. Of the new ASC pronouncements, the following standards are relevant to the Group, which the Group has opted not to adopt early:

2006		
PAS 19 (Amendment)	:	Employee Benefits
PAS 39 (Amendment)	:	The Fair Value Option
PAS 39 and PFRS 4 (Amendment)	:	Financial Guarantee Contracts
IFRIC 4	:	Determination whether an Arrangement Contains a Lease
2007		
PAS 1 (Amendment)	:	Presentation of Financial Statements
PFRS 7	:	Financial Instruments: Disclosures

The Group will apply the relevant new accounting standards in 2006 and 2007 in accordance with their transitional provisions. It is currently evaluating the impact of those standards on its financial statements and has initially determined that the new standards discussed in the following sections may have significant effects on the financial statements for 2006, as well as for prior and future periods.

- **PAS 19 (Amendment), *Employee Benefits*.** This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It imposes additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Group does not intend to change the accounting policy adopted for recognition of actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment will only impact the format and extent of disclosures presented in the accounts. The Group will apply this amendment for annual periods beginning January 1, 2006.
- **PAS 39 (Amendment), *The Fair Value Option*.** This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment will not have a significant impact on the classification of financial instruments, as the Group would be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Group will apply this amendment for annual periods beginning January 1, 2006.
- **PFRS 7, *Financial Instruments: Disclosures*** and complementary amendment to PAS 1. PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group has assessed the impact of PFRS 7 and the amendment to PAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of PAS 1. The Group will apply PFRS 7 and the amendment to PAS 1 for annual periods beginning January 1, 2007.
- **IFRIC 4, *Determining whether an Arrangement contains a Lease*.** IFRIC 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset; and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of IFRIC 4 on the Group's operations.

As for the other new accounting standards, the Group has initially assessed that they will not result in significant changes to the amounts or disclosures in its financial statements.

### 3.3 Principles of Consolidation

The consolidated financial statements comprise the accounts of the Company and its subsidiaries listed in Note 1, after elimination of material intercompany transactions and balances.

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date the Company obtains control until such time that such control ceases.



The Company's and its subsidiaries' financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. The financial statements of the Company and its subsidiaries are prepared for the same reporting period, except for the financial statements of Skyworld, Starworld, and LIIP which are prepared as of and for fiscal years ended October 31. Adjustments were made for the effects of significant transactions or events that occur between those dates and the date of the Company's financial statements.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group, except for companies under common control which are accounted for in a manner similar to pooling of interest method. The cost of the acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired, is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statements of income.

### 3.4 Segment Reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

### 3.5 Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, demand deposits and short-term, highly liquid investments readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value. Cash and cash equivalents are initially and subsequently measured at fair value.

### 3.6 Financial Assets

Financial assets include cash and financial instruments. The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired. The designation of financial assets is re-evaluated at every reporting date at which date a choice of classification or accounting treatment is available, subject to compliance with specific provisions of applicable accounting standards.

All financial assets are recognized on their trade date. All financial assets that are not classified as at fair value through profit or loss are initially recognized at fair value, plus transaction costs.

- **Financial Assets at Fair Value through Profit or Loss.** This category includes financial assets that are either classified as held for trading or are designated by the entity to be carried at fair value through profit or loss upon initial recognition. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorized as 'held for trading' unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the consolidated balance sheet date.

Subsequent to initial recognition, the financial assets included in this category are measured at fair value with changes in fair value recognized in profit or loss. Financial assets originally designated as financial assets at fair value through profit or loss may not subsequently be reclassified.

- **Loans and Receivables.** Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. They are included in current assets, except for maturities greater than 12 months after the consolidated balance sheet date which are classified as non-current assets.

Loans and receivables are subsequently measured at amortized cost using the effective interest method, less any impairment losses. Any change in their value is recognized in profit or loss.

Loans and receivables are presented as Trade and Other Receivables and Advances to Related Parties accounts in the consolidated balance sheets.

Impairment loss is provided when there is objective evidence that the Group will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the impairment loss is determined as the difference between the asset's carrying amount and the present value of estimated cash flows.

- **Available-for-Sale Financial Assets.** This include non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. They are included in the non-current assets section of the consolidated balance sheets unless management intends to dispose of the investment within 12 months of the consolidated balance sheet date.

All financial assets within this category are subsequently measured at fair value, unless otherwise disclosed, with changes in value recognized in equity, net of any effects arising from income taxes. Gains and losses arising from securities classified as available-for-sale are recognized in the consolidated statements of income when they are sold or when the investment is impaired.

In the case of impairment, any loss previously recognized in equity is transferred to the consolidated statements of income. Losses recognized in the consolidated statements of income on equity investments are not reversed through the consolidated statements of income. Losses recognized in prior period consolidated statements of income resulting from the impairment of debt instruments are reversed through the consolidated statements of income.

For investments that are actively traded in organized financial markets, fair value is determined by reference to exchange quoted market bid prices at the close of business on the consolidated balance sheet date. For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment.

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

Derecognition of financial assets occurs when the rights to receive cash flows from the financial instruments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

### 3.7 Inventories

Inventories are valued at the lower of cost and net realizable value.

Cost incurred in bringing each product to its present location and condition is accounted for as follows:

- Raw materials and supplies – purchase cost on a moving average basis; and,
- Finished goods and work-in-process – determined on a moving average method; cost includes direct materials and labor and a proportion of manufacturing overheads based on normal operating capacity.

Net realizable value for finished goods and work-in-process is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. Net realizable value for raw materials and supplies is the current replacement cost.

### 3.8 Real Estate Inventories

Real estate inventories include land and land development costs, and property development costs.

- **Land and Land Development Costs (Starworld and LIIP)**

Acquisition costs of raw land intended for future development and sale, including other costs and expenses incurred to effect the transfer of property title are included in the Land and Development Costs account.

Land and development costs are carried at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs to complete development work and cost to sell.

- **Property Development Costs (Zen)**

Property development costs include the cost of land used as a building site for a condominium project and the accumulated costs incurred in developing and constructing the property for sale.

Property development costs are carried at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs of completion and the estimated costs necessary to make the sale.

### 3.9 Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and amortization and any impairment in value. The cost of an asset comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Expenditures for additions, major improvements and renewals are capitalized; expenditures for repairs and maintenance are charged to expense as incurred. When assets are sold, retired or otherwise disposed of, their cost and related accumulated depreciation and amortization and impairment losses are removed from the accounts and any resulting gain or loss is reflected in income for the period.

Construction in progress is stated at cost. This includes cost of construction of property, plant and equipment and other direct costs. Construction in progress is not depreciated until such time as the relevant assets are completed and put into operational use.

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

Buildings and improvements	10-25 years
Cable system equipment	5-20 years
Machinery and equipment	5-10 years
Furniture, fixtures and office equipment	2-5 years
Transportation equipment	5 years
Test, communication and other equipment	5 years
Computer system	5 years
Tools and equipment	2 years

Leasehold improvements are amortized from 2-15 years or over the term of the lease, whichever is shorter.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 3.16).

The residual values and estimated useful life and depreciation and amortization method are reviewed and adjusted, if appropriate, at each balance sheet date.

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



### 3.10 Investment Property

Investment property consists of land and/or building held for rentals, capital appreciation or for unspecified purposes. Investment property is stated at cost less accumulated depreciation and impairment in value. The cost of investment property comprises its purchase price and directly attributable costs.

Depreciation on building and improvements classified as investment property is computed using the straight-line basis over the estimated useful lives of the asset of 10 to 25 years.

The carrying amount of investment property is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note 3.16).

### 3.11 Financial Liabilities

Financial liabilities include bank loans, trade and other payables and advances from related parties.

Financial liabilities are recognized when the Group becomes a party to the contractual agreements of the instrument. All interest related charges are recognized as an expense in the consolidated statements of income under the caption Finance Costs.

Bank loans are raised for investing activities. They are recognized at proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are charged to profit or loss on an accrual basis using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Trade and other payables and advances from related parties are recognized initially at their nominal values and subsequently measured at amortized cost less settlement payments.

Dividend distributions to shareholders are recognized as financial liabilities when the dividends are approved by the shareholders.

Financial liabilities are derecognized from the consolidated balance sheets only when the obligations are extinguished either through discharge, cancellation or expiration.

### 3.12 Provisions

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

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the consolidated balance sheet date, including the risks and uncertainties associated with the present obligation. Any reimbursement expected to be received in the course of settlement of the present obligation is recognized, if virtually certain as a separate asset, not exceeding the amount of the related provision. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. In addition, long-term provisions are discounted to their present values, where time value of money is material.

A reserve for warranty based on a certain percentage of sales of equipment (net of consumable items) is maintained for expected warranty claims on products sold during the year. Sales of equipment are covered by one year warranty on services. The sufficiency of reserve is assessed annually based on the Group's past experience of the level of repairs and returns. Any excess provision over the actual claims is reversed on the year following the recognition of provision for warranty.

Provisions are reviewed at each consolidated balance sheet date and adjusted to reflect the current best estimate.

In those cases where the possible outflow of economic resource as a result of present obligations is considered improbable or remote, or the amount to be provided for cannot be measured reliably, no liability is recognized in the consolidated financial statements.

Probable inflows of economic benefits that do not yet meet the recognition criteria of an asset are considered contingent assets, hence, are not recognized in the consolidated financial statements.

### 3.13 Revenue and Cost Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

- Rendering of services – Revenue is recognized when services are rendered.
- Sale of goods – Revenue is recognized when the risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably (see also Note 3.7).
- Sale of investments – Revenue is recognized when the risks and rewards of ownership of the investments have passed to the buyer and the amount of revenue can be measured reliably.
- Sale of land – Revenue from sale of land is accounted for using the full accrual method. Under this method, income is recognized when it is probable that the economic benefits from the sale will flow to Starworld and collectibility of the sales price is reasonably assured. Cost of real estate property sold before completion of the development is determined on the basis of the acquisition cost of the land plus its full development costs, which include estimated costs for future development, as determined by Starworld's technical staff. The estimated future expenditures for the development of the real estate property for sale are shown under the Estimated Liability for Land and Development Costs account in the consolidated balance sheets.
- Rental – Revenue is recognized on a straight-line basis over the duration of the lease term (see Note 3.14).
- Interest income on loans receivables – Revenue is recognized when earned using effective interest method. In accordance with RA No. 8556, interest income is not recognized on loans receivable that remain outstanding beyond their maturity dates.
- Other interest – Revenue is recognized as the interest accrues (taking into account the effective yield on the asset).

