MERALCO

2012 Annual Report

execute

Equipped with game-changing strategies that were executed company-wide, Meralco's employee corps led by its dedicated leaders went on to prove that a team that is unified in its vision and focused on its special mission will prevail – no matter the circumstances.

aim

Meralco faced 2012 with excitement, ready to meet a new round of challenges in the competitive arena of Philippine business. It aimed to register a record-high, to surpass prior year's performance with passion and determination.

excel

Year-end 2012 stellar results prove that excellence is an integral part of Meralco corporate culture, and that its strongest core competency is the ability to use the achievements of the past to benefit and strengthen the present - so that it can plan and move to a brighter future with foresight and conviction.

The children of Isla Verde, an islet off the coast of Batangas, happily engage in a new pastime - soccer. This is the visual expression of their new lives, changed with the advent of electricity.

Who We Are

Our Company is the largest electric distribution utility in the Philippines.

We celebrate our 110th year in service in 2013.

We power 5,189,247 customers.

Our footprint covers 9,337 km^2

- Home to approximately 25% of Philippine population
- About 50% of Philippine Gross Domestic Product (GDP) generated within the Meralco franchise
- 60% of Philippine manufacturing output produced within the franchise
- Accounts for nearly 75% of Luzon's and 55% of Philippine energy sales
- Social, political and economic center of the Philippines
- Strong organic growth

Our sales revenues was PhP285.3 billion in 2012, equivalent to US$6.8 billion.

Our market capitalization at year-end 2012 was PhP293.7 billion, equivalent to US$7.2 billion.

Our Company recorded all-time best levels in sales, operational and financial performance in 2012.

We aim to be the total energy solutions provider of choice.

Our Growth Pillars

- Core Electricity Distribution Service
- Power Generation
- Retail Electricity Supplier
- Franchise Expansion
- Subsidiaries
- Overseas
- Innovative Solutions

Contents

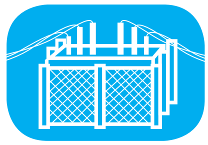
Isla Verde Island, looking forward to a glorious day.

Financial and Operating Highlights

COMPARATIVE HIGHLIGHTS

	2008	2009	2010	2011	2012
FINANCIAL INFORMATION					
(in Million Pesos, Except Per Share Data and Percentage)					
Revenues					
Electric	186,999	178,686	239,077	253,989	282,991
Non-electric	4,776	2,072	1,856	2,819	2,279
Total	191,775	180,758	240,933	256,808	285,270
Costs and Expenses					
Purchased power cost	156,872	150,928	200,916	205,674	232,068
Operations and maintenance	14,807	14,634	16,462	19,133	18,833
Depreciation and amortization	4,426	4,831	5,911	5,504	5,576
Interest and other financial charges (income) - net	1,216	499	(1,044)	(819)	(1,041)
Others	9,254	1,811	5,370	8,617	7,957
Total	186,575	172,703	227,615	238,109	263,393
Net income attributable to equity holders of the parent	2,800	6,005	9,685	13,227	17,016
Core net income	2,605	7,003	12,155	14,887	16,265
EBITDA	11,021	13,169	18,841	24,602	27,545
Utility plant and others - net	100,853	101,858	103,250	105,510	109,312
Interest-bearing long-term financial liabilities	16,359	21,303	21,072	24,376	22,826
Notes payable	9,828	513	149	67	1,787
Equity attributable to equity holders of the parent	52,607	57,369	58,969	63,788	67,479
Capital expenditures	9,175	8,890	9,053	8,748	10,321
Market price per share at end of year	59.50	205.00	228.00	247.20	260.60
Core earnings per share	2.36	6.32	10.78	13.21	14.43
Cash dividends declared per share	1.00	2.50	6.95	7.80	8.10
Market capitalization	65,674	231,091	257,018	278,625	293,722
Total shareholder return	(27%)	249%	15%	12%	9%
OPERATING INFORMATION					
Number of Customers (in Thousands)					
Residential	4,144	4,277	4,412	4,580	4,735
Commercial	414	410	421	433	440
Industrial	10	10	10	10	10
Streetlights	4	4	4	4	4
Total	4,572	4,701	4,847	5,027	5,189
Energy Sales (in GWh)					
Residential	8,620	8,904	9,540	9,344	9,779
Commercial	10,607	10,922	11,830	12,027	12,749
Industrial	7,682	7,548	8,734	9,080	10,111
Streetlights	140	142	143	141	132
Total	27,049	27,516	30,247	30,592	32,771
System Loss (in %)					
Meralco	9.28	8.61	7.94	7.35	7.04
Clark Electric	4.76	3.86	3.81	3.96	3.75

FINANCIAL AND OPERATING HIGHLIGHTS



32,771GWh
energy sales

5.2M
number of customers

7.04%
meralco system loss

PhP17.0B
reported net income

PhP8.10*
cash dividend per share

PhP16.3B
core net income

PhP285.3B
total revenues

PhP14.43
core EPS

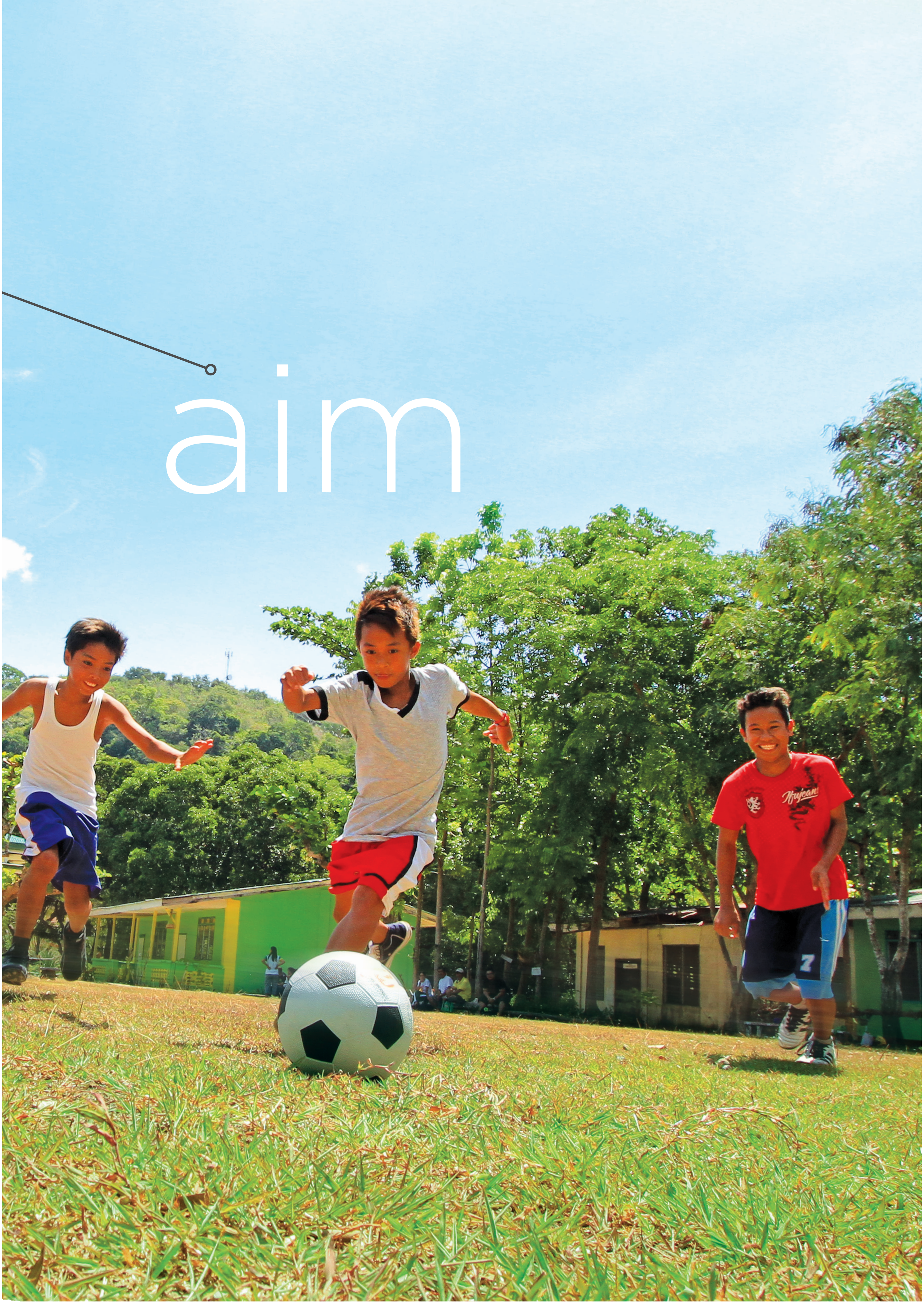
PhP27.5B
EBITDA

PhP293.7B
market capitalization

*Representing the sum of 2011 final dividend plus 2012 interim dividend declared and paid in 2012.

We are a determined team that aims for the goal, sets new records and lasting value to our customers and shareholders yet we never forget that the upliftment of the underprivileged is the reason why we are in the game.

aim



Message from the Chairman

To our Shareholders,

The past three years preceding this year have delivered sterling results. But 2012 was quite unprecedented as performance reached new historic highs. The exceptional growth of the economy and the resulting confidence of the investment community in it have contributed to our buoyant numbers. Internally, strategic and timely business initiatives helped the year's outstanding results, executed by our dedicated and competent workforce committed to excellence.

Our 2012 Consolidated Core Net Income, which excludes one-time, exceptional charges, rose 9% to PhP16.3 billion from PhP14.9 billion in 2011. Consolidated Reported Net Income stood at PhP17.0 billion, 29% higher than in 2011. Energy sales volume reached 32,771 GWh to record a 10-year compound annual growth rate (CAGR) of 3.6%.

These results enabled the Company to declare and pay cash dividends consistent with our policy. We declared a total of PhP10.10 a share out of our 2012 Core Net Income, including a special dividend, which takes our payout to 70% of the 2012 Core Net Income. The final dividend of P6.10 declared last February 25, 2013, was paid on April 24, 2013.

The share price of Meralco rose from PhP247.20 to PhP260.60 at the close of December 2011 and 2012, respectively. Meralco's share price surged further to PhP374.00 as of end-April 2013, resulting in a market capitalization of PhP421.5 billion, the fourth highest market cap among publicly listed companies in the Philippines Stock Exchange (PSE) - up from PhP293.7 billion as of end-2012, an increase in market value of our Company of PhP127.8 billion in those four months.