Cost and expenses are recognized in the consolidated statements of income upon utilization of the service or at the date they are incurred. Expenditure for warranties is recognized and charged against the associated provision when the related revenue is recognized. Finance costs are reported on an accrual basis.

### 3.14 Leases

- Group as lessee – Leases, which do not transfer to the Group substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as expense in the consolidated statements of income on a straight-line basis over the lease term.
- Group as lessor – Leases, whereby the Group does not substantially transfer all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as revenue in the consolidated statements of income on a straight-line basis over the lease term.

### 3.15 Functional Currency and Foreign Currency Transactions

#### • Functional and Presentation Currency

Items included in the consolidated financial statements of the Group are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Philippine pesos, which is the Company's functional currency.

#### • Transaction and Balances

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

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

#### • Remeasurement of Transactions of a Foreign Subsidiary

The operating results and financial position of BRL, which are measured using the U.S. dollar as functional currency, are remeasured to Philippine Pesos, the Group's functional currency as follows:

- Foreign currency monetary items are remeasured using the closing rate;
- Non-monetary items that are measured in terms of historical cost are remeasured using the exchange rate at the date of the transactions;
- Non-monetary items that are measured at fair value in the foreign currency are remeasured using the exchange rates at the date when the monthly fair value was determined; and
- Profit and loss accounts are translated using the average exchange rates.

On consolidation, exchange differences arising from the remeasurement are taken to equity under Revaluation Reserves. When a foreign operation is sold, such exchange differences are recognized in the consolidated statements of income as part of the gain or loss on sale.

The remeasurement of the financial statements into Philippine peso should not be construed as a representation that the U.S. dollar amounts could be converted into Philippine peso amounts at the translation rates or at any other rates of exchange.

### 3.16 Impairment of Non-financial Assets

The Group's property, plant and equipment, investment property and other non-financial assets are subject to impairment testing whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

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

An impairment loss is recognized for the amount by which the asset or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation. Impairment loss is charged pro-rata to the other assets in the cash generating unit.

All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist and the carrying amount of the asset is adjusted to the recoverable amount resulting in the reversal or reduction of the impairment loss.

### 3.17 Employee Benefits

#### • Defined Benefit Plan Obligations

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The legal obligation for any benefits from this kind of pension plan remains with the Group, even if plan assets for funding the defined benefit plan have been acquired. Plan assets may include assets specifically designated to a long-term benefit fund, as well as qualifying insurance policies. The Group's defined benefit pension plan covers all regular full-time employees. The pension plan is tax-qualified, noncontributory and administered by a trustee.

The liability recognized in the consolidated balance sheets for defined benefit pension plans is the present value of the defined benefit obligation (DBO) at the consolidated balance sheet date less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs. The DBO is calculated by independent actuaries using the projected unit credit method. The present value of the DBO is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses are not recognized as an expense unless the total unrecognized gain or loss exceeds 10% of the greater of the obligation and related plan assets. The amount exceeding this 10% corridor is charged or credited to profit or loss over the employees' expected average remaining working lives. Actuarial gains and losses within the 10% corridor are disclosed separately. Past-service costs are recognized immediately in the consolidated statements of income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.



- **Defined Contribution Plan Expense**

The Group also contributes to a retirement benefit plan maintained by the Social Security System, which is considered a defined contribution plan. Under a defined contribution plan, an entity has no legal or constructive obligations to pay further contributions after payment of the fixed contribution. The contributions recognized in respect of defined contribution plans are expensed as they fall due. Liabilities and assets may be recognized if underpayment or prepayment has occurred and are included in current liabilities or current assets as they are normally of a short term nature.

- **Termination Benefits**

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either: (a) terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or (b) providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

- **Compensated Absences**

Compensated absences are recognized for the number of paid leave days (including holiday entitlement) remaining at the consolidated balance sheet date. They are included in Trade and Other Payables account at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

### 3.18 Borrowing Costs

Borrowing costs are recognized as expenses in the period in which they are incurred. Borrowing costs are recognized using the effective interest rate of the financial liabilities.

### 3.19 Income Taxes

Current income tax assets or liabilities comprise those claims from, or obligations to, fiscal authorities relating to the current or prior reporting period, that are uncollected or unpaid at the consolidated balance sheet date. They are calculated according to the tax rates and tax laws applicable to the fiscal periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognized as a component of tax expense in the consolidated statements of income.

Deferred tax is provided, using the balance sheet liability method on temporary differences at the consolidated balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes.

Under the balance sheet liability method, with certain exceptions, deferred tax liabilities are recognized for all taxable temporary differences and deferred tax assets are recognized for all deductible temporary differences and the carryforward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deferred tax asset to be utilized.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the consolidated balance sheet date.

Most changes in deferred tax assets or liabilities are recognized as a component of tax expense in the consolidated statements of income. Only changes in deferred tax assets or liabilities that relate to a change in value of assets or liabilities that is charged directly to equity are charged or credited directly to equity.

### 3.20 Equity

Capital stock is determined using the nominal value of shares that have been issued.

Additional paid-in capital includes any premiums received on the issuance of capital stock, as well as equity adjustments as a result of uniting of interest of companies under common control. Any transaction costs associated with the issuing of shares are deducted from additional paid-in capital, net of any related income tax benefits.

Treasury shares are stated at the cost of re-acquiring such shares.

Revaluation reserves comprise accumulated gains and losses from remeasurement of the foreign subsidiaries balances and transactions into the Group's functional currency, and gains and losses due to revaluation of certain financial assets.

Deficit includes all current and prior period results as disclosed in the consolidated statements of income.

### 3.21 Critical Accounting Judgments

Accounting judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The critical accounting judgments discussed in the subsequent sections may be applicable, among many other possible areas not presented in the Group's financial statements.

#### (a) Estimated allowance for impairment loss on receivables

The Group maintains allowance for impairment loss on receivables at a level considered adequate to provide for potential uncollectible receivables. The level of this allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. These factors include, but are not limited to, the length of the Group's relationship with the customer, the customer's payment behavior and known market factors. The Group identifies and provides for specific accounts that are doubtful of collection and reviews the age and status of the remaining receivables, and establishes a provision considering, among others, historical collection and write-off experience.

Allowance for impairment loss on receivables amounted to P113,519,174 and P116,482,969 as of December 31, 2005 and 2004, respectively (see Note 8).

#### (b) Impairment of available-for sale financial assets

The Group follows the guidance of PAS 39, *Financial Instruments: Recognition and Measurement*, on determining when an investment is other-than-temporarily impaired. This determination requires significant judgment. In making this judgment, the Group evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

If the assumptions made regarding the duration that, and extent to which, the fair value is less than its cost, there would be no loss that the Group would have to recognize representing the transfer of the Revaluation Reserves related to fair value gain (loss) on available-for-sale financial assets to the consolidated statements of income, because the fair value is still more than cost.

#### (c) Distinction between investment property and owner-managed properties

The Group determines whether a property qualifies as investment property. In making its judgment, the Group considers whether the property generated cash flows largely independently of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to property but also to other assets used in the production or supply process.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use in the production and supply of goods and services or for administrative purposes. If these portions can be sold separately (or leased out separately under finance lease), the Group accounts for the portions separately. If the portion cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Group considers each property separately in making its judgment.

## 4. DISCONTINUED OPERATIONS

In prior years, the Company and Sony entered into an agreement granting SLC exclusive rights to manufacture certain Sony products and related parts and components in the Philippines. The agreement, which further binds Sony to purchase certain products exclusively from the SLC, was terminated on September 30, 2002. As a result, SLC's manufacturing operations of Sony products was discontinued in December 2002.

Property relating to the discontinued operations, with a carrying value of P13,042,541 as of December 31, 2004 are presented as part of the Other Non-Current Assets account in the 2004 consolidated balance sheet (see Note 14). Also, presented below are the amounts relating to the discontinued operations that have been segregated from continuing operations and presented under Loss from Discontinued Operations account in the 2004 consolidated statement of income and the Cash Flows from Discontinued Operations which is presented in the 2004 consolidated statement of cash flows.

#### Loss from Discontinued Operations

Revenues:	
Rental	P 2,694,545
Interest	168,696
	<u>2,863,241</u>
Costs and expenses:	
Depreciation	2,972,901
Taxes and licenses	2,727,061
Repairs and maintenance	520,846
Outside services	500,000
Miscellaneous	1,162,507
	<u>7,883,315</u>
	<u>( P 5,020,074 )</u>

#### Cash Flows from Discontinued Operations

Loss from discontinued operations	( P 5,020,074 )
Adjustment for depreciation	2,972,901
	<u>P 2,047,173</u>

In 2005, Omni began negotiations with SLC to lease SLC's manufacturing plant on an annual basis. Consequently, the property and equipment under discontinued operations were reclassified to Property, Plant and Equipment in the 2005 consolidated balance sheet in accordance with GAAP (see Notes 12 and 14). Also, income and expenses relating to the use of the assets for 2005 are now presented as part of income and expenses from continuing operations in the 2005 consolidated statement of income.

## 5. SEGMENT INFORMATION

The Group's operating businesses are organized and managed separately according to the nature of products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets. Broadband Services segment is presently engaged in providing data transport services, including audio and video, and connectivity through its broadband cable infrastructure. The Manufacturing and Manufacturing Support Services segment is engaged in the business of manufacturing plastic injection molding parts and rendering of after sales service operations as the recognized authorized Service Network for Sony products. Real Estate segment activities include leasing and development and sale of industrial and other real estate properties. The Trading segment is involved in the sale of plastic resins and professional audio/video equipment and peripherals. Lastly, Investing, Financing and Others segment is presently engaged in the business of automotive and consumer financing, and credit extension. It is subject to the rules and regulations provided under RA No. 8556. Segment accounting policies are the same as the policies described in Note 3.

The following tables present certain assets and liability information regarding industry segments as of December 31, 2005 and 2004 and revenue and profit information regarding industry segments for the years then ended (in thousands).