Moored on the economic vigor and bright prospects of the country, Meralco's record results drew momentum from the vibrant performance of the services, real estate and manufacturing sectors. The notable rise in remittances sent home by some 10 million overseas Filipino workers likewise share the credit in spurring the increase in domestic consumption, causing residential and commercial energy sales to grow. Warmer

"We continue to carry out strategic capital expenditure projects to ensure a robust electric system and a solid platform for new products and services of value to the customer."

temperatures in 2012 also drove higher energy sales which helped temper the negative impact of six weather disturbances that affected our franchise area. The Company added 162,704 more customers in 2012, bringing the year-end total to 5,189,247 customers - 3.2% higher than 2011. This growth rate is greater than the 10-year annual average of 2.8%.

We remain fully committed to staying ahead of the curve in meeting the power needs engendered by the rapidly growing business community, the rising consumer demand and expectations, and our regulatory commitments. In response, we continue to carry out strategic capital expenditure projects to ensure a robust electric system and a solid platform for new products and services of value to the customer.

This pursuit of innovative customer engagements and services has contributed to higher Revenues and Core Net Income. These initiatives include an even faster energization of new customers, shifting self-generating or directly-connected customer accounts to Meralco service, quality execution of our distribution system expansion and upgrading projects, and stringent cost-containment policies and measures across the entire organization. They have together served to improve results. It is gratifying to note that in the midst of all these initiatives came various recognitions from industry leaders and peers. The Employer of the Year Award from the People Management Association of the Philippines, the harvest of Philippine Quill and Anvil Awards for corporate and customer communications and public relations, the local and international awards in Corporate Governance for best practices and investor communications all serve to inspire us to drive organizational and customer service performance to global standards further.

Areas for Growth

Meralco has been actively pursuing new areas for growth: in power generation, retail electricity supply, power distribution, and our subsidiaries.

Our wholly-owned subsidiary Meralco PowerGen Corporation (MGen) has been focused on the development of new domestic power generation projects, primarily serving the Luzon Grid. These include Redondo Peninsula Energy (RP Energy), a joint venture for a 2 x 300 MW base load circulating fluidized bed (CFB) coal-fired power project in the Subic Freeport Economic Zone, with Therma Power, Inc. (TPI) and Taiwan Cogeneration International Corp. (TCIC), a mid-merit LNG-fired power plant project and related storage and regasification facilities with potential strategic partners, and other base load and peaking coal-fired and renewable power projects.

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Towards the end of 2012, MGen commenced extensive due diligence jointly with the First Pacific Company Limited on an opportunity to acquire a 70% interest in Singapore-based GMR Energy. GMRE is nearing completion of a 2 x 400 MW LNG-fired power plant project in Jurong Island in the island city-state. This joint investment with First Pacific was concluded in late March 2013.

Retail Competition and Open Access (RCOA) is currently scheduled to be launched commercially late June 2013. Our retail electricity supply unit, MPower, is set to serve competitively contestable customers with an average load of 1MW and above upon commencement of RCOA.

As well, we continue to explore opportunities with certain private distribution utilities and electric cooperatives to bring Meralco's track record of excellent power distribution service to underserved areas outside Meralco's franchise coverage. In the process, Meralco expects to create value for its customers and the communities in these areas.

Lastly, Meralco subsidiaries engaged in various businesses related to electricity are also pursuing further growth by tapping more non-Meralco markets.

During the year, our One Meralco Foundation (OMF) carried out different projects on community electrification, grassroots partnerships, youth and sports advocacy and emergency preparedness and disaster response. OMF provided electricity to more than 2,000 marginalized households and engaged in various enterprise development programs. Through our school electrification program, OMF helped upgrade the learning and living environment by bringing light to six public schools and the community in Isla Verde, Batangas. In the succeeding pages, you will read more about OMF's milestones, as expression of our commitment to building and improving the communities where we operate.

Indeed, we look forward to a busier 2013 as we fulfill our vision for a brighter Philippines.

To our customers and stakeholders, thank you once again for giving us the opportunity to serve you. To our employees, congratulations for a job well done. To our Board of Directors, our deep appreciation for your continued guidance and confidence in our Management.

At sa buong bansa, mula sa amin sa Meralco - Ang Liwanag ng Bukas!

MANUEL V. PANGILINAN
Chairman

OMF provided electricity to more than

marginalized households and engaged in various enterprise development programs.

Report of the President & CEO

To our Shareholders,

2012 proved to be another year of record highs and historic firsts for Meralco in its 110-year corporate history.

Record Highs

We set new records in Sales (32,771 GWh and 5.19 million customers), Operations (lowest interruption frequency and duration indices, lowest system loss rate at 7.04%, improved power quality, speed to process and to connect customers and call center performance), People Management (highest productivity ratios at 870 Customers per Employee and over 5 GWh Sales per Employee) and Financial Results (record Consolidated Core and Reported Net Income, EBITDA, and cash dividend per share).

We ended 2012 with a more robust financial position, providing a strong financial base to meet the capital expenditures needed for our growing load demand, the equity investments required by MERALCO PowerGen Corporation (MGen) to build its power plant portfolio locally and overseas, the funding for our retail electricity supply business, and to support the distribution service expansion and the growth of our subsidiaries.

Historic Firsts

We continue to develop Meralco's re-entry into power generation through MGen's first joint venture, Redondo Peninsula Energy, Inc. (RP Energy). RP Energy is developing its 2 x 300 MW coal-fired power plant project in Subic.

In late 2012, the opportunity arose for Meralco's first overseas investment in power generation. As mentioned in the Message from the Chairman, we successfully concluded in March 2013 the acquisition of a 70% interest in GMR Energy (Singapore) Pte Ltd (GMRE), which is building a 2 x 400 MW LNG-fired power plant in Singapore. This investment was made jointly with First Pacific Company Limited of Hong Kong. The Singapore plant should be completed towards the end of 2013.

Meralco was likewise engaged by Integrated Energy Distribution and Marketing (IEDM) of Nigeria to be its technical partner in the competitive bidding for selected electric distribution areas in Nigeria.

This would be the Company's first overseas venture in power distribution. The IEDM-Meralco consortium was awarded the Preferred Bidder Status for two

We believe that the true measure of our success lies in serving the customer better.

(2) electric distribution companies last October 16, 2012. The technical services agreement and investment agreement for minority participation by Meralco remain to be discussed.

The Company will be among the first retail electricity suppliers to contestable customers when Retail Competition and Open Access is operationalized commercially in June 2013.

Key Enablers

Key to enabling us in outperforming "all-time bests" of prior years and to break new ground in new business and innovations locally and in new markets overseas are (a) clear strategies and deliverables on customer and shareholder value creation process, as well as growth and profitability; (b) disciplined execution; and (c) a highly motivated, energized and cohesive organization which is determined to excel.

Equally disciplined CAPEX and OPEX-spend, prudent risk management and a high standard of corporate governance provide the quality assurance for staying on track and driving stretch performance in our core power distribution business.

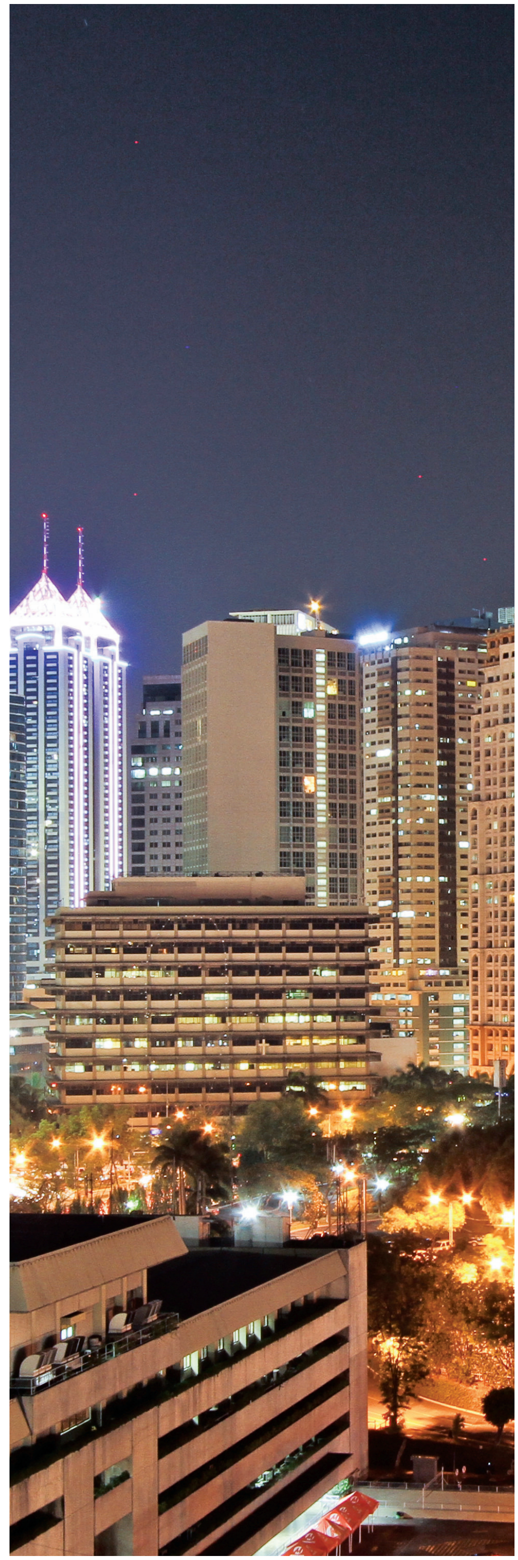
Serving The Customer Better

But above all, we believe that the true measure of our success lies in serving the customer better. Our sustained gains in driving customer service to new highs, in strengthening customer engagement, and in providing innovative solutions and services are more extensively discussed in our Review of Operations.

In addition to upgrading customer service, we have also made significant strides towards helping contain generation charge, the largest component (58% in 2012) in the customer's bill, and the related system loss charge (5% in 2012). Even as MGen is still developing its portfolio of highly fuel efficient and reliable power plants, Meralco has increased its power supply envelope of new competitively priced long-term Power Supply Agreements (PSAs) to 2,880 MW. These PSAs came into effect in late December 2012, replacing supply from the expiring but comparatively higher-priced Transition Supply Contract (TSC) with the National Power Corporation (NPC). System loss was reduced to 7.04% by end-2012, down from 7.35% in 2011, helping lower this component of the customer's bill.

Our Peak-Off Peak (POP) offers, energy efficiency advisories such as Bright Ideas and Tipid Tips for residential customers and energy audits for commercial and industrial customers, are among the measures we have made available to help customers in all segments reduce their own electricity spend.