	<u>Broadband Services</u>	<u>Manufacturing and Manufacturing Support Services</u>	<u>Real Estate</u>	<u>Trading</u>	<u>Investing, Financing and Others</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>2005</b>							
<b>REVENUES</b>							
Sales to external customers	P 192,575	P 570,715	P 110,594	P 223,525	P 22,417	P —	P 1,119,826
Intersegment sales	9,900	—	6,012	—	8,092	( 24,004)	—
Total revenues	<u>P 202,475</u>	<u>P 570,715</u>	<u>P 116,606</u>	<u>P 223,525</u>	<u>P 30,509</u>	<u>(P 24,004)</u>	<u>P 1,119,826</u>
<b>RESULTS</b>							
Segment results	(P 87,109)	P 6,266	P 120,385	P 24,028	P 81,040	(P 107,763)	P 36,847
Finance cost	—	( 107)	( 106)	—	( 20,045)	—	( 20,258)
Other income (charges) - net	—	45,890	( 5,860)	( 651)	( 37,452)	34,424	36,351
Income before tax	( 87,109)	52,049	114,419	23,377	23,543	16,632	52,941
Tax expense	65	18,018	( 8,914)	1,322	( 600)	—	9,891
Net income	<u>(P 87,174)</u>	<u>P 34,031</u>	<u>P 123,333</u>	<u>P 22,055</u>	<u>P 24,143</u>	<u>P —</u>	<u>P 43,050</u>
<b>ASSETS AND LIABILITIES</b>							
Segment assets	P 819,170	P 568,478	P 3,812,177	P 143,544	P 2,264,541	P —	P 7,607,910
Investments in subsidiaries-at cost	—	—	142,687	—	4,126,078	( 4,268,765)	—
Advances to related parties	117,163	—	557,226	717	480,049	( 1,102,431)	52,724
Total assets	<u>P 936,333</u>	<u>P 568,478</u>	<u>P 4,512,090</u>	<u>P 144,261</u>	<u>P 6,870,668</u>	<u>(P 5,371,196)</u>	<u>P 7,660,634</u>
Segment liabilities	P 105,325	P 123,421	P 187,934	P 18,534	P 527,997	P —	P 963,211
Advances from related parties	106,756	53,156	780,193	26,807	135,603	( 1,004,423)	98,094
Total liabilities	<u>P 212,081</u>	<u>P 176,577</u>	<u>P 968,127</u>	<u>P 45,341</u>	<u>P 663,601</u>	<u>(P 1,004,421)</u>	<u>P 1,061,305</u>
<b>OTHER SEGMENT INFORMATION</b>							
Capital expenditures	P 43,392	P 35,416	P 16,057	P 164	P 92	P —	P 95,121
Depreciation and amortization	60,852	29,147	36,795	1,615	646	—	129,055
Impairment losses	11,701	88	6,339	—	8,338	( 12,106)	14,360
Other non-cash expenses	—	—	742	2,192	2,360	—	5,294



2004

	Broadband Services	Manufacturing and Manufacturing Support Services	Real Estate	Trading	Investing, Financing and Others	Eliminations	Consolidated
<b>REVENUES</b>							
Sales to external customers	P 178,139	P 529,971	P 315,284	P 227,895	P 22,646	P —	P 1,273,935
Intersegment sales	9,900	—	7,217	—	7,590	( 24,707)	—
Total revenues	P 188,039	P 529,971	P 322,501	P 227,895	P 30,234	(P 24,706)	P 1,273,935
<b>RESULTS</b>							
Segment results	(P 130,080)	P 28,279	P 60,421	P 28,066	P 56,931	P 93,783	P 137,402
Finance cost	( 482)	( 206)	( 50)	—	( 8,647)	552	8,833
Other income (charges) - net	—	46,468	12,574	( 1,352)	( 4,778)	( 13,798)	39,112
Income before tax	( 130,562)	74,541	72,945	26,714	43,506	80,537	167,680
Tax expense	66	20,097	12,765	923	12,670	—	46,521
Income from continuing operations	( 130,628)	54,444	60,180	25,791	30,836	80,537	121,159
Loss from discontinued operations	—	( 5,020)	—	—	—	—	( 5,020)
Net income	P 130,628	P 49,424	P 60,180	P 25,791	P 30,836	P 80,537	P 116,139
<b>ASSETS AND LIABILITIES</b>							
Segment assets	P 827,047	P 636,270	P 3,604,931	P 115,001	P 2,107,387	P —	P 7,290,636
Investments in subsidiaries	—	—	133,335	—	4,053,255	( 4,186,590)	—
Advance to related parties	100,864	—	501,261	5,405	291,030	( 820,175)	78,385
Total assets	P 927,911	P 636,270	P 4,239,527	P 120,406	P 6,451,672	(P 5,006,765)	P 7,369,021
Segment liabilities	P 102,436	P 101,268	P 225,182	P 9,900	P 258,644	P —	P 697,520
Advances from related parties	92,242	42,442	635,874	31,807	72,738	( 778,406)	96,697
Total liabilities	P 194,678	P 143,710	P 861,056	P 41,797	P 331,382	(P 778,406)	P 794,217
<b>OTHER SEGMENT INFORMATION</b>							
Capital expenditures	P 60,009	P 14,429	P 55,782	P 957	P 329	P —	P 131,506
Depreciation and amortization	90,870	25,927	32,627	1,124	862	—	151,410
Impairment losses	9,679	—	6,703	—	145,399	( 146,483)	15,298
Other non-cash expenses	—	—	—	1,004	1,430	—	2,434



## 6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are as follows as of December 31:

	2005	2004
Cash on hand and in banks	P 198,777,987	P 174,357,648
Short-term placements	1,184,072,816	1,444,855,925
	<u>P 1,382,850,803</u>	<u>P 1,619,213,573</u>

Cash accounts with the banks generally earn interest at rates based on daily bank deposit rates. Short-term placements are made for varying periods of between 30 to 60 days and earn interest at the respective short-term placement rates ranging from 3.4% to 9% per annum in 2005 and 1.84% to 10% per annum in 2004.

Dollar-denominated cash and cash equivalents amounted to P889,997,307 (US\$16,771,201) and P553,677,407 (US\$9,840,180) as of December 31, 2005 and 2004, respectively.

## 7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This account consists of the following:

	2005	2004
Mutual funds	P 484,712,907	P 328,302,566
Equity securities	3,578,676	—
	<u>P 488,291,583</u>	<u>P 328,302,566</u>

The amounts for mutual funds have been determined directly by reference to net asset value per share quoted in mutual fund statements. The fair values of equity securities have been determined directly by reference to published prices in an active market.

The Group recognized the net increase in value of financial assets at fair value through profit or loss of P32,691,738 in 2005 and P20,447,356 in 2004, which were included in the line item Other Operating Income in the statements of income (see Note 21).

## 8. TRADE AND OTHER RECEIVABLES

This account included the following:

	Note	2005	2004
Current:			
Trade	26	P 407,564,052	P 373,917,620
Advances to contractors		51,499,928	—
Finance receivables – current	26	69,824,510	9,487,976
Others		74,177,335	63,347,911
		<u>603,065,825</u>	<u>446,753,507</u>
Allowance for impairment		( 113,519,174)	( 116,482,969)
		<u>P 489,546,651</u>	<u>P 330,270,538</u>
Non-current:			
Investment in cash surrender value of life insurance		P 461,755,119	P 230,750,766
Finance receivables – net of current portion	26	125,297,498	194,521,262
Receivables from sale of land		605,144	75,224,938
		<u>P 587,657,761</u>	<u>P 500,496,966</u>

A reconciliation of the allowance for impairment at beginning and end of 2005 and 2004 is shown below:

	2005	2004
Balance at beginning of year	P 116,482,969	P 121,487,634
Impairment loss during the year	19,565,838	8,409,330
Reversal of impairment loss on receivables	( 19,856,635)	( 13,413,995)
Write off of receivables	( 2,673,998)	—
	<u>P 113,519,174</u>	<u>P 116,482,969</u>

Trade and other receivables are usually collected within 30 to 90 days and do not bear any effective interest rate. All trade and other receivables are subject to credit risk exposure. However, the Group does not identify specific concentrations of credit risk with regard to trade and other receivables, as the amounts recognized resemble a large number of receivables from various customers and third parties.

Advances to contractors pertain to downpayments made by Zen to various contractors for the construction of the Tri-Towers condominium building, which is expected to be completed in 2006.

As of December 31, 2004, other receivables include P2,362,158 receivables from an insurance company representing SLC's claims for the value of property and equipment that were destroyed during a fire in December 2004 (see Note 12). The amount was fully collected in 2005.

Interest rates on finance receivables range from 9% to 22% per annum in 2005 and 9% to 29% per annum in 2004. Certain business loans of SMFI are secured by land and shares of stock of companies which are owned by some stockholders.

Investment in cash surrender value of life insurance pertains to insurance policies purchased by BRL for its directors. The beneficiary of the insurance policies is SGI and the investment is accounted for under the Cash Surrender Value method. Under the cash surrender value method, initial cash surrender value of the insurance policies is recognized immediately by BRL. The difference between initial cash surrender value and the premiums paid represents insurance service fees which are recorded as prepaid insurance under Other Non-Current Assets and is amortized over 10 years (see Note 14). The balance in 2004 pertains to the cash surrender value of life insurance policies purchased in 2003. The balance in 2005 includes the additional investments in cash surrender values of insurance policies made in June 2005. The investment in cash surrender values of life insurance is used as collateral for short-term bank loans of BRL (see Note 15). Dollar-denominated cash surrender value amounted to US\$8,701,361 and \$4,100,996 for 2005 and 2004, respectively.

## 9. AVAILABLE-FOR-SALE FINANCIAL ASSETS

The amounts in the consolidated balance sheets comprise the following financial assets:

	2005	2004
Current:		
Investment in foreign currency denominated bonds	P 499,411,952	P 422,620,365
Non-current:		
Investment in equity securities	13,680,324	18,542,862
Club shares	26,170,000	20,370,000
Others	277,127	277,127
	<u>40,127,451</u>	<u>39,189,989</u>
Allowance for impairment losses	( 17,890,000)	( 18,030,000)
	<u>22,237,451</u>	<u>21,159,989</u>
	<u>P 521,649,403</u>	<u>P 443,780,354</u>

A reconciliation of the carrying amounts of available-for-sale financial assets are as follows:

	Note	2005	2004
Balance at beginning of year		P 443,780,354	P 187,120,473
Additions		453,135,905	263,875,896
Disposals		( 375,120,097)	—
Impairment losses	24	140,000	( 5,220,000)
Fair value gains (losses)	24	729,645	( 196,094)
Foreign currency gains (losses)	24	( 1,016,404)	200,079
		<u>P 521,649,403</u>	<u>P 443,780,354</u>

Investment in equity securities include P8,580,000 investment in shares of stock of SPH, which was reclassified from Investment and Advances account since management believes that it has no longer significant influence over the investee company (see Note 1.5). The investment in SPH is fully provided with allowance for impairment loss.

The Group's management has determined that there is objective evidence that the decline in the values of certain equity securities and club shares is other than temporary. Accordingly, the Group recognized impairment losses amounting to P5,220,000 in 2004. Impairment losses on permanent decline of value of available-for-sale financial assets are presented as part of Other Charges in the consolidated statements of income (see Note 21).