Lastly, as we continue to help enhance the quality of life of residential customers and the performance and prospects of businesses and industries through improved services and products, we ensure that our



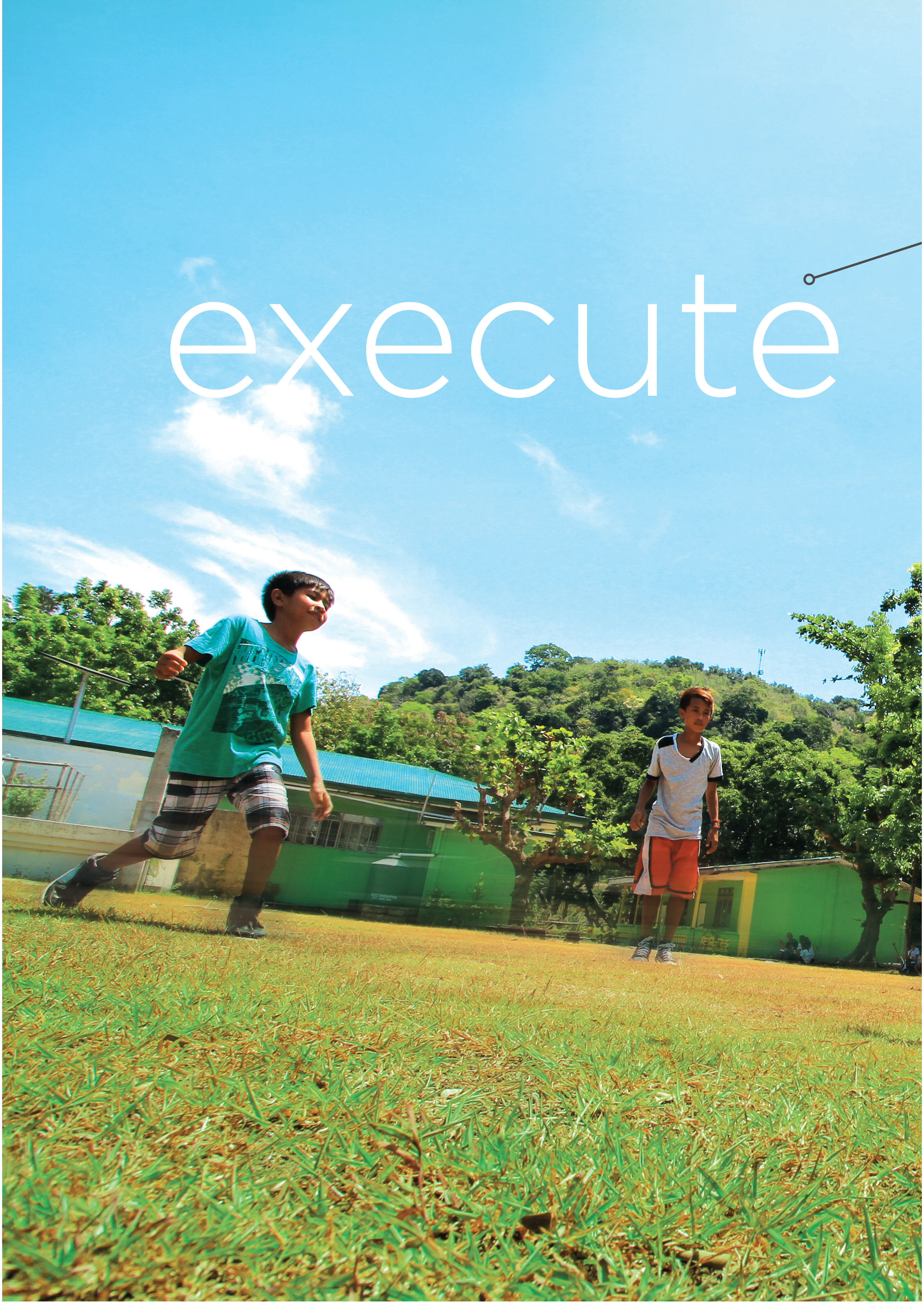
Corporate Social Responsibility (CSR) program is fully supported, resourced and carefully executed. We remain committed to grow the benefits of our CSR program to targeted beneficiaries and communities not only in the areas we operate, but also elsewhere where we can make a difference. This reflects our corporate conviction that Meralco should indeed reach out to the customers we service - and be identified as an integral part of the community.

The landmark gains that characterized our operations in 2012 provide us with a stronger foundation to move forward, and aim for more challenging targets, execute well and excel well into our 110th year and beyond.

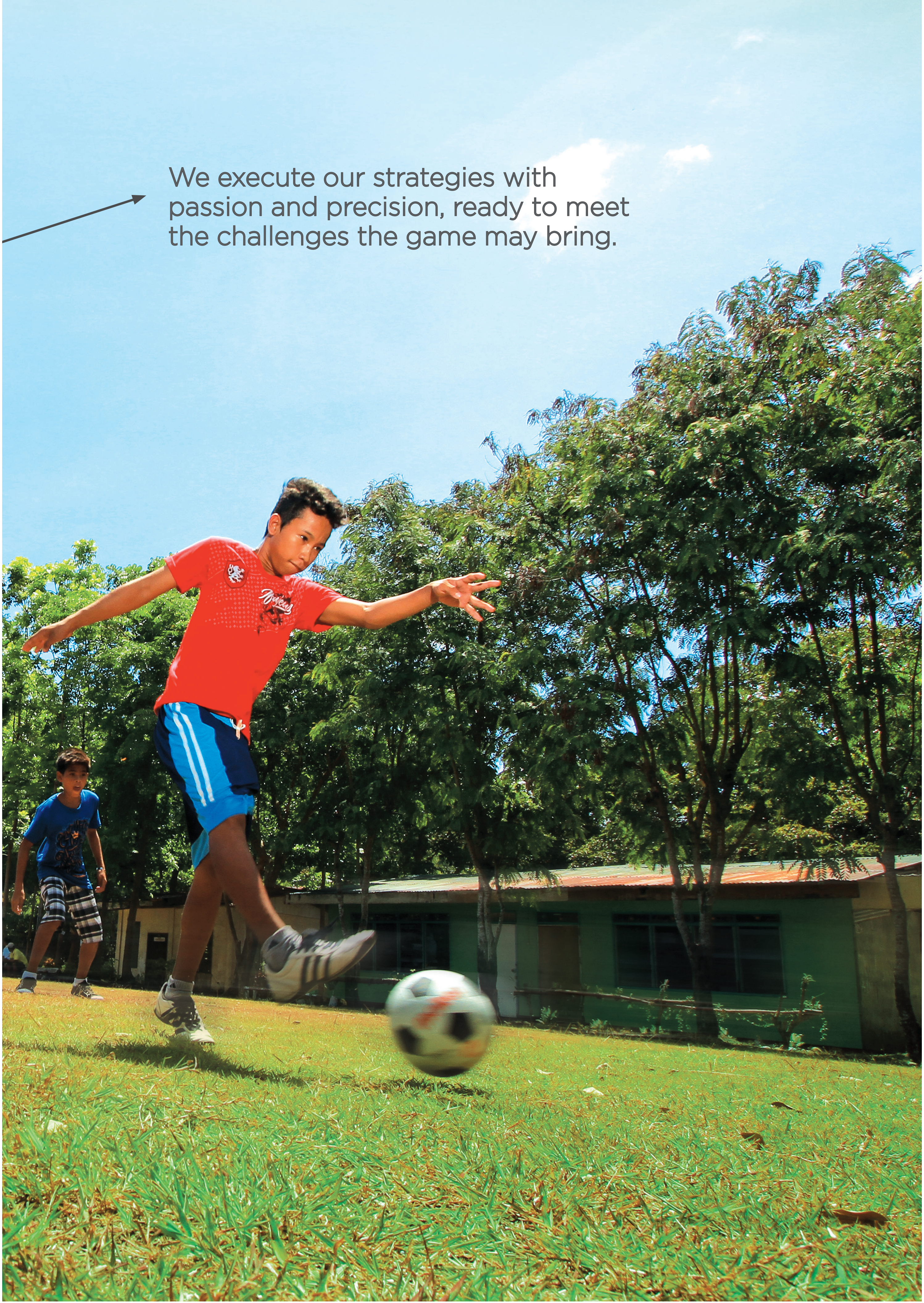
Maraming salamat po sa inyong lahat.

OSCAR S. REYES
President and Chief Executive Officer

execute



We execute our strategies with passion and precision, ready to meet the challenges the game may bring.



Looking back:

The Philippine Economy in 2012

- Gross Domestic Product (GDP) grew 6.6% in 2012, from only 3.9% in 2011. About 50% of the Philippine GDP is generated within the Meralco franchise.
- The economy benefited from the consistent performance of the industrial and services sector.
- Given the economic uncertainties abroad, the country leaned on domestic drivers, in particular, private consumption and government spending, for growth.
- Remittances of Filipino workers and residents overseas and Business Process Outsourcing (BPO) inflows reached all-time highs, aggregating over US$36 billion in 2012, exceeding growth targets and expectations, boosting household income and spending.
- Annual inflation rate remained benign at 3.2%, a significant decrease from the 4.6% rate recorded in 2011.
- The Philippine Peso was stronger in 2012 against the US Dollar, averaging PhP42.23 compared with PhP43.31 in 2011.

GDP GROWTH

6.6%

Review of Operations

- Consolidated energy sales, inclusive of volume sold by Clark Electric Distribution Corporation (CEDC), rose 7.1% reaching an all-time high of 32,771 GWh.
- Average annual sales volume growth since 2010 was at 6%, higher than the annual sales volume growth of 4% for the preceding three years (2007 – 2009).
- Energy sold from sales initiatives accounted for 1,473 GWh or 68% of the total incremental sales volume of 2,179 GWh, with the balance derived from organic growth.
- Recovered sales from previously self-generating and directly-connected customers accounted for 74% of total sales initiatives or 1,096 GWh, and the balance from new applications.
- Growth in sales across all major classes was driven by higher ambient temperature, favorable domestic conditions encouraging consumer spending, increase in household disposable income; and domestic business expansion.
- Total energy sales is composed of 39% commercial, 31% industrial and 30% residential.

Key **Growth Drivers**

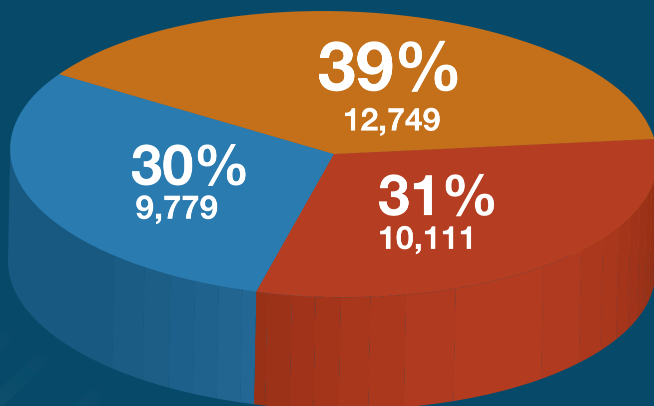
- Industrial segment expanded by 11.4% to 10,111 GWh in 2012 from 9,080 GWh in 2011.
  - > Electrical machinery and food manufacturing growth mirrored economic expansion.
  - > Electronics accounted for 56% of total goods exported in 2012.
  - > Newly energized industrial customers, composed of previously directly connected (including the Cavite Economic Zone), and self-generating customers pushed industrial sales growth in 2012.
- Commercial segment grew by 6.0% to 12,749 GWh in 2012 from 12,027 GWh in 2011.
  - > Robust Real Estate sector reflected continued strong demand for housing (affordable, mid- and high-rise condominiums) and commercial space (business process outsourcing and malls).
  - > A healthy transport, storage and communications sector reflected improvements in infrastructure.
  - > Private services demand anchored on travel and tourism, and on recreation and entertainment, fueled growth among hotels, restaurants and recreational venues.
- Residential segment grew by 4.7% to 9,779 GWh in 2012 from 9,344 GWh in 2011.
  - > Growth rebounded from a 2% decline in 2011.
  - > Major weather disturbances including typhoon *Gener* and the "*habagat*" (monsoon) dampened second semester growth in residential consumption. Consumption picked up anew in the last quarter towards the holiday season.

Industrial Segment
Manufacturing and construction sub-sectors, including semiconductor companies; food and beverage products and basic metals - processing and refining.

Commercial Segment
Real estate, private services, communications, transport and storage.

Residential Segment
Higher ambient temperature and increase in household disposable income.

SALES, in GWh



- Commercial
- Industrial
- Residential

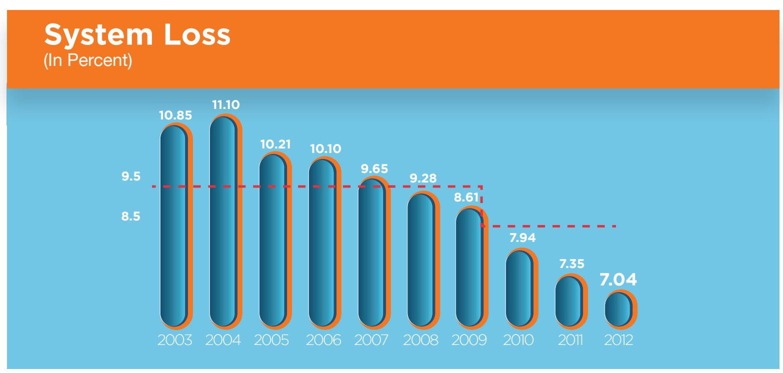
Flat streetlights account for less than 1% of total sales.

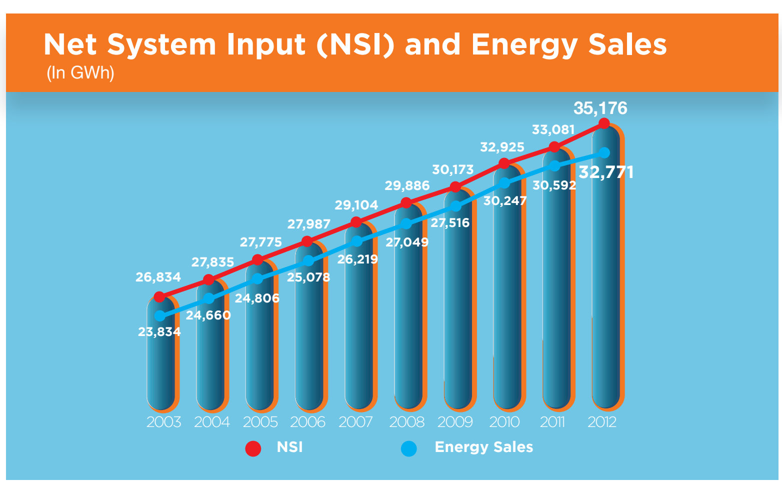
Customer Count: Growth Continues

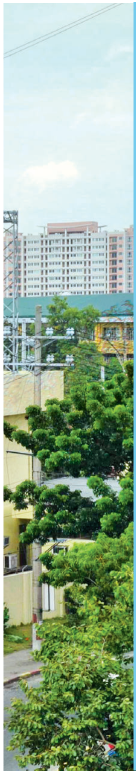
- Number of customers increased 3.2% in 2012 to 5,189,247 from 5,026,543 in 2011.
  - > Net additional 162,704 customers in 2012.
  - > Growth was higher than the 10 year average growth of 2.8%.
- Residential customers accounted for 91% of the total customer count, numbering 4,734,637 in 2012, from 4,579,603 in 2011.
- Commercial customers comprised 8% of total count at 440,372.
- Industrial customers made up less than 1% of total count at 9,789 but contributed 31% to the total energy sales volume in 2012.

Net System Input and Peak Demand: Highest Ever

- Net System Input (NSI) rose by 6.3% to a record 35,176 GWh in 2012 from 33,081 GWh in 2011.
  - › Lower rate of increase in NSI relative to total energy sales indicate further gains in system loss reduction.
  - › Meralco peak demand rose by 6.6% at 5,633 MW, up from the 2011 peak demand at 5,283 MW. Similarly, Luzon peak demand was higher in 2012 at 7,889 MW compared with 7,552 MW in 2011.







Meralco Electric Distribution Data	2012
Count of Substations	115
Delivery Point (230 kV)	8
Major (115 kV and 69 kV)	80
Distribution (34.5 kV Below)	27
Substation Aggregate Capacity (MVA)	15,676
Circuit Length (km.)	17,050
Distribution	16,213
Sub-transmission	837
Count of Circuits	850
Distribution	750
Sub-transmission	100
Distribution Transformers in Service	157,118
Distribution Transformer Capacity (MVA)	12,907
Poles in Service	723,239
Meralco Peak Demand (MW)	5,633

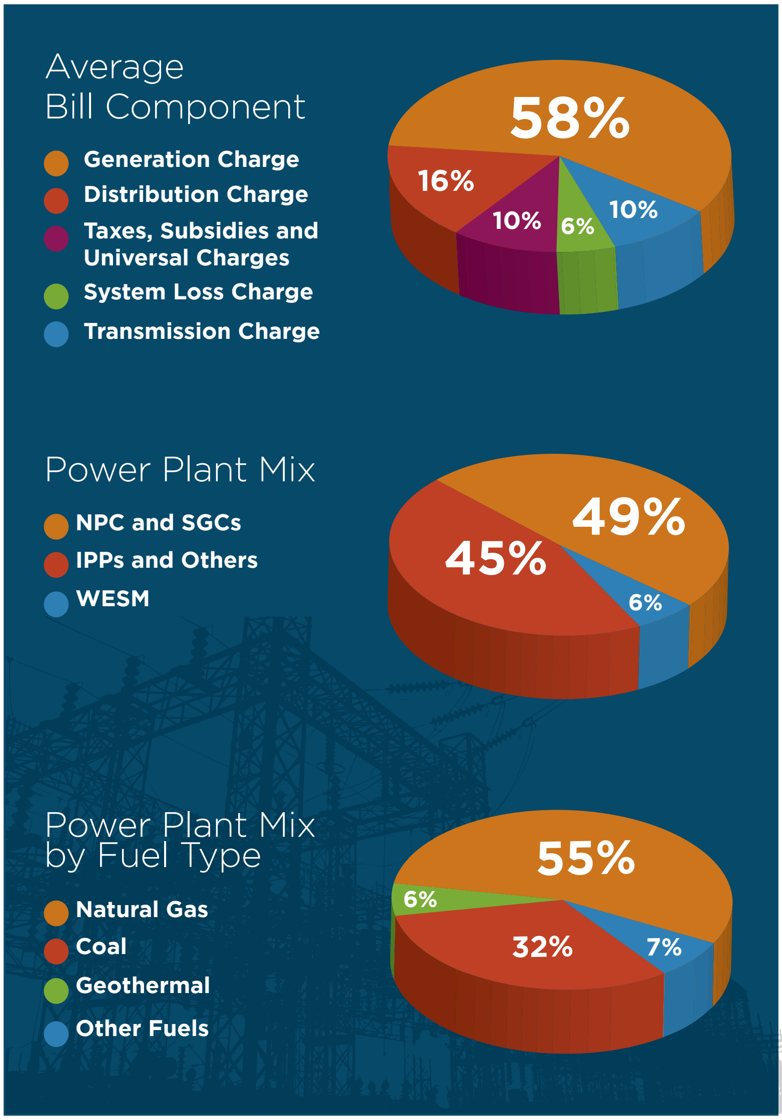
PACO SUBSTATION, *a major electric capital project enhancing the capacity, reliability and efficiency of Meralco's distribution system.*

Network and Operating Performance: Surpassing Prior Bests

- Meralco's network and customer service performance surpassed previous records.
  - › Outperformed all eight S-Factor and GSL standards set by the Energy Regulatory Commission (ERC) as well as actual levels achieved since 2007.
- System loss, system reliability and availability, power quality, time-to-process applications and time-to-connect customers, and Call Center performance reached record levels.
- Improvement in system reliability and availability resulted in increase sales volume.
- System performance gains translated into rewards and savings, under the Performance Incentive Scheme (PIS) of the Performance-Based Regulation (PBR).
- System loss level in 2012 was at all-time low of 7.04% from 7.35% in 2011.
  - › 1.46 percentage points lower than the 8.5% system loss cap of the ERC and 0.31 percentage points improvement from previous year's level.
  - › PhP3.43 billion savings in 2012 or a cumulative PhP8.7 billion savings over the last five years, equivalent to PhP5.96 per kWh, realized by customers.
  - › Equivalent to 108 GWh avoided system loss compared with 2011 level.
  - › CEDC's system loss rate was at 3.75%.
- Daily Sales Outstanding (DSO) level in 2012 was at 26.3 days surpassing target of 27.0 days.

Capital Expenditures: For A More Robust System

- Capital expenditures in 2012 was at PhP10.3 billion.
- Electric Capital Projects (ECP) accounted for majority of the expenditures to:
  - (a) meet growth in power demand of existing and new customers.
  - (b) sustain improvements in system loss performance.
  - (c) enhance the robustness of the system against natural calamities and other contingencies.



The Meralco Customer Bill: Stable Distribution Rates

- Average retail rate of electricity across all customer classes was PhP9.64 per kWh in 2012.
  - › A 5.5% increase over the average bill of PhP9.14 per kWh in 2011.
- Average Generation Charge amounted to PhP5.61 per kWh in 2012, up 9.6% over PhP5.12 per kWh in 2011. Generation Charge made up 58% of the total bill.
- Meralco's Distribution Charge of PhP1.56 per kWh accounted for only 16% of the average bill.
- Transmission Charge comprised 10% of customer bill averaging 98 centavos per kWh.
- Taxes, Subsidies and Universal Charges comprised 10% of the bill at 97 centavos per kWh.
- System Loss Charge made up 6% of the average bill at 52 centavos per kWh.