Certain investments in foreign currency denominated bonds were used as collaterals for interest-bearing loans of BRL (see Note 15).

The fair value of investment in SPH has been determined by discounting expected future cash flows on the investment using a discount rate for similar financial instruments. The fair values of other available-for-sale financial assets have been determined directly by reference to published prices in active market.

## 10. INVENTORIES

The details of inventories are shown below:

	Notes	2005	2004
Merchandise and finished goods	18	P 36,601,637	P 27,383,375
Work in process	18	6,645,348	3,051,116
Raw materials	18	19,623,731	29,342,021
Service parts, supplies and others	18	77,330,051	130,618,621
		<u>140,200,767</u>	<u>190,395,133</u>
Allowance for obsolescence	18	( 44,642,340)	( 69,957,085)
		<u>P 95,558,427</u>	<u>P 120,438,048</u>

The movement in allowance for obsolescence is as follows:

	Notes	2005	2004
Balance at beginning of year		P 69,957,085	P 67,424,276
Additional provisions	18	1,902,649	3,032,010
Reversal of allowance	19	( 27,217,394)	( 499,201)
		<u>P 44,642,340</u>	<u>P 69,957,085</u>

## 11. REAL ESTATE INVENTORIES

This account is composed of:

	Notes	2005	2004
Land and land development costs:			
Land		P 165,613,570	P 167,465,662
Land development costs		150,403,643	150,996,968
		<u>316,017,213</u>	<u>318,462,630</u>
Allowance for impairment	21	( 2,022,800)	—
		<u>313,994,413</u>	<u>318,462,630</u>
Property development costs:			
Land	29	103,589,162	—
Construction in progress and developments costs		107,482,166	—
		<u>211,071,328</u>	<u>—</u>
		<u>P 525,065,741</u>	<u>P 318,462,630</u>

Land and land development costs pertain to cost of land and related improvements held by Starworld and LIIP for sale. Property development costs pertain to cost of land used as a building site and the accumulated construction costs of the condominium building project being developed by Zen for sale.

Impairment loss for 2005 is for the estimated cost of parcels of land deemed unsaleable by management.

Under its registration with the Board of Investments (BOI), Starworld shall develop 118 hectares of land. As of October 31, 2005 and 2004, lot areas totaling 65 hectares were already acquired and developed while 18 hectares of land already acquired are still under development.

The Group, through Zen, has initiated the planning and construction of the Tri-Towers condominium building. Currently, Zen is in the process of securing permits that would allow preselling of the condominium units upon the completion of the building and has entered into several construction contracts with various contractors for the construction of the building (see Note 29).

## 12. PROPERTY, PLANT AND EQUIPMENT

A reconciliation of the carrying amounts at the beginning and end of 2005 and 2004 and the gross carrying amounts and the accumulated depreciation, amortization and impairment losses of property, plant and equipment are shown below:

	Land	Buildings and Improvements	Machinery and Equipment	Furniture, Fixtures and Office Equipment	Transportation Equipment	Cable System Equipment
Balance at January 1, 2005, net of accumulated depreciation, amortization and impairment loss	P 121,200,000	P 78,853,265	P 30,770,746	P 20,988,699	P 19,002,913	P 396,967,127
Additions	—	9,200,338	5,148,844	5,870,044	9,324,907	44,330,563
Reclassifications	—	—	( 852,427)	—	—	—
Disposals	—	( 5,662)	( 127,294)	( 533,976)	( 528,691)	—
Depreciation and amortization charges for the year	—	( 6,239,052)	( 14,269,063)	( 7,023,577)	( 8,199,224)	( 44,631,917)
Balance at December 31, 2005, net of accumulated depreciation, amortization and impairment losses	P 121,200,000	P 81,808,889	P 20,670,806	P 19,301,190	P 19,599,905	P 396,665,773
December 31, 2005						
Cost	P 121,200,000	P 132,852,827	P 131,871,211	P 106,593,820	P 94,965,188	P 1,098,340,889
Accumulated depreciation and amortization	—	( 51,043,938)	( 111,200,405)	( 87,292,630)	( 75,365,283)	( 351,675,116)
Accumulated impairment loss	—	—	—	—	—	( 350,000,000)
Net carrying amount	P 121,200,000	P 81,808,889	P 20,670,806	P 19,301,190	P 19,599,905	P 396,665,773

	Land	Buildings and Improvements	Machinery and Equipment	Furniture, Fixtures and Office Equipment	Transportation Equipment	Cable System Equipment
Balance at January 1, 2004, net of accumulated depreciation, amortization and impairment loss	P 121,200,000	P 27,866,597	P 107,803,560	P 23,099,599	P 15,516,031	P 398,702,396
Property and equipment from Data Division of DCI	—	—	—	402,977	1,360,735	29,898,373
Additions	—	—	3,108,472	5,317,208	6,965,519	40,351,335
Reclassifications	—	58,709,250	( 58,709,250)	( 1,345,960)	2,523,678	( 424,608)
Disposals	—	—	( 11,690,653)	( 395,388)	( 367,388)	—
Depreciation and amortization charges for the year	—	( 7,722,582)	( 9,741,383)	( 6,089,737)	( 6,966,005)	( 74,560,369)
Balance at December 31, 2004, net of accumulated depreciation, amortization and impairment losses	P 121,200,000	P 78,853,265	P 30,770,746	P 20,988,699	P 19,002,913	P 396,967,127
December 31, 2004						
Cost	P 121,200,000	P 354,008,429	P 123,681,952	P 131,643,154	P 88,956,675	P 1,054,010,326
Accumulated depreciation and amortization	—	( 275,155,164)	( 92,911,206)	( 110,654,455)	( 69,953,762)	( 307,043,199)
Accumulated impairment loss	—	—	—	—	—	( 350,000,000)
Net carrying amount	P 121,200,000	P 78,853,265	P 30,770,746	P 20,988,699	P 19,002,913	P 396,967,127



<u>Test, Communication and Other Equipment</u>	<u>Computer System</u>	<u>Leasehold Improvements</u>	<u>Tools and Equipment</u>	<u>Construction in Progress</u>	<u>Total</u>
P 51,491,591	P 6,536,070	P 9,372,415	P 387,392	P 13,812,387	P 749,382,605
2,042,041	3,322,575	887,645	4,371,359	8,037,320	92,535,636
394,959	( 402,665)	—	( 860,133)	—	—
—	—	( 14,000)	( 103,175)	—	( 1,312,798)
( 8,994,883)	( 4,010,682)	( 3,076,545)	( 1,419,636)	—	( 97,864,579)

<u>P 44,933,708</u>	<u>P 5,445,298</u>	<u>P 7,169,515</u>	<u>P 4,096,073</u>	<u>P 21,849,707</u>	<u>P 742,740,864</u>
P 105,844,521	P 56,307,766	P 37,512,249	P 17,528,200	P 21,849,707	P 1,924,866,378
( 60,910,813)	( 50,862,468)	( 30,342,734)	( 13,432,127)	—	( 832,125,514)
—	—	—	—	—	( 350,000,000)
<u>P 44,933,708</u>	<u>P 5,445,298</u>	<u>P 7,169,515</u>	<u>P 4,096,073</u>	<u>P 21,849,707</u>	<u>P 742,740,864</u>

<u>Test, Communication and Other Equipment</u>	<u>Computer System</u>	<u>Leasehold Improvements</u>	<u>Tools and Equipment</u>	<u>Construction in Progress</u>	<u>Total</u>
P 55,491,678	P 9,768,916	P 7,836,842	P 328,095	P 581,298	P 768,195,012
2,693,927	1,085,775	2,394,437	—	—	37,836,224
2,807,337	1,540,432	1,852,986	957,028	13,231,089	76,131,406
( 20,615)	—	( 732,495)	—	—	—
—	—	—	( 74,705)	—	( 12,527,881)
( 9,480,736)	( 5,859,053)	( 1,979,355)	( 822,936)	—	( 120,252,156)

<u>P 51,491,591</u>	<u>P 6,536,070</u>	<u>P 9,372,415</u>	<u>P 387,392</u>	<u>P 13,812,387</u>	<u>P 749,382,605</u>
P 99,079,928	P 64,576,890	P 36,638,604	P 12,561,693	P 13,812,387	P 2,100,170,038
( 47,588,337)	( 58,040,820)	( 27,266,189)	( 12,174,301)	—	( 1,000,787,433)
—	—	—	—	—	( 350,000,000)
<u>P 51,491,591</u>	<u>P 6,536,070</u>	<u>P 9,372,415</u>	<u>P 387,392</u>	<u>P 13,812,387</u>	<u>P 749,382,605</u>



In 2004, a portion of SLC's office and warehouse located in Bicutan, Paranaque was destroyed by fire. The cost and corresponding accumulated depreciation of the assets destroyed that were written off amounted to P13,627,503 and P11,265,345 in 2004. Additionally, in 2005, SLC wrote off the cost amounting to P1,093,373 and the related accumulated depreciation amounting to P582,676 of furniture and fixtures that were determined to have been affected by the fire. The net amount written-off in 2004 was recognized as receivables from an insurance company and is presented as part of Trade and Other Receivables in the 2004 consolidated balance sheet (see Note 8). The insurance proceeds were collected in 2005 resulting in a gain (see Note 21).

As discussed in Note 4, certain building and improvements of SLC previously classified under Other Non-current Assets in 2004 as Property under Discontinued Operations were reclassified in 2005 to property, plant and equipment (see also Note 14).