Energy Sourcing: New Power Supply Agreements To Bring Down Power Rates

- Independent Power Producers (IPPs) - Quezon Power, FGPC-Santa Rita and FGP Corp-San Lorenzo - contributed 40% to Meralco's energy supply at an average cost of PhP5.27 per kWh. NPC, under the extended Transition Supply Contract (TSC), supplied 49% of Meralco's energy requirement at a cost of PhP5.40 per kWh.
- New Power Supply Agreement (PSA) with Sem-Calaca Power Corporation (SCPC) took effect in 2012 and helped temper the rise in the generation charge by supplying 5% at PhP3.87 per kWh. While Meralco's contracted capacity from SCPC was only 210 MW in 2012, this will double to 420 MW in 2013, and will help lower Generation Charge.
- The balance of 6% was sourced mostly from the Wholesale Electricity Spot Market (WESM) at an average cost of PhP12.48 per kWh.
- On December 17, 2012, the ERC approved competitively-priced PSAs entered into by Meralco to replace the expiring NPC TSC and avoid the Company's exposure to the WESM, consequently shielding customers from the price volatility in the spot market:
  - > South Premiere Power Corporation (Ilijan) – 1,180 MW
  - > San Miguel Energy Corporation (Sual) - 500 MW
  - > Sem-Calaca Power Corporation (SCPC) – 420 MW
  - > Masinloc Power Partners Company Ltd (Masinloc) – 430 MW
  - > Therma Luzon, Inc. (Pagbilao) – 350 MW

Customer Centricity and Engagement: Stronger Relationships

- A re-engineered Customer Retail Services organization put more focus on the customer, enabling the creation of segment partners providing services unique to each segment:
  - > Meralco Corporate Partners for large industrial and commercial business.
  - > SME Partners for small & medium scale enterprises
  - > HMB Partners for home and micro businesses.
- Meralco Corporate Partners' Relationship Managers (RMs) address the needs of over 17,000 commercial and industrial customers, including conglomerates, and national government accounts.
  - > RMs worked with companies to ensure power quality, maintenance and reliability of service, as business and engineering partners.
  - > RMs conducted joint planning sessions with customers to ensure that expansion plans are included in the Company's capital expenditures and infrastructure blueprints.
- Meralco SME Partners cover 75,000 small and medium scale enterprises, touted as the country's growth engine.
  - > SME Partners tapped Accredited Meralco Contractors (AMCs) to provide first-level services, including guidance on service applications.
  - > RMs deployed to all Meralco Business Centers, bringing them closer to customers.
- Meralco Home and Microbiz Partners address 5,163,633 customers.
  - > Broadened and enhanced service delivery touch points, from the simple monthly bill to the Business Centers and Call Center, to communicate the Company's values and the warmth of the Filipino spirit.
- The Company ventured into new media to reach out to customers, via its own Twitter account and putting up a Facebook page through which customer concerns and reports may be handled 24/7.

- The Company launched its first-ever mobile app called Meralco Virtual Engine (MoVE), a suite of services that enables access to Meralco from anywhere.
- The Meralco Luminaries, a centerpiece awards program, showcased the year's top partnerships with Commercial and Industrial firms, SMEs and Local Government Units. Through these partnerships, Meralco demonstrated the value it can provide customers.
  - > In 2012, joint planning with conglomerates enabled early opening of malls and integrated gaming and resort operations.
  - > Partnerships resulted in SMEs availing of Meralco Peak/Off-Peak pricing and allowed companies to re-engineer their high consumption operations to off-peak hours, and shave costs and allow for expansion.
- Meralco achieved a Consumer Satisfaction Index of 7.60, an affirmation of last year's historic high, and remarkable considering that during the year, electricity prices were significantly up and customer price sensitivity was at an all-time high. The Company measures its level of satisfaction via a third party survey.

Human Resources: Excellence in People Management

- 2012 Employer of the Year by the People Management Association of the Philippines (PMAP), Meralco's second Employer of the Year title after 32 years.
  > Recognizing the Company's people management programs, values and practices; an employer of choice where best talents would like to join and stay with.
- Top Employer Organization at the Asia CEO Awards, citing Meralco's leadership excellence in the Philippines.
- Finalist in the KPMG-Executive Leader Team at the Asia CEO Awards.
- Awardee for safety practices from the Safety Organization of the Phils. Inc. (SOPI), garnering a total of seven awards.
  > Special recognition for Sta. Rosa Sector which recorded the longest number days worked without Lost Time Accident attained in 2012 at 3,520 days.
- 5,960 employees in 2012, down 1.8% from 6,071 in 2011, the lowest level for the last five years achieved amidst record-high operating performance and customer service.
  > Sustained labor productivity improvement records for Customer per Employee Ratio (CPER) at 870, the highest in the past 10 years, improving by 5.2% compared with 828 in 2011.
  > Sales per Employee Ratio (SPER) at more than 5 GWh per employee, the highest ever recorded, improving by 9.1% from 2011.

Innovation Revolution: For a Brighter Philippines

- Meralco leveraged on technology even more in 2012 to level up service reliability and efficiency, laying the foundation for what is envisioned to be a "Smart Grid" infrastructure. Smart Grid is a two-way communications-enabled electric system that uses intelligent devices and advanced metering to optimize grid performance and provide customer options on the efficient use of electricity.
  - > 370 units of remote controlled line switches and 23 units of line reclosers led to a significant decrease in the duration of several service interruptions.
  - > A Smart Grid demonstration area was set up in Masinag, Antipolo, Rizal to test Smart Grid technologies: Smart Meterings, Fault Location Isolation Restoration, Integrated Volt-Var Optimization, and a Smart Substation using digital equipment and fiber optics to reduce installation and maintenance costs.
  - > Technical testing was conducted for Prepaid Electricity Service (PRES) to pave the way for a pilot for residential households in 2013. Meralco's PRES service was configured to align with consumer preferences, similar to the prepaid telco experience, validated through research.
  - > After hosting the 2012 Electric Vehicle (EV) Summit with stakeholders from Japan, Korea and Taiwan, and the Philippines, Meralco is putting up a pilot EV charging station in its compound in early 2013, and actively exploring partnerships with EV manufacturers and suppliers to build the EV ecosystem in the Philippines.
- Now more than ever, Meralco is leveraging on technology to drive innovation and provide better value service to customers. It is aligning with all stakeholders on the benefits of an integrated Smart Grid solution that will allow Meralco to provide the following:
  - > Demand response via rate options, i.e., critical peak pricing, and dynamic peak/off-peak rates .
  - > Net-metering accommodates distributed generation and renewable energy sources from solar panels and wind turbines.
  - > More responsive customer service that can communicate estimated times of restoration during normal outages, backed up by an automated field force and a self-healing network.
  - > Empowered customers to manage their consumption via access to near real time consumption data and the ability to switch appliances on and off remotely.
- Meralco is networked with the more advanced utilities that have implemented these technologies. This allows the Company to be in the 'sweet spot' of learning from the pioneers while localizing applications to the unique topography and customer landscape in our franchise area.

Our Growth Pillars: Milestones Reached

Meralco Power Gen Corporation (MGen)

- Achieved several milestones in its project Redondo Peninsula Energy, Inc. (RP Energy).
  > Issuance by the Department of Environment and Natural Resources (DENR) of an Environmental Compliance Certificate (ECC) for the additional 300 MW power plant capacity.
  > BOI approval of RP Energy's application for registration with incentives.
  > Finalization of negotiations on the Engineering, Procurement and Construction Contracts.

- Entered into an agreement with Chubu Electric Power Co. of Japan, extending the period of the Joint Study Agreement for determining the feasibility of developing a liquefied natural gas (LNG)-fired combined-cycle gas turbine power plant in Atimonan, Quezon.

- Established a partnership with Shell Companies in the Philippines to look into the viability of putting up a liquefied natural gas-fired power plant in Batangas.
- Signed a Memorandum of Understanding with Global Business Power Corporation (GBPC) for joint investment in potential power projects in Visayas and Mindanao.
- Commenced extensive due diligence on the acquisition jointly with First Pacific Company Ltd. of 70% interest in GMR Energy. GMR Energy has a 2 x 400 MW LNG-fired power plant nearing completion in Singapore. The acquisition was successfully concluded in record time in March 2013.