The amount of depreciation and amortization computed on property, plant and equipment is allocated as follows:

	Note	2005	2004
Cost of sales		P 17,792,573	P 11,297,845
Cost of services	18	64,127,872	93,382,703
General and administrative expenses		12,028,508	11,267,541
Selling and distribution expenses		3,915,626	4,304,067
		<u>P 97,864,579</u>	<u>P 120,252,156</u>

### 13. INVESTMENT PROPERTY

A reconciliation of the carrying amounts at the beginning and end of 2005 and 2004, and the gross carrying amounts and the accumulated depreciation of investment property is shown below:

	Land and Improvements	Buildings and Improvements	Total
Balance at January 1, 2005, net of accumulated depreciation and impairment	P 2,275,727,960	P 434,316,099	P 2,710,044,059
Additions	—	2,585,175	2,585,175
Transfer to property development costs	( 103,589,162)	—	( 103,589,162)
Disposal	( 1,841,788)	—	( 1,841,788)
Depreciation charge for the year	( 502,814)	( 30,687,485)	( 31,190,299)
Balance at December 31, 2005, net of accumulated depreciation and impairment	<u>P 2,169,794,196</u>	<u>P 406,213,789</u>	<u>P 2,576,007,985</u>
December 31, 2005			
Cost	P 2,174,919,934	P 783,522,580	P 2,958,442,514
Accumulated depreciation and amortization	( 5,125,738)	( 372,565,674)	( 377,691,412)
Accumulated impairment Loss	( — )	( 4,743,117)	( 4,743,117)
	<u>P 2,169,408,143</u>	<u>P 406,213,789</u>	<u>P 2,576,007,985</u>
Balance at January 1, 2004, net of accumulated depreciation and impairment	P 2,220,670,545	P 448,357,835	P 2,669,020,384
Additions	55,250,256	125,000	55,375,256
Depreciation charge for the year	( 192,841)	( 30,965,838)	( 31,158,679)
Reversal of impairment loss	—	16,807,098	16,807,098
Balance at December 31, 2004, net of accumulated depreciation and impairment	<u>P 2,275,727,960</u>	<u>P 434,316,099</u>	<u>P 2,710,044,059</u>
December 31, 2004			
Cost	P 2,280,638,868	P 780,937,405	3,061,576,273
Accumulated depreciation	( 4,910,908)	( 341,878,189)	( 346,789,097 )
Accumulated impairment Loss	—	( 4,743,117)	( 4,743,117 )
	<u>P 2,275,727,960</u>	<u>P 434,316,099</u>	<u>P 2,710,044,059</u>

In 2004, Kita partially reversed the impairment loss on buildings amounting to P16,807,098 due to increase in its recoverable amount resulting from the income generated by the asset through various lease agreements entered into with third parties. The recoverable amount in 2004 was based on value in use and was determined by discounting the net cash flows attributable to the lease agreements at a nominal rate of 12% on a pre-tax basis.

Certain land properties of SMC are the subject of litigation brought about by third parties. Certain parcels of land of SC are being subject to expropriation coverage under agrarian reform and claims by third parties. Also, certain land properties of SMC are the subject of litigation and claim by third parties (see Note 29).

Depreciation charge on investment property is shown as part of Cost of Rentals account in the consolidated statements of income.

### 14. OTHER CURRENT AND NON-CURRENT ASSETS

The composition of these accounts as of December 31 is shown below:

	Notes	2005	2004
Current:			
Creditable withholding taxes		P 38,657,059	P 42,141,317
Input value-added tax		35,200,278	22,574,363
Prepaid expenses	8	17,730,097	13,670,667
Others		7,503,711	3,996,840
		<u>P 99,091,146</u>	<u>P 82,383,187</u>
Non-current:			
Property under discontinued operations		P —	P 75,044,351
Accumulated impairment loss		—	( 35,000,000)
Accumulated depreciation		—	( 27,001,810)
	4, 12	—	13,042,541
Prepaid insurance	8	24,682,124	11,813,554
Others - net	19	16,504,523	20,329,979
		<u>P 41,186,647</u>	<u>P 45,186,074</u>

The Group reclassified the cost and related accumulated depreciation and impairment losses of property under discontinued operations to Property, Plant and Equipment in 2005 (see also Notes 4 and 12).

### 15. INTEREST-BEARING LOANS

This account pertains to loans obtained by BRL from ING Private Bank, which are secured by investment in cash surrender value of life insurance and certain available-for-sale securities (see Notes 8 and 11). The loans bear interest at prevailing market rates ranging from 3.9% to 6.0% per annum in 2005 and 2.8% to 3.7% in 2004. Amount of interest bearing loans amounted to P596,583,614 (US\$11,242,083) and P262,412,605 (US\$4,663,704) as of 2005 and 2004.

The fair value of loans obtained is equal to the carrying values since the interest rates used are equal to effective interest rates as of consolidated balance sheet date.

### 16. TRADE AND OTHER PAYABLES

This account consists of:

	Notes	2005	2004
Trade		P 129,985,524	P 152,056,231
Accrued expenses		71,171,274	71,074,145
Refundable deposits	17	10,987,126	8,991,578
Output value-added tax		3,883,663	1,846,517
Provisions for warranty	28	2,191,763	1,004,016
Payable to SPH	13	—	35,000,000
Others	26	114,933,156	113,995,105
		<u>P 333,152,506</u>	<u>P 383,967,592</u>

The fair values of trade and other payables, due to their short duration, have not been disclosed as management considers the carrying amounts recognized in the consolidated balance sheets to be a reasonable approximation of their fair values.

The changes in provisions for warranty are as follows:

	2005	2004
Balance at beginning of year	P 1,004,016	P 793,002
Additional provisions	2,191,763	1,004,016
Reversals and application during the year	( 1,004,016)	( 793,002)
Balance at end of year	<u>P 2,191,763</u>	<u>P 1,004,016</u>

A provision is recognized for expected warranty claims on products sold during the year, based on the Group's past experience of the level of repairs and returns. SVC accrues warranty costs for products sold to customers.

### 17. REFUNDABLE DEPOSITS

Refundable deposits represents long-term deposits from various tenants amounting to P11,640,096 with lease term ranging until 2009 to 2011. The refundable deposits are remeasured at amortized cost using the effective interest rate of 15.24% to 15.77% for nine and ten years, respectively, at the inception of the lease term in 1999 and 2000. Interest expense recognized in 2005 and 2004 is presented under Other Operating Expense account in the consolidated statements of income (see Note 19). The present value of the noncurrent refundable deposits in 2005 and 2004 amounted to P5,495,516 and P4,753,433, respectively. The current portion of refundable deposits is presented as part of Trade and other payables accounts.

### 18. COST OF SALES, SERVICES AND RENTALS

#### 18.1 Cost of Services

The following are the breakdown of direct costs and expenses from rendering of services:

	Notes	2005	2004
Employee benefits	22	P 83,000,184	P 104,537,605
Materials and other consumables		81,057,966	73,376,058
Depreciation and amortization	12	64,127,872	93,382,703
Repairs and maintenance		47,063,406	11,498,097
Manpower services		45,253,042	42,600,020
Transponder rental and leased line		41,717,081	58,382,963
Rent		40,156,870	36,363,537
Communication, light and water		38,869,506	32,022,502
Transportation and travel		15,162,679	9,645,266
Cable services		6,854,000	10,206,055
Others		19,104,581	12,086,056
		<u>P 482,367,187</u>	<u>P 485,100,862</u>

### 18.2 Cost of Sales

The details of this account are shown below:

	Notes	2005	2004
Merchandise and finished goods at beginning of year	10	P 27,383,375	P 14,560,349
Net purchases of merchandise during the year	20	202,964,214	214,209,707
Cost of goods manufactured:			
Raw materials at beginning of year	10	29,342,021	24,214,986
Work-in-process at beginning of year	10	3,051,116	3,433,593
Net purchases of raw materials during the year		132,393,767	111,795,252
Direct labor	22	19,565,284	24,036,399
Manufacturing overhead		81,528,416	90,073,262
Raw materials at end of year	10	( 19,623,731)	( 29,342,021)
Work-in-process at end of year	10	( 6,645,348)	( 3,051,116)
		<u>239,611,525</u>	<u>221,160,355</u>
Merchandise and finished goods at end of year	10	( 36,601,637)	( 27,383,375)
Loss from inventory obsolescence		304,153	2,532,089
		<u>P 433,661,630</u>	<u>P 425,079,125</u>

### 18.3 Cost of Rentals

The details of this account are as follows:

	Notes	2005	2004
Depreciation	13	P 31,190,299	P 31,158,679
Taxes and licenses		11,179,677	5,575,873
Light and water		7,859,549	6,095,313
Rental		3,056,981	8,458,274
Security and janitorial services		3,789,026	2,276,221
Repairs and maintenance		2,903,871	3,473,027
Employee benefits	22	848,356	572,220
Others		4,889,652	3,921,452
		<u>P 65,717,411</u>	<u>P 61,531,059</u>

## 19. OTHER OPERATING INCOME

Presented below are the details of this account:

	Notes	2005	2004
Interest income	26.4	P 103,603,700	P 144,876,587
Reversal of impairment of receivables, inventories and leasehold rights	8, 10, 14	47,074,029	48,943,196
Fair value gains on financial assets at fair value through profit or loss – net	7	32,691,738	20,447,356
Gain on sale of available-for-sale financial assets – net	9	15,465,100	7,008,121
Increase in cash surrender value of investment in life insurance		4,760,029	3,054,936
Foreign currency gains		—	3,930,132
Others		21,619,627	35,011,542
		<u>P 225,214,223</u>	<u>P 263,271,870</u>

## 19. OPERATING EXPENSES BY NATURE

Operating expenses is composed of the following:

	Notes	2005	2004
Materials, supplies and other consumables		P 239,949,730	P 216,625,594
Employee benefits	22	233,695,018	245,474,317
Net purchases of merchandise inventories	18	202,964,214	214,209,707
Depreciation and amortization	12, 13	129,054,878	151,410,835
Manpower and other outside services		85,350,163	74,964,748
Communication, light and water		82,721,426	73,288,725
Repairs and maintenance		67,443,584	29,933,244
Rentals	29	59,205,434	55,509,756
Foreign currency losses - net		50,418,973	( 3,930,132)
Transponder rental and leased line		41,717,081	58,382,963
Transportation and travel		30,473,630	23,652,698
Taxes and licenses		27,851,232	33,237,373
Cost of land sold		5,925,376	170,139,677
Change in merchandise, finished goods and work-in process inventories		( 12,812,494)	( 12,440,549)
Others		64,234,476	65,416,134
		<u>P 1,308,192,721</u>	<u>P 1,399,805,222</u>

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

	Notes	2005	2004
Cost of services	18.1	P 482,367,187	P 485,100,862
Cost of sales	18.2	433,661,630	425,079,125
Cost of rentals	18.3	65,717,411	61,531,059
Cost of land sold		5,925,376	170,139,677
General and administrative expenses		293,451,028	238,305,278
Selling and distribution costs		27,070,89	19,649,221
		<u>P 1,308,192,721</u>	<u>P 1,399,805,222</u>

## 21. OTHER GAINS (LOSSES)

The other Gains (Losses) - net account consists of the following:

	Notes	2005	2004
Gain from insurance proceeds	12	P 45,448,725	P —
Impairment loss	18,10,21	( 5,742,930)	( 136,433)
Gain on sale of property and equipment		633,779	8,647,543
Gain from return of investment in an associate	1.5	—	26,730,000
Recognition of negative goodwill as income	1.3	—	19,298,410
Others - net		( 4,017,882)	( 15,427,514)
		<u>P 36,351,692</u>	<u>P 39,112,006</u>

## 22. EMPLOYEE BENEFITS

Expense recognized for employee benefits is summarized below:

	2005	2004
Salaries, wages and other short-term benefits	P 226,500,126	P 237,949,514
Retirement - defined benefit plan	3,354,766	5,923,474
Termination benefits	3,840,126	1,601,329
	<u>P 233,695,018</u>	<u>P 245,474,317</u>

The Group maintains a tax-qualified, noncontributory retirement plan that is being administered by a trustee covering all regular full-time employees.

The Group obtained an updated actuarial valuation as of January 1, 2004 to ascertain its transitional asset (liability) as of that date in accordance with PAS 19. The Group's transition to PAS 19 is discussed in Note 2. Actuarial valuations are made every two years to update the retirement benefit costs and the amount of contributions.

The amounts of total retirement benefit asset of the subsidiaries that is recognized in the consolidated balance sheets are determined as follows:



	2005	2004
Fair value of plan assets	P 83,663,336	P 69,730,419
Present value of the obligation	( 39,929,141)	( 24,318,969)
Excess of plan assets	43,734,195	45,411,450
Unrecognized actuarial losses (gain)	31,882	( 7,134,889)
Retirement benefit asset	P 43,766,077	P 38,276,561

The amounts of retirement benefit liability of SGI that is recognized in the consolidated balance sheets are determined as follows:

	2005	2004
Fair value of plan assets	P 29,920,673	P 25,407,921
Present value of the obligation	( 26,943,023)	( 24,614,841)
Excess of plan assets	2,977,650	793,080
Unrecognized actuarial gains	( 6,314,378)	( 3,460,502)
Retirement benefit obligation	P 3,336,728	P 2,667,422

The amounts of retirement benefit expense recognized in the consolidated statements of income are as follows:

	2005	2004
Current service costs	P 4,046,206	P 5,772,389
Interest costs - net	6,929,702	6,367,737
Expected return on plan assets	( 7,611,066)	( 6,216,652)
Net actuarial gains recognized during the year	( 10,076)	—
	P 3,354,766	P 5,923,474

Actual returns on plan assets were a gain of P9,803,293 in 2005 and a loss of P750,352 loss in 2004.

The movements of the total retirement benefit asset of the subsidiaries and retirement benefit liability of SGI recognized in the books are as follows:

	2005	2004
Retirement benefit asset:		
Balance at beginning of year	P 38,276,561	P 29,978,507
Expense recognized	( 1,013,912)	( 3,499,412)
Contribution	6,503,428	11,747,466
Balance at end of year	P 43,766,077	P 38,276,561
Retirement benefit obligation:		
Balance at beginning of year	(P 2,667,422)	(P 4,962,005)
Expense recognized	( 2,340,854)	( 2,474,062)
Contributions and direct payment	1,671,548	4,768,645
Balance at end of year	(P 3,336,728)	(P 2,667,422)

For determination of the retirement benefits, the following actuarial assumptions were used:

	2005	2004
Discount rates	11.6% - 14.5%	12.0% - 14.5%
Expected rate of return on plan assets	8.0%	8.0%
Expected rate of salary increases	10.0%	10.0%

### 23. INCOME TAXES

#### 23.1 Current and Deferred Tax Expense

The major components of tax expense for the years ended December 31 are as follows:

	2005	2004
Consolidated statements of income:		
Current tax expense:		
Regular corporate income tax (RCIT) at 35% and 32% in 2005 and 32% in 2004	P 27,472,829	P 16,646,663
Final taxes at 20% and 7.5%	9,119,310	19,881,593
Preferential taxes at 5%	861,760	3,891,616
Minimum corporate income tax (MCIT) at 2%	77,640	834,439
	37,531,539	41,254,311
Deferred tax expense (income):		
Deferred tax relating to origination and reversal of temporary differences	( 24,722,255)	5,343,218
Benefit from previously unrecognized MCIT	( 2,378,627)	( 76,651)
Deferred tax resulting from an increase in RCIT rate	( 539,225)	—
	( 27,640,107)	5,266,567
Tax expense reported in consolidated statements of income	P 9,891,432	P 46,520,878
Consolidated statements of changes in equity:		
Deferred tax on fair value gains of available-for-sale financial assets	P 49,000	P —

Kita is duly registered with Clark Development Corporation (CDC) while SMC and Starworld are registered with Philippine Economic Zone Authority (PEZA) which entitle them to tax and duty-free importation of goods, and exemption from national and local taxes (see Note 27).

The reconciliation of tax on pretax income computed at the applicable statutory rate to tax expense attributable to continuing operations reported in consolidated statements of income is as follows:

	2005	2004
Tax on pre-tax income at 35% in 2005 and 32% in 2004	P 18,529,358	P 53,657,742
Adjustment for income subject to lower tax rates	( 19,573,976)	( 35,219,327)
Tax effects of:		
Nondeductible expenses	38,845,693	24,383,765
Derecognized and unrecognized deductible temporary differences	35,959,535	39,513,205
Amortization of goodwill attributable to property, plant and equipment	7,105,351	6,496,321
Intercompany income and expenses eliminated during consolidation	2,085,580	( 2,395,290)
Increase in temporary differences due to increase in RCIT rate	( 539,225)	—
Fair value gains of financial assets at fair value through profit or loss	( 11,465,831)	( 6,543,154)
Income of foreign subsidiary not subject to taxes	( 11,475,971)	( 10,403,415)
Benefit from previously unrecognized deferred tax assets	( 50,020,040)	( 1,751,547)
Gain from return of investment	—	( 8,553,600)
Negative goodwill recognized in income	—	( 6,175,491)
Non-taxable income	—	( 4,500,016)
Others - net	440,958	( 1,988,315)
Tax expense reported in consolidated statements of income	P 9,891,432	P 46,520,878

The net deferred tax assets of companies having a net deferred tax asset position as of December 31 relates to the following:

	Consolidated Balance Sheets		Consolidated Statements of Income	
	2005	2004	2005	2004
Deferred tax assets:				
Allowance for impairment of receivables	P 16,052,556	P 1,568,726	(P 14,483,830)	P 31,629
Advance rental	2,102,530	420,826	( 1,681,704)	( 420,826)
Unamortized past service costs	1,263,344	377,590	( 885,754)	61,846
Accrued employee benefits	529,773	1,712,296	1,182,523	192,764
Allowance for inventory obsolescence	350,000	320,000	( 30,000)	—
Deferred tax liabilities:				
Rent receivable	( 3,111,571)	—	3,111,571	—
Retirement benefits	( 2,689,480)	—	2,689,480	—
Benefit from previously unrecognized MCIT	—	—	( 2,378,627)	( 76,651)
Deferred Tax Income	—	—	(P 12,476,341)	(P 211,238)
Net Deferred Tax Assets	P 14,497,152	P 4,399,438		

The net deferred tax liabilities of companies which have a net deferred tax liability position as of December 31 relates to the following

	Consolidated Balance Sheets		Consolidated Statements of Income	
	2005	2004	2005	2004
Deferred tax assets:				
Unamortized past service costs	P 2,231,362	P 2,006,589	(P 224,773)	(P 899,493)
Deferred revenue	1,590,909	—	( 1,590,909)	—
Accrued employee benefits	1,167,855	—	( 1,167,855)	693,484
Provision for warranty	767,117	—	( 767,117)	—
Allowance for impairment of receivables	406,108	—	( 406,108)	509,794
Allowance for inventory obsolescence	338,429	—	( 338,429)	—
Allowance for prepayments	231,056	—	( 231,056)	—
Net operating loss carry-over (NOLCO)	—	5,275,176	5,275,176	2,128,242
MCIT	—	145,329	145,329	—
Deferred tax liabilities:				
Unrealized foreign exchange gain	( 5,395,010)	( 21,269,694)	( 15,874,684)	1,224,077
Retirement benefits	( 1,400,875)	( 1,508,068)	( 187,193)	364,160
Deferred costs	( 1,317,567)	—	1,317,667	( 1,244,098)
Rent receivable	—	( 1,193,814)	( 1,193,814)	2,701,639
Deferred tax expense (income) recognized in consolidated statements of income	—	—	(P 15,163,766)	5,477,805
Deferred tax liability on change in fair value of available-for-sale financial assets and tax expense recognized directly in equity	( 49,000)	—	P 49,000	P —
Net Deferred Tax Liabilities	P 1,429,716	P 16,544,482		

The movements in the Group's recognized and unrecognized NOLCO and MCIT are as follows:

Year	Original Amount	Applied in Previous Year	Applied in Current Year	Expired Balance	Remaining Balance	Valid Until
<b>NOLCO:</b>						
2005	P 119,237,175	P —	P —	P —	P 119,237,175	2008
2004	142,411,891	—	—	—	142,411,891	2007
2003	222,810,617	—	11,688,485	—	211,122,132	2006
2002	177,421,013	8,424,566	78,468,235	90,528,212	—	2005
2001	178,940,797	7,883,894	—	171,056,903	—	2004
	<u>P 640,821,493</u>	<u>P 10,481,120</u>	<u>P 90,156,720</u>	<u>P 26,585,115</u>	<u>P 472,771,198</u>	
<b>MCIT:</b>						
2005	P 77,640	P —	P 679,941	P —	P 77,640	2008
2004	728,628	—	1,383,673	—	48,687	2007
2003	1,876,633	338,098	1,849,000	—	154,862	2006
2002	2,739,758	867,140	—	23,618	—	2005
2001	4,350,784	1,042,719	3,912,614	3,308,065	—	2004
	<u>P 9,773,443</u>	<u>P 2,247,957</u>	<u>P 3,331,683</u>	<u>P 281,189</u>		

The NOLCO, MCIT and other deductible temporary differences as of the end of 2005 for which the related deferred tax assets have not been recognized are shown below:

	Amount	Tax Effect
NOLCO	P 472,771,198	P 165,469,920
Allowance for impairment	385,000,000	134,750,000
Allowance for impairment of receivables	60,258,029	21,090,310
Valuation allowance on inventories	35,516,809	12,430,883
Allowance for impairment loss on available-for-sale financial asset	5,220,000	1,827,000
Unamortized past service cost	4,708,183	1,647,864
Unrealized foreign exchange gain	2,475,046	866,266
Allowance for obsolescence	2,287,254	800,539
MCIT	281,189	281,189
	<u>P 968,517,707</u>	<u>P 339,163,971</u>

## 23.2 New Tax Regulation

On May 24, 2005, Republic Act No. 9337 (RA 9337), amending certain sections of the National Internal Revenue Code of 1997, was signed into law and become effective beginning November 1, 2005. The following are the major changes brought about by RA 9337 that are relevant to the Group:

- RCIT rate was increased from 32% to 35% starting November 1, 2005 until December 31, 2008 and will be reduced to 30% beginning January 1, 2009;
- 10% VAT rate remains unchanged, with the President of the Philippines having a stand-by authority effective January 1, 2006 to increase the VAT rate to 12% under certain conditions (the rate was increased to 12% effective February 1, 2006);
- 10% VAT is now imposed on certain goods and services that were previously zero rated or subject to percentage tax;
- Input tax on capital goods shall be claimed on a staggered basis over 60 months or the useful life of the related assets, whichever is shorter; and,
- Creditable input VAT is capped by a maximum of 70% of output VAT per quarter.