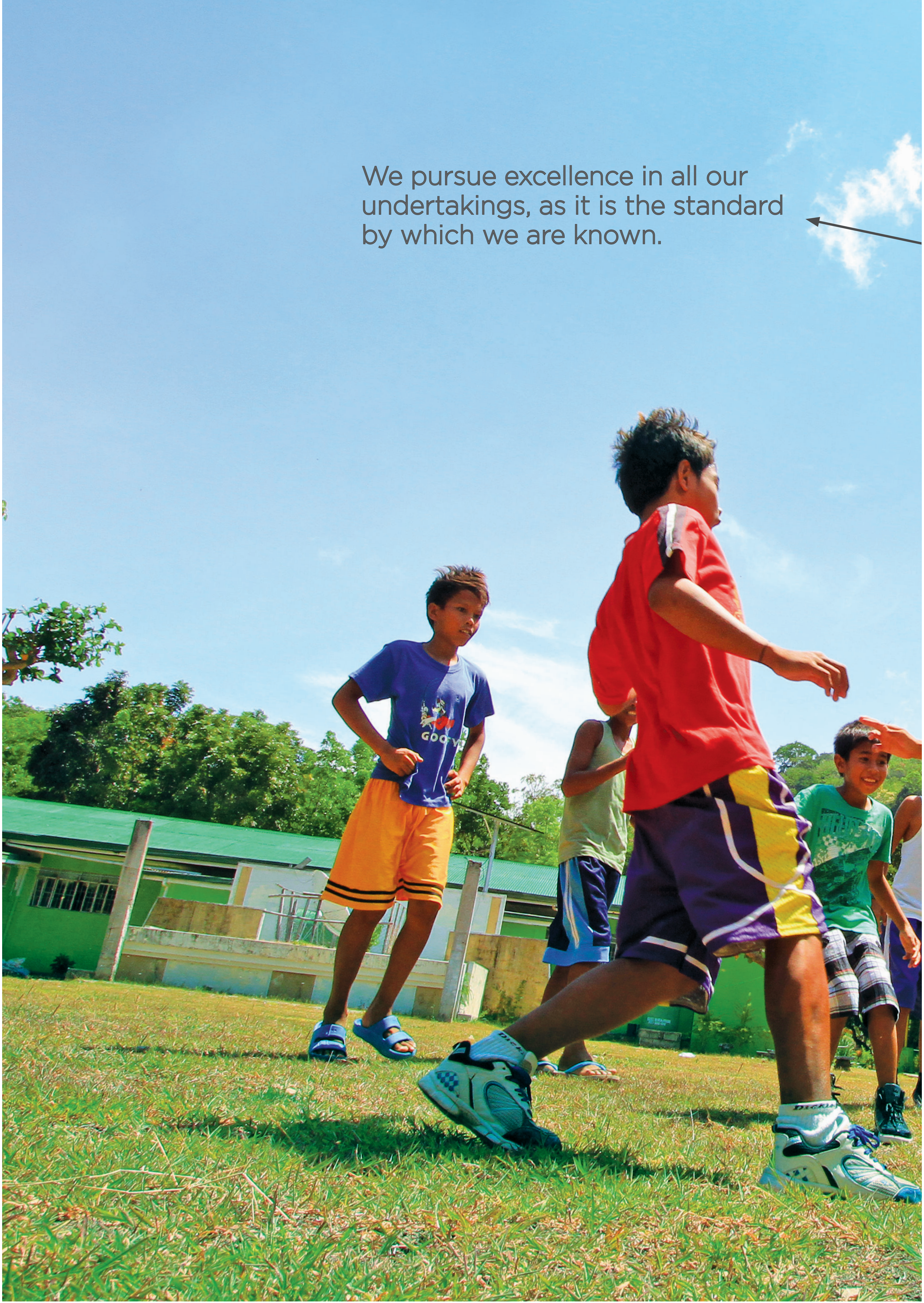
Franchise Expansion

- Meralco partnered with Integrated Energy Distribution and Marketing (IEDM), a Nigerian Special Purpose Vehicle (SPV), for bidding in the government-sponsored privatization of 11 electricity distribution companies (EDC) serving Nigeria.
  - > The Meralco-IEDM partnership topped the bidding for four electric distribution companies but was awarded with two distribution areas, the most allowed by the Federal Government of Nigeria.
  - > The partnership was eventually declared Preferred Bidder for the Ibadan Electricity Distribution Company (IBEDC), the largest Nigerian EDC in connections, and Yola Electricity Distribution Company (YEDC), the EDC with the largest geographical area.
  - > To date, Meralco is finalizing a Technical Services Agreement with IEDM for the expected handover of the EDCs by the third quarter of 2013.
- On the local front, Meralco continues to find ways with government agencies, local government units and other members of the private sector to help other distribution utilities operate in a more efficient manner.

Retail Electricity Supply

- Retail and Customer Service
  - > Engaged contestable customers in the franchise area for updates on Retail Competition and Open Access (RCOA) and on supply contracting requirements.
  - > Finalized Retail Pricing Models.
  - > Developed in-house systems for load profiling and tariff analysis.
  - > Developed collaterals for marketing.
- Energy Management
  - > Negotiated and signed five Power Supply Agreements.
  - > Developed and simulated processes for Planning, Operations and Billing Settlement
  - > Optimized plant dispatch
- Regulatory and Legal
  - > Participated in consultative meetings with the Retail Electricity Supply Association (RESA), business organizations, Philippine Electricity Market Corporation (PEMC), Department of Energy and Energy Regulatory Commission
- Resource and Support Systems
  - > MPower start-up organization filled-in the core positions for Energy Management Group, Retail & Customer Service Group and the Support functions, including Energy Sourcing Engineers, Strategic Account Managers and Marketing Analysts.

We pursue excellence in all our undertakings, as it is the standard by which we are known.



excel

Corporate Social Responsibility

Dream, Believe, Achieve

One Meralco Foundation empowers a strong Filipino nation

Meralco's social development arm, the One Meralco Foundation, Inc. (OMF) continues to live up to its commitment of empowering communities to rise above the challenges of poverty through high-impact and sustainable corporate social responsibility (CSR) initiatives in four areas: Community Electrification, Grassroots Partnerships, Youth and Sports Advocacy, and Emergency Preparedness and Disaster Response.

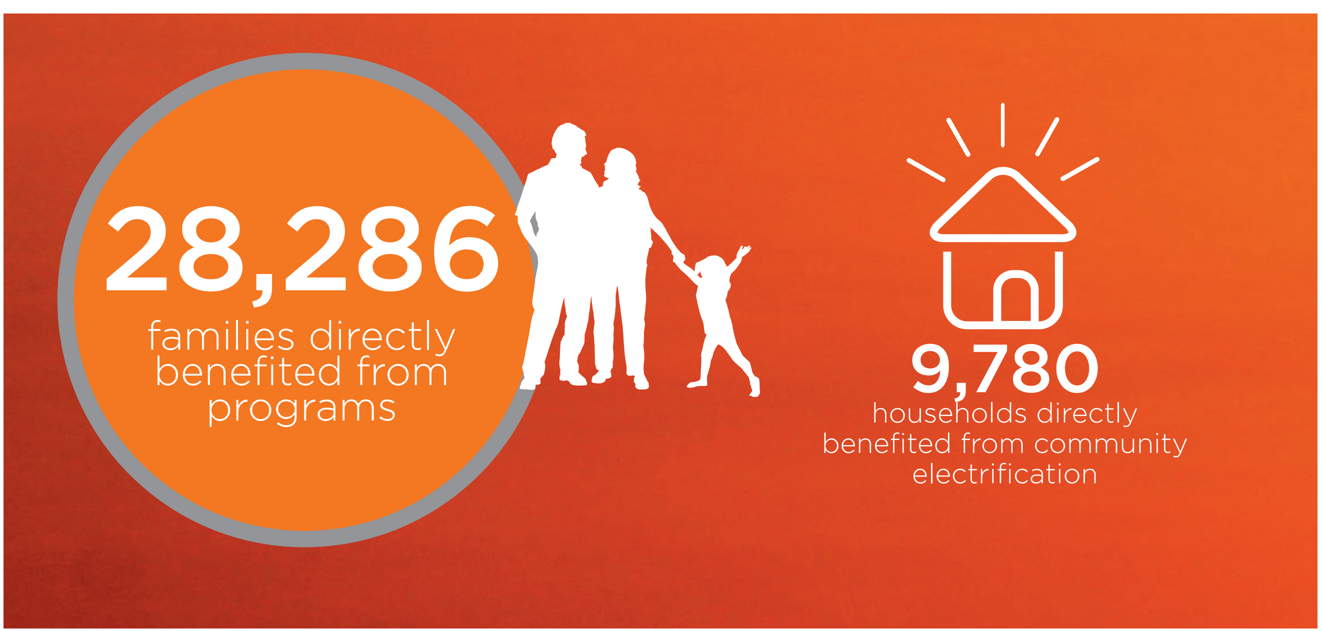
In 2012 these programs, which have directly touched the lives of 28,286 Filipino families, also opened up avenues for the almost 6,000 employees of Meralco to engage with the communities we serve.

The year was defined by milestones as the OMF dreamed, believed and achieved together with its stakeholders - Meralco management and employees, business and government partners, non-government organizations (NGOs) and community groups, for the benefit of the Filipinos and the country.

dream

Through various programs centered on the education of the youth, our dream of a brighter future is already becoming a reality.

Investing in the youth and getting them engaged in personal and social development remain to be a strong advocacy for the Foundation. On its 2nd year, the MVP Academic Assistance Awards (MVP AAA) recognized 180 exceptional dependents of Meralco



employees. The program was also expanded to include dependents of Meralco subsidiaries and affiliates. On top of the awardees this year, the Foundation also recognized 57 MVP AAA alumni from batch 2011 who graduated with the highest distinction in their respective schools.

To support the education of bright young Filipinos who lack the necessary resources to enter the top schools in the country, the Foundation also supported various scholarship programs, such as the One La Salle Scholarship Program for public school students and the Project Light-A-Dream with Miriam College's Adult Education Program for out-of-school-youth and underserved adults.

The Meralco Basketboys program is comprised of a basketball clinic and a values integration program benefited a total of 1,047 youth. Other sports programs such as football clinics and chess workshops were also implemented benefiting a total of 538 disadvantaged youth.
The idea of promoting safety awareness among the youth prompted the Foundation to partner with the Philippine Red Cross for the Youth First Aid Challenge, a competition-based initiative, which trains students on first aid. A total of 1,464 students in 122 schools in disaster-prone areas were trained and have become the community's emergency response teams. The program was implemented in Rizal, Cavite, Laguna, Ilocos Norte, Quezon City and Isabela.

frontlines' relationships with local government officials and community organizations. Along with these, 886 families benefited from the Foundation's community enterprise and livelihood programs. Their products and services such as processed meat and fish, household care products, massage therapy services, to name a few, reached various markets and were showcased in two trade fairs.

believe

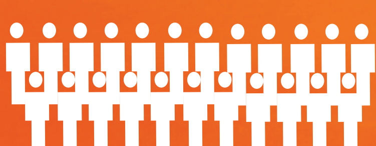
The Foundation's strong belief in the power of partnerships is evident as we joined hands with different Meralco offices, Local Government Units (LGUs) and people's organizations to create lasting positive social transformation.

Stakeholder engagement is a key strategy in contributing to the general well-being of the communities we serve. The 24 community relations projects fortified the Company

Through the Meralco Employees Fund for Charity (MEFCI), outreach programs such as medical missions, livelihood training, institutional donations, individual medical assistance and scholarship grants benefiting two institutions and 5,475 individuals from marginalized communities were also implemented.

As participation to Meralco's yearly Christmas campaign – the *Maliwanag ang Pasko,* the Foundation conducted various

19,356 volunteer hours by Meralco employees



3,286 disadvantaged youth benefited from education and sports programs

886 families earning from **15** livelihood programs

16,820 families helped during disasters fundraising activities with over 2,000 donors who participated to support the electrification of public schools located in the remote island barangays in Quezon, Palawan, Bohol and Dinagat Islands. Aside from this, Meralco's Liwanag Park touched the lives of 3,436 marginalized kids who with Meralco employee volunteers experienced a more meaningful Christmas.

Truly, partnerships shine most especially, in times of tragedies. In January 2012, the Foundation continued its relief support to Typhoon *Sendong*-stricken Cagayan De Oro and Iligan Cities. This time, together with PLDT-Smart Foundation and TV5 Alagang Kapatid Foundation, the team distributed goods to 2,000 families in evacuation centers in Cagayan De Oro. The group also brought Filipino-American artist *Apl 'd Ap* to help in the psychological relief of the families especially the children. The Foundation staff also taught art to the children in the evacuation center as a form of therapy.

The southwest monsoon rains in August 2012 severely affected thousands of families in Metro Manila, South Luzon and Central Luzon. OMF mobilized relief operations in various evacuation centers in the franchise area benefiting 7,194 families.

Meralco forged a partnership with the Davao Oriental Electric Cooperative (DORECO) during the latter's electric facilities rehabilitation in the Typhoon *Pablo*-stricken province of Davao Oriental. Without any delay and hesitation, Meralco and the Foundation crossed boundaries, reached out, and brought the light of hope to the homes of 7,626 families in the towns of Cateel and Boston.

achieve

Our accomplishments in the past year pushed us to further innovate to reach maximum impact on society, especially the marginalized. With the Meralco Business Centers and Networks Teams, LGUs and partner organizations, the Foundation was able to benefit 9,780 marginalized households through its Community Electrification program.

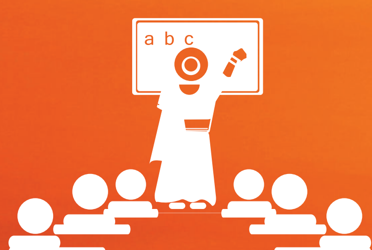
The year reflected the Foundation's re-energized focus on community electrification by diversifying the electrification program to include public schools and communal infrastructures such as eskinitas, rural health centers, farms and livelihood centers. Since 2007, the program was centered on energizing households. However, to make the benefits of electrification reach more marginalized sectors, the Foundation included infrastructures such as six public schools in Isla Verde, Batangas, a farming community system and a rural health clinic in Bulacan, resulting to 7,600 families benefiting from the program.

The Foundation also continued to support the electrical safety, assessment and audit, inspection of service wires and tree trimmings in more than 350 public elementary schools as its contribution to the Department of Education's annual *Brigada Eskwela*.

The Foundation achieved these results through the active involvement of Meralco management and employees who have ignited and kept the corporate values of *Malasakit* and *Makabayan* alive in their daily lives.

Volunteerism is a hallmark in the Meralco culture. To maximize the employees' "*time, talent and treasure*," OMF launched the Makabayan Volunteerism Program (MVP) – which aims to make volunteerism opportunities move from transactional to transformational. Through a structured volunteer program, volunteers now have unlimited options and opportunities where they can participate and share their *time, talent and treasure* and contribute to uplifting the lives of communities located in their work areas. 3,406 Meralco employee-volunteers rendered 19,356 volunteer hours in 17 various activities within the franchise in 2012.

This set of measurable results that the Foundation brought in 2012 is a concrete manifestation of its enduring commitment to strengthen Filipino families' hope for a brighter tomorrow and a stronger Philippines.



185,519

students and teachers benefiting from electrical safety assessment in public schools in the franchise area.

We are stewards of our talents and resources, and look forward to the opportunity to mentor the next generation.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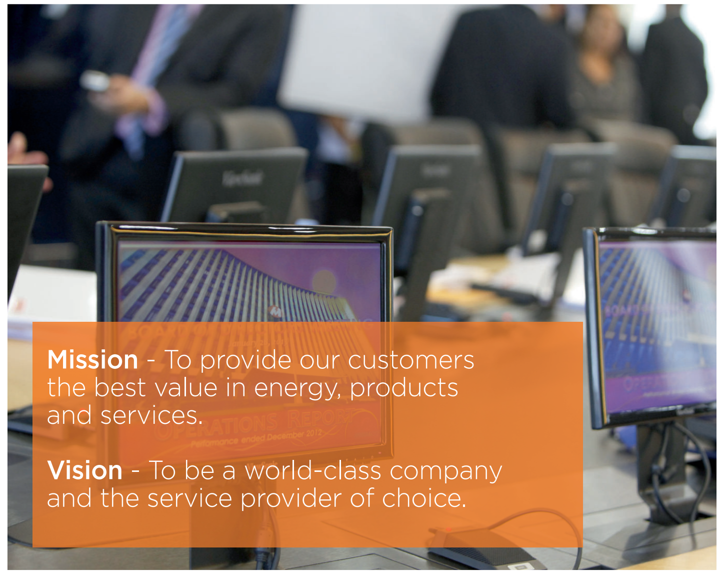
MERALCO

Corporate Governance Report

Meralco (or the "Company,") a publicly listed company in the Philippines, adheres to all the rules and regulations of the Securities and Exchange Commission (SEC) and the Philippine Stock Exchange (PSE); and in particular to those rules and regulations intended for the development of the Philippine capital market. The Company has regularly been cited as a leader in good corporate governance, locally and in the region by various reputable institutions. In 2012, the Company was named Employer of the Year by the Personnel Management Association (PMAP), and as Best in Asia on Investors Relations and Corporate Governance by Corporate Governance Asia, among others. Other major awards and recognitions received by the Company and its officers are listed on page 160 of this Annual Report.



I. RIGHTS OF THE SHAREHOLDERS

Because shareholder and customer interests are primary, we take every effort to protect and promote their interest. We ensure that all shareholders are treated equally. The Company welcomes the entry of all investors - retail and institutional. Institutional investors are entities which pool large sums of money and invest them in securities, real property and other investment assets. As at December 31, 2012, approximately 7% of the Company's shares were held by non-controlling institutional investors. The Company conducts quarterly briefings for analysts and investors. Briefings are conducted to provide equity investors information, which serve as a basis for assessing the Company's performance and a guide in any decision to invest. There is no deliberate effort to influence purchase of the Company's shares or divestment of all or portion of the investor's holdings.

All shareholders are given the opportunity to exercise their basic rights as described in the Company's Manual of Corporate Governance. These include the right to participate in the Annual General Meeting (AGM), the right to appoint a proxy to participate and vote in the AGM, the right to vote for the appointment and/or replacement of the members of the Board of Directors (BOD or Board), the right to vote on the performance of other corporate acts as prescribed by the Corporation Code of the Philippines, the right to vote for the appointment of external auditors, the pre-emptive right to subscribe in proportion to their shareholdings, the right to receive information in a timely manner and inspect the books and records of the Company, and the right to receive dividends in accordance with the policy agreed upon and approved by the shareholders during the AGM. The full description of the shareholders' rights is found in the Company's Manual of Corporate Governance, a copy of which is published in the Company's website, www.meralco.com.ph for ease of access and reference.

In addition, shareholders are given accurate, timely, complete and transparent updates of relevant events through the Company's website, the contents of which are in the English language. Included in these regular updates are the products and service offerings of the Company, business operations and locations, business offices contact numbers, shareholdings and corporate structures, corporate vision, mission and objectives. The website also provides downloadable copies of the Company's Articles of Incorporation, By-laws, Manual of Corporate Governance, Annual Reports issued in the last five years, Consolidated Financial Reports for the last three years, Notice of AGM, Information Statements, and other relevant Company disclosures, governance policies, rules and regulations. Earlier reports are posted in the Company's website.

The Company's Manual of Corporate Governance serves as the guide to ensure the equitable treatment of shareholders, who are given opportunities to participate in, and voting rights on, the following matters:

a) Changes and/or amendments to the Company's Articles of Incorporation and By-laws – In 2012, no such changes and/or amendments were made, which required the vote of shareholders.

b) Sale, purchase and/or transfer of a significant share of corporate assets that may result in a change in the character of the Company – In 2012, no such transaction took place, which required the vote of shareholders.

c) Authorization for the issuance of additional shares of the Company – In 2012, no such transaction took place, which required the vote of shareholders.

d) Opportunity to nominate candidates for membership in the BOD – Shareholders, minority included, participated in the nomination and election of the members of the 2012 BOD.

e) Opportunity to elect individually the members of the BOD – The Notice of 2012 AGM, sent to all shareholders included the profiles of all nominees for seats in the BOD, which include age, qualifications and experience, date of first appointment to the Board of the Company, and directorships in subsidiaries and other publicly listed corporations. Non-controlling shareholders were encouraged to exercise their right to vote and elect the Company's BOD.

f) Approval of the remuneration of all non-executive Directors – In 2012, there was no change in the remuneration of the BOD that required shareholder approval.

g) Appointment of external auditors – The Notice of 2012 AGM identified SyCip Gorres Velayo & Co., as the external auditors seeking re-appointment and the same was duly re-appointed by the shareholders.

In cases of acquisition of corporate control in the capital markets and other extraordinary transactions such as mergers and sales of substantial portions of the corporate assets, the Company, through its BOD, shall appoint an independent party to evaluate the fairness of the transaction. The Company shall also fully disclose such transactions, report on fair value and other terms and conditions, for better understanding by shareholders of their rights and course of action. There were none such transactions in 2012.

II. EQUITABLE TREATMENT OF SHAREHOLDERS

The Company adopts and observes the basic principle of "one vote for one share". In extraordinary circumstances where the Company may be required to issue special classes of shares that may result in a disproportionate claim on voting rights of shareholders, the Company shall fully disclose and justify such action. The Company shall also seek shareholder approval before taking such extraordinary action.

Annual General Meeting (AGM)

The Notice of 2012 AGM, together with other supporting information and documents, all in the English language, was sent by the Company through the Office of the Corporate Secretary to all stockholders of record as at March 16, 2012 on April 20, 2012, 39 days ahead of the AGM date. The Notice of 2012 AGM indicated the following: a) date, time and place of the meeting; b) profiles of the nominees and/or directors seeking election and/or re-election, including details such as age, qualifications, experiences, positions or directorships in other companies, and for re-electionists – the date of their first appointment; c) name and profile of the public accounting firm (external auditors) recommended for appointment; d) issues to be voted together with the opinion of the BOD and supporting documents that provide sufficient information for the shareholders to make a decision, and; e) brief description of the dividend policy and amount of final dividend declared.

The Company facilitates the attendance of all shareholders, including institutional investors in the AGM. Shareholders are encouraged to personally attend the AGM and if unable to do so, are advised of their right to appoint a proxy on their behalf. A copy of the proxy form was sent together with the Notice of AGM. Notarization of a proxy is not required but the proxy shall comply with the requirements under the law. All of the aforementioned AGM-related documents were also made available to the shareholders in the Company's website beginning April 20, 2012, thirty nine (39) days ahead of the AGM. Such information was provided well ahead of the scheduled AGM to allow the stockholders reasonable time to review the items in the agenda.

In 2012, the AGM was held on May 29, 2012 at the Meralco Theater, Lopez Building, Ortigas Avenue, Pasig City, a location which is very accessible to shareholders. Before the meeting commenced, the Corporate Secretary read the rules to be observed during the meeting. The voting rules and procedures were included in the Notice of 2012 AGM sent to all the shareholders ahead of the scheduled AGM and published in the Company website, as well.

The 2012 AGM was presided by the Chairman of the Board, Ambassador Manuel M. Lopez. Stockholders, representing 1,002,197,522 shares or approximately 88.9% of the total issued and outstanding common shares of the Company attended the meeting in person or by proxy. Also present at the AGM were the Company's President and Chief Executive Officer, Mr. Manuel V. Pangilinan, the Chairperson of the Audit Committee, Retired Chief Justice Artemio V. Panganiban, and all other members of the BOD elected at the AGM, except Atty. Estelito P. Mendoza. The report of the meeting was disclosed to the SEC and PSE within the day of the AGM. Detailed attendance of the BOD in the AGM is presented on page 46 of this Annual Report.