## 24. EQUITY

### 24.1 Capital Stock and Additional Paid-in Capital Stock

In 2003, the Company recognized the constructive issuance of 224,461,752 of the Company's shares of stock to DCI for the acquisition of DI pending the approval of the Philippine Stock Exchange (PSE) and SEC. In 2004, the Company and DCI agreed to exclude the receivable and payable accounts of certain related parties from the net asset valuation for the acquisition of DI. The re-valuation changed DI's financial position from net assets to net liability. Consequently, the Company and DCI agreed that the 224,461,752 shares of stock would no longer be issued to DCI. Instead, the Company would assume the net liability of DI representing the deficiency of the estimated fair value of DI's broadband cable infrastructure and its existing cable internet subscriber base over their aggregate book value. The change on the acquisition value for DI resulted in the reversal of the capital stock issuance recognized in the previous year and the decrease in additional paid-in capital recorded for the acquisition of DI amounting to P23,201,010, representing the net liability position assumed by the Company (see Note 1.3).

## 24.2 Revaluation Reserves

The components of this account and their movement are as follows:

	Notes	2005	2004
Fair value gains on available-for-sale financial assets:			
Balance at beginning of year		P 11,056,485	P 11,052,500
Foreign currency gains (losses)		( 1,016,404 )	200,079
Fair value gains (loss) for the year	9	869,644	( 196,094 )
Tax expense on fair value gains for the year	23	( 49,000 )	—
Balance at end of year		<u>10,860,725</u>	<u>11,056,485</u>
Foreign exchange difference:			
Balance at beginning of year		3,368,934	—
Exchange differences on remeasuring balances of foreign operations		( 18,329,519 )	3,368,934
Balance at end of year		<u>( 14,960,585 )</u>	<u>3,368,934</u>
		<u>(P 4,099,860)</u>	<u>P 14,425,419</u>

## 25. EARNINGS PER SHARE

Basic earnings per share were computed as follows:

	2005	2004
Net income (a):		
Continuing operations	P 48,716,330	P 106,067,038
Discontinued operations	—	( 5,020,074 )
	<u>P 48,716,330</u>	<u>P 101,046,964</u>
Weighted average shares outstanding (b):		
Number of shares issued	2,030,975,000	2,030,975,000
Treasury shares	( 209,433,000 )	( 209,433,000 )
	<u>1,821,542,000</u>	<u>1,821,542,000</u>
Earnings per share (a/b)	<u>P 0.03</u>	<u>P 0.03</u>

Earnings per share from discontinued operations in 2004 is less than P0.01.

There were no outstanding potentially dilutive instruments as of December 31, 2005 and 2004, hence, no information on diluted earnings per share is presented.

## 26. RELATED PARTY TRANSACTIONS

The Group's related parties include companies owned by the ultimate majority stockholders and the Company's key management personnel.

The following are the transactions with related parties:

### 26.1 Sale of Goods and Services

	Amount of Transactions		Outstanding Balance	
	2005	2004	2005	2004
Sale of goods:				
Professional equipment, accessories and tapes	P 345,041	P 18,258,886	P 82,871	P 953,623
Sale of services:				
Use of cable infrastructure	43,008,182	29,850,000	237,274,339	208,115,196
Commissions	4,157,050	1,354,366	46,241,770	55,244,687
Management services	1,200,000	1,700,000	—	—
	<u>48,365,232</u>	<u>32,904,366</u>	<u>283,516,109</u>	<u>263,359,883</u>
	<u>P 48,719,273</u>	<u>P 51,163,252</u>	<u>P 283,598,980</u>	<u>P 264,313,506</u>



SVC sells professional equipment, accessories and tapes to Avid Sales Corporation (Avid), a company owned by the ultimate majority stockholders. SVC also earns commissions from the sales of a company owned by the ultimate majority stockholders, to customers in the Philippines.

SBC's broadband cable infrastructure is used by DCI, a company owned by the ultimate majority stockholders. Billings were based on a fixed fee per subscriber and per type of service.

SGI provides management services to CPD Access Corporation (CPD), a company owned by the ultimate majority stockholders in accordance with a management contract.

Revenue from sale of goods and services are recorded as part of revenues. Outstanding receivables from sale of goods and services to companies owned by ultimate majority stockholders are recorded as part of Trade and Other Receivables (see Note 6).

## 26.2 Purchase of Goods and Services

	Amount of Transactions		Outstanding Balance	
	2005	2004	2005	2004
Purchase of goods	P 76,070,918	P 69,701,748	P 2,268,262	P 6,282,045
Availment of management services	3,344,498	4,052,259	—	—
	<u>P 79,415,416</u>	<u>P 73,754,007</u>	<u>P 2,268,262</u>	<u>P 6,282,045</u>

SE Corp. purchases parts and supplies from CPD while SMC avails of management services from AA Commercial, a company owned by the ultimate majority stockholders.

Purchases of goods and availment of management services are recorded as part of Cost of services and General and Administrative Expenses, respectively (see Note 26.3). Outstanding payables from purchases of sale of goods are recorded as part of Trade and Other Payables. (see Note 16.)

## 26.3 Lease of Real Property

	Amount of Transactions		Outstanding Balance	
	2005	2004	2005	2004
Group as lessor	P 626,213	P 1,321,845	P —	P 492,089
Group as lessee	190,269	185,734	—	—

SMC leases out certain land and buildings to Avid. Income from these leases is shown as part of Rental in the consolidated statements of income. Uncollected billings, on the other hand, forms part of Trade and Other Receivables account in the balance sheets (see Note 8).

SLC rents portion of a building of a company owned by the ultimate majority stockholders. Rental expense relating to this lease is shown as part of Rentals under Operating Expenses in the consolidated statements of income (see Note 20).

## 26.4 Granting of Loans

	Amount of Transactions		Interest Income Earned		Outstanding Balance	
	2005	2004	2005	2004	2005	2004
Business loans	P 35,000,000	P 60,000,000	P 4,179,533	P 2,502,250	P 51,201,200	P 20,254,000
Car loans	3,394,000	4,294,650	837,720	320,773	3,747,785	3,637,526
	<u>P 38,894,000</u>	<u>P 64,294,650</u>	<u>P 5,017,253</u>	<u>P 2,823,023</u>	<u>P 54,948,985</u>	<u>P 23,891,526</u>

SMFI grants interest-bearing business and other loans to companies owned by the ultimate majority stockholders. Interest rates range from 9% to 12% for both 2005 and 2004. Interest earned on these loans are presented as part of Interest Income under Other Operating Income in the consolidated statements of income (see Note 19) while outstanding balances are shown as Finance Receivables under the Trade and Other Receivables account in the consolidated balance sheets (see Note 8).

## 26.5 Advances to and from Related Parties

Certain subsidiaries of the Company grants advances to companies owned by the ultimate majority stockholders for working capital, acquisition of property and equipment and other purposes. Outstanding balances arising from these transactions are presented as Advances to Related Parties account in the consolidated balance sheets.

Certain subsidiaries also obtain advances for working capital requirements from the ultimate majority stockholders and companies owned by the ultimate majority stockholders. Outstanding liabilities arising from these transactions are presented as Advances from Related Parties in the consolidated balance sheets.

## 26.6 Key Management Personnel Compensations

Salaries and other benefits given to key management personnel for 2005 and 2004 are as follows:

	2005	2004
Salaries, professional fees and other short-term benefits	P 23,635,258	P 24,659,000
Retirement benefit expense	1,243,537	598,731
Termination benefits	1,500,000	—
	<u>P 26,378,795</u>	<u>P 25,557,731</u>

## 27. REGISTRATION WITH ECONOMIC ZONE AUTHORITIES

### 27.1 Registration with the CDC

Kita is registered with the CDC under the Bases Conversion and Development Act of 1992 as a Clark Special Economic Zone (CSEZ) enterprise primarily engaged in the business of manufacturing consumer electronic products. As a registered CSEZ enterprise, Kita is entitled to tax and duty free importation of raw materials, equipment, household and personal items, and is exempted from national and local taxes. In lieu of all these taxes, Kita is subject to 5% preferential tax rate. In addition, the 32% regular corporate income tax rate is applied to those income which come from sources other than Kita's registered activities (see Note 29.6)

### 27.2 Registration with the PEZA

SMC is registered with the PEZA as an Ecozone Facilities Enterprise at the Laguna International Industrial Park – Special Economic Zone ("LIIP – SEZ"). As an Ecozone Facilities Enterprise, SMC shall lease its building in LIIP – SEZ to PEZA-registered export enterprises located therein. SMC is subject to 5% tax on gross income earned on such facilities in lieu of all national and local taxes.

On July 1, 1998, the PEZA approved Starworld's registration as an Ecozone developer/operator of the CPIP – Special Economic Zone located at Bo. Parian, Calamba City. Under the terms of the registration and subject to certain requirements, Starworld shall be exempt from all national and local taxes and instead will be subject to the 5% preferential tax rate on gross income after allowable deductions.

## 28. SIGNIFICANT CONTRACTS AND AGREEMENTS

### 28.1 Memorandum of Understanding with SPH

In July 1, 2003, SEC entered into a Memorandum of Understanding ("MOU") with SPH for Network Support for AIWA products. Under the MOU, SPH authorized the Company to perform in-warranty and out-of-warranty services to customers in the Philippines for a fee calculated as a percentage of SPH's annual sales.

In-warranty services shall be rendered free of charge to customers. The actual cost of replacement parts related to in-warranty services shall be shouldered by SPH. Also, SPH agrees to pay the Company network support fee equal to 1% of net sales for SONY products and 1% or P50,000 per month whichever is higher for AIWA products. This MOU covers the period from July 1, 2003 to September 30, 2004. In October 1, 2004, the Company and SPH renewed the MOU with a new term from October 1, 2004 to May 1, 2005. In May 2005, the Company entered into an informal agreement with SPH wherein agreement was renewed up to September 2006. There had been no changes in the terms of agreement with SPH.

The breakdown of network support fees is shown below

	Amount of Transactions		Outstanding Balances	
	2005	2004	2005	2004
SONY products	P 27,074,743	P 25,057,688	P 10,328,121	P 11,993,754
AIWA products	600,000	1,550,000	275,000	193,402
	<u>P 27,674,743</u>	<u>P 26,607,688</u>	<u>P 10,603,121</u>	<u>P 12,187,156</u>

Network support fees earned are presented as part of revenue from Rendering of Services in the consolidated statements of income. Outstanding receivables arising from this transaction are included in Trade and Other Receivables account in the consolidated balance sheets (see Note 8).

### 28.2 Distributorship Agreement with Sony Corporation

SVC has a non-exclusive Distributorship Agreement (the Agreement) with Sony Corporation of Hong Kong Limited (Sony HK), a corporation organized and existing under and by virtue of the laws of Hong Kong. Under the Agreement, SVC was designated by Sony HK as its non-exclusive distributor of Sony products in the Philippines. In addition, SVC shall provide the customers in the Philippines with repair and parts replacement services, including but not limited to repair and parts replacement services rendered by SVC which are under the 12 month-warranty period at its own costs and expenses. The Agreement is good for one year and renewable for another year upon mutual agreement between SVC and Sony HK.

## 29. COMMITMENTS AND CONTINGENCIES

The following are the significant commitments and contingencies involving the Group:

### 29.1 Planned Acquisition of Land Registration Systems, Inc. (LARES)

In 2005, the Company, together with other investors, entered into a negotiation with LARES, a company engaged in computerizing and modernizing the land registration system of Land Registration Authority (LRA). Under the negotiation plan, the Group, thru SGTC, will acquire 51% interest in LARES. Realization of the planned acquisition depends on several conditions, including government's approval for LARES to continue the project.



Relative to the planned acquisition, SMFI granted loans to LARES amounting to P900,000 in 2005. The amount is unpaid as of December 31, 2005. Also, Starworld entered into a loan agreement with LARES wherein LARES has requested Starworld for a loan of P6 million to finance its operations and expenses pertaining to the arbitration proceedings with the LRA. The use of the proceeds shall be subject to the following limits:

- P3 million shall be used for expenses pertaining to LARES arbitration proceedings with the LRA; and,
- The balance of P3 million shall be used for working capital and operating expenses of LARES.

As of December 31, 2005, LARES has already obtained a portion of the loan amounting to P3,308,929.

As of the consolidated balance sheet date, there is no clear indication whether the planned acquisition will be realized.

## 29.2 Operating Lease Commitments – Company as Lessor

Certain subsidiaries lease various properties for a period of 1 to 10 years. Some of these lease transactions are subject to 5% to 10% escalation rate. The future minimum rentals receivable under these non-cancellable operating leases as of December 31 are as follows

	2005	2004
Within one year	P 75,138,776	P 65,823,711
After one year but not more than five years	173,991,314	185,689,511
More than five years	17,879,714	36,113,907
	<b>P 267,009,804</b>	<b>P 287,627,129</b>

## 29.3 Operating Lease Commitments – Company as Lessee

Kita is a lessee to non-cancellable operating leases covering land and certain leasehold improvements. As of December 31, 2004, these leases have a remaining term of 14 years, expiring in 2019. Lease payments are fixed for the first five years. Thereafter, the lease on land is subject to 100% escalation rate every five years while the lease on land improvements is subject to an annual escalation rate of 10%. The future minimum rentals payable under these non-cancellable operating leases as of December 31 are as follow

	2005	2004
Within one year	P 4,544,560	P 3,880,509
After one year but not more than five years	22,345,582	18,025,984
More than five years	77,794,530	76,738,689
	<b>P 104,684,672</b>	<b>P 98,645,182</b>

Total rent expense from these operating leases amounted to P7,415,493 and P4,747,033 in 2005 and 2004, respectively, and are shown as part of Rental under Cost of Service in the consolidated statements of income (See Note 20).

## 29.4 Legal Claims

Certain subsidiaries are involved in litigation, which arose in the normal course of business. These include, among others, the following:

- SC is involved in a litigation with a local bank concerning letters of credit issued in connection with shipments of electronic parts to SC and parcels of land that are being subject to expropriation coverage under agrarian reform and claims by third parties. Management believes that the ultimate liability or loss, if any, with respect to such litigation will not materially affect the financial position and results of operations of SC.
- As of December 31, 2004, there are claims by a third party against SLC for alleged infringement of copyrights and sound recording. On March 14, 2005, the Supreme Court ruled that the issuance of warrants did not meet the requirements of probable cause and dismissed the petition. The complainants sought the reconsideration of the Supreme Court decision but was denied on June 27, 2005. Management believes that the outcome of such lawsuit will not materially affect SLC's financial position and results of operations.
- SMC is involved in a number of litigation and is subject to certain claims such as:
  - Portion of land in Pililla, Rizal, with a carrying value of P3.5 million, subject to expropriation coverage under agrarian reform.
  - Land, with a carrying value of P59 million, subject to claims by third parties who filed court cases against the Company.

Management believes that the ultimate liability or loss from the above contingencies, if any, with respect to such litigations will not materially affect the financial position and results of operation of the Group.

## 29.5 Possible Impact of Government Project

In 2005, Zen received a notification from the Urban Roads Projects Office (URPO) of the Department of Public Works and Highways that the location of the Tri-Towers condominium building project might be affected by the plans of the National Government for the construction of the proposed 2nd Ayala Bridge. However, the URPO stated that it has not yet undertaken the detailed engineering design that will ascertain if the location of the Zen's property will be affected by the road right-of-way of the government project.

The Group decided to continue the Tri-towers condominium building project despite the notification received from the DPWH because management believes that the likelihood of a possible expropriation of the land is remote given the current status of the government project (see Note 11).

## 29.6 Presidential Proclamation Converting Clark Special Economic Zone under PEZA Law

In a decision promulgated last October 24, 2003, the Supreme Court declared null and void the tax incentives for the John Hay Special Economic Zone (SEZ) provided under Section 3 of Presidential Proclamation No. 420 (PP No. 420), which created the John Hay SEZ. The Supreme Court concluded that under Republic Act (RA) No. 7227, Congress granted tax exemption and other investment incentives only to the Subic SEZ. Thus, while the PP No. 420 authorized the President to create other SEZs by executive proclamation, there is nothing in the law which allows the President to extend the incentives granted to Subic SEZ to the other SEZs which may be subsequently created. The impact of this decision may extend to other ecozones created by the Government, including Clark Special Economic Zone (CSEZ).

On March 10, 2006, the President issued Proclamation No. 1035, converting CSEZ into a zone under the PEZA law. The proclamation entitled "Creating and Designating Certain Parcels of Land of the Public Domain Situated at Angeles City, Municipalities of Mabalacat and Porac, Pampanga and the Municipalities of Capas and Bamban, Tarlac as a Special Economic Zone Pursuant to RA 7916 as Amended by RA 8784 which allows locators in the former military base to enjoy the same tax and duty privileges granted to other special economic zones. However, the tax incentives will only apply from the date of the signing of Proclamation No. 1035 which does not allow retroactive application of the tax incentives. Accordingly, Kita maybe assessed for taxes prior to Proclamation No. 1035 using the regular corporate income tax and not the 5% preferential tax rates. However, management believes that, liabilities or losses, if any, that may arise relating to this contingency will be remote because of continuing efforts of the government to resolve the issue. Accordingly, no adjustments were made by Kita as of December 31, 2005 and 2004.

## 30. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed to a variety of financial risks which result from both its operating and investing activities. The Group's risk management is coordinated by its Board of Directors, and focuses on actively securing the Group's short-to medium-term cash flows by minimizing the exposure to financial markets.

The Group does not actively engage in the trading of financial assets for speculative purposes. The more significant financial risks to which the Group is exposed to are described in the succeeding sections.

### 30.1 Foreign Currency Risk

The Group's exposure to foreign exchange risks arise from its foreign currency denominated investments in BRL, as well as from dollar-denominated sales to customers of the Company's subsidiaries.

Dollar-denominated receivables are generally settled as soon as possible in order to avoid exposure to fluctuations in foreign exchange rates. In addition, the Group actively monitors the volatility of foreign currency notes to minimize foreign currency losses.

### 30.2 Credit Risk

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the consolidated balance sheets (or in the detailed analysis provided in the notes to the financial statements). Credit risk, therefore, is only disclosed in circumstances where the maximum potential loss differs significantly from the financial asset's carrying amount.

The Group has no significant concentrations of credit risk. The Group's trade and other receivables are actively monitored to avoid significant concentrations of credit risk. Majority of SMFI's finance receivables are made to related parties and for a significant proportion of the receivables, collaterals are received to mitigate the credit risk. The Group has adopted a no-business policy with customers lacking an appropriate credit history where credit records are available. Also, it has policies in place to ensure that rental contracts are made with customers with an appropriate credit history.

### 30.3 Cash Flow and Fair Value Interest Rate Risks

The Group's interest rate risk arises from short-term borrowings of BRL. Borrowings of the foreign subsidiary are repriced every 30 days and expose the Group to cash flow interest rate risk.

The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest costs may increase as a result of such changes. They may reduce or create losses in the event that unexpected movements arise.



# Investor Relations

## INVESTOR INQUIRIES

### SOLID GROUP INC.

Corporate Information Office  
Solid House Building  
2285 Don Chino Roces Avenue  
Makati City, Philippines  
Tel. (632) 843-1511  
Email: [info@solidgroup.com.ph](mailto:info@solidgroup.com.ph)  
Website: [www.solidgroup.com.ph](http://www.solidgroup.com.ph)

## STOCK AND TRANSFER AGENT

Rizal Commercial Banking Corporation  
RCBC Building  
333 Sen. Gil J. Puyat Avenue  
Makati City, Philippines  
Tel. (632) 894-9000

## AUDITOR

Punongbayan & Araullo  
20th Floor, Tower 1  
The enterprise center  
6766 Ayala Avenue  
1200 Makati City, Philippines  
Tel. (632) 886-5511  
Website: [www.punongbayan-araullo.com](http://www.punongbayan-araullo.com)  
Member of Grant Thornton International

## LEGAL COUNSEL

Castillo Laman Tan Panteleon & San Jose  
The Valero Tower  
122 Valero Street, Salcedo Village  
Makati City, Philippines  
Tel. (632) 817-6791 to 95



2285 Don Chino Roces Avenue, Makati City, Philippines  
Tel, (632) 843-1511; Email: [info@solidgroup.com.ph](mailto:info@solidgroup.com.ph); Website: [www.solidgroup.com.ph](http://www.solidgroup.com.ph)