All Shareholders were given an equal opportunity to voice their opinions and raise questions during the meeting. The director or officer of the Company to whom the specific question was addressed, answered and provided clarifications to such question. Prior to the meeting, shareholders were also allowed to submit their questions through phone directly to the Stockholders Relations office at 632-8765 or via email to stockholder.affairs@meralco.com.ph.

The minutes of the meeting recorded in writing every resolution with detailed information on the number votes representing approval, objection and abstention for each agenda item. Questions, responses, opinions that were raised during the meeting were fully documented and made available for examination afterwards. Highlights of the 2012 AGM and Organizational Meeting were made available within the day after the said meeting and posted in the Company website at http://www.meralco.com.ph/pdf/corporategovernance/052912_AGM_MINUTES.pdf.

The Company strictly implements its dividend policy, approved by the BOD in 2010. The BOD approved the payment of regular cash dividends equivalent to fifty percent (50%) of the Consolidated Core Net Income for the year with a "look-back". The "look-back" policy allows the Company to pay special dividend of up to 70% of the Consolidated Core Net Income for the year subject to availability of unrestricted retained earnings, consistent with the guidelines of the SEC, and free cash. In 2012, the Company paid cash dividend of PhP8.10 a share to all its shareholders of record, consisting of PhP4 a share as final dividend out of the 2011 Consolidated Core Net Income and PhP4.10 a share as interim regular cash dividends out of the 2012 Consolidated Core Net Income. In addition, the Company distributed its 51% holdings in Rockwell Land, Inc. (Rockwell Land), through a property dividend declaration, to all shareholders of record as at March 23, 2012 at an equivalent 2.82 Rockwell Land shares for each Meralco share held, as part of its divestment from the real estate business. The Company paid out such property dividends on May 14, 2012, 17 days after receipt of final regulatory clearance from the SEC. Finally, on February 25, 2013, the BOD approved the declaration of the final dividend of PhP6.10 a share, inclusive of PhP2.89 a share special dividend on a look-back basis, or a payout of 70% out of the 2012 Consolidated Core Net Income.

Insider Trading Policy

The Company implemented its "Policy on Restrictions on Trading of Shares (or Blackout Period)" on July 16, 2010, setting the rules and explicitly prohibiting any shareholder, director, officer or employee from benefiting from knowledge not available to minority shareholders and/or the general public. All directors, officers, and certain employees with access to the Company's unpublished price-sensitive information, including their associates, are prohibited from trading Meralco shares in the stock market during the "Blackout Period."

The policy imposes the appropriate sanctions on any director, officer or employee found to have violated the provisions. The Company immediately discloses stock market transactions of Meralco shares of its directors and officers, as required by the SEC not later than three (3) business days from the date of the transaction.

Code of Ethics and Conflict of Interest Policy

The Company's Code of Ethics (COE) and Conflict of Interest Policy (COI) serve as the embodiment of its unwavering dedication to the fundamental corporate governance principles of fairness, accountability, integrity and transparency. All directors, officers and employees of the Company are required to read, understand and commit in writing, their compliance with the principles prescribed therein, which include the disclosure of any possible conflict of interest. The aforementioned persons are likewise prohibited from participating in any discussions, deliberations, and decision-making on any issue or transaction with the Company, where they maybe conflicted.

The Company prohibits the grant of loans or any special financial assistance to directors or any related party. Any exception to this rule is required to be duly justified. Moreover, any such loan or assistance may only be provided on an arm's-length basis, under terms and conditions that do not deviate from those of the market, and do not jeopardize the best interests of the Company.

Copies of the COE and COI have been provided to all directors, officers and employees during the corporate-wide road shows and are similarly accessible in the Meralco Portal and Meralco website.

In 2012, the Company enhanced the corporate governance awareness, compliance and monitoring through the launch of the HR Express Corporate Governance Facility. This facility is accessible in all computers deployed within the Company premises and is the means by which the Company implements and monitors compliance with its corporate governance policies.

III. ROLE OF STAKEHOLDERS

The Company strictly observes fairness, accountability, integrity and transparency in its obligations and dealings with its various stakeholders. The Company values its stakeholders and protects their rights, as mandated by relevant laws and internal policies. Sanctions and penalties based on the provisions of the Company's Code of Right Employee Conduct (COREC) and other related policies are imposed on anyone found to have violated these laws and policies.

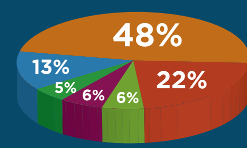
Shareholders

The Company honors the trust and commitment of its shareholders by promptly disclosing to the concerned regulators, stakeholders and the public in general, the Company's financial performance and other relevant events it is involved in. Disclosures are through Company press releases and filings with the SEC and PSE. The same press releases are posted in the Company website.

In compliance with the PSE requirements, a quarterly report of Meralco's top 100 shareholders is filed with the PSE and posted in the website.

Shareholders
(as at December 31, 2012)

- Beacon Electric Asset Holdings, Inc.- (544.442.898)
- San Miguel Corporation- (241,872,280)
- SMC Global Power HOldings Corporation- (69,059,538)
- PCD Nominee Corporation (Filipino) - (66,636,795)
- San Miguel Purefoods Company, Inc.- (59,090,909)
- Others - with < 5% shares- (145,996,844)



The complete list of the " List of Top 100 Stockholders as at December 31,2012" was filed with the PSE on January 10, 2013.

The Shareholders chart presents the security ownership of beneficial owners of more than 5% of any class of the Company's voting securities, as recorded in the stock and transfer book as at December 31, 2012.

The Company has 47,892 stockholders as at December 31, 2012 with 46,601 holding at least more than one (1) board lot. Meralco's public ownership level as of this date, as submitted to the PSE, is 13.37%.

Customers

The Company's main priority is to provide customer satisfaction in the distribution of electricity. In line with this, the general health and safety concerns of customers and the public are centrally managed by the Company's Environment, Safety and Health Office. Business Centers and Extension Offices also manage and address health and safety concerns of the customers.

Our safety programs include a campaign on kite-flying safety, the emergency hotline number 16211, and the Company's inclusion of a five percent (5%) weight for adherence to safety standards in the performance rating of all contracted services. Please refer to the section Environment, Safety and Health Policy of this Annual Report, for the details of the health and safety programs of the Company.

The Company also has a dedicated "Customer" section in its website (http://www.meralco.com.ph/consumer-index.html) where it publishes up-to-date and relevant information for customers, including products and services, customer service policies and programs, locations of our business offices, customer contact points, among others and through which the customers may voice their concerns/or complaints arising from any violations of their rights.

Suppliers

The Company's suppliers are expected to adhere to the Company's fundamental principles of fairness, accountability, integrity and transparency and commitment to high standards of business ethics. Part of the requirements for accreditation is the supplier's written commitment the Company's Suppliers Business Conduct (SBC) policy. Only accredited suppliers will be considered for inquiry, participation in bids and award.

A sourcing plan is prepared for all purchases, indicating the criteria and sourcing method to be used for the selection of the supplier, and the same passes through the Procurement hierarchy for approval. A pre-bid conference is conducted with prospective bidders, in coordination with the end-user, to enable prospective bidders to determine site conditions and other requirements that may not be apparent in the bid documents.

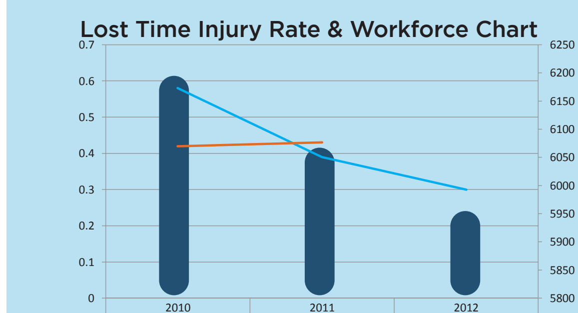
Corporate Audits conducts a regular random audit to determine compliance with the bidding process.

Employees

The Company is committed to the development and welfare of its employees. Training programs and other developmental interventions are implemented to enable employees to acquire the technical and leadership competencies to effectively perform their jobs for their professional growth. Learning and development initiatives are delivered using the 70-20-10 framework: 70% on-the-job learning, 20% from coaching and feedback and 10% formal training. All training and development programs are communicated to the employees through a general internal announcement and are posted in the Company's website.

An integrated approach to workplace health, wellness and safety programs is also implemented by the Company. The Orange Fit program promotes a healthy lifestyle for all employees through company sponsored sports tournaments and exercise programs. Employee safety is also of utmost importance to the Company. Thus, it implements programs such as executive safety visit at the worksite, Company-wide earthquake forum, and contractor summit.

2012 Safety and Health Performance



	2010	2011	2012
Workforce	6203	6071	5960
LTIR	0.58	0.39	0.30
OGP Average*	0.42	0.43	

Workforce — LTIR GP — Average*

* OGP 2012 data reports not available until May 31, 2013.

The Lost Time Injury Rate represents the number of Lost Time Injuries per 1,000,000 of worked man-hours. Meralco's LTI Rate has moved better than the global average in 2011 as benchmarked with the International Association of Oil and Gas Producers.

The improvements in Occupational Safety and Health Management practices continues as the company works together for an integrated ISO 18001 & 14001 certification.

Employees are compensated based on performance, overall qualifications and market competitiveness. Recently, the Company implemented RACE: Revving up to Achieve a Culture of Excellence, an enhanced performance management system. It enabled organizational units and employees to identify significant contributions and establish accountabilities in the attainment of the Company's strategies and plans. A Long-Term Incentive Plan based on the achievement of corporate performance targets, measured in terms of the Consolidated Core Net Income for a 3 year-performance period, was also implemented beginning 2010 for qualified employees at the managerial and executive positions, in order to fully support the attainment of the Company's strategic objectives and help retain key talents.

The Company sustains a high level of engagement with employees through programs such as the Leaders Briefing, One Meralco: Cool-tural Festival, MVP Olympics and Orange Fit. Employee communication is facilitated with regular updates through the new HR Online – Usapang M3. This keeps employees well informed on significant developments. Employees are likewise encouraged to give feedback and suggestions to Management to further improve corporate and operational performance, thereby promoting employee accountability and empowerment.

Creditors

The Company respects the rights of its creditors and strictly abides by its obligations to all creditors. The Company also consistently, promptly and accurately reports to creditors its financial standing. The rights of creditors are safeguarded by the Company through its faithful compliance to the terms and conditions of its agreements with its creditors.

Competitors

We treat our competitors and players within the electricity industry supply chain with respect and are always guided by professionalism and integrity in dealing with them. We avoid taking undue advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other form of deceptive practice.

Government and Community

Launched in July 2011, One Meralco Foundation, Inc. (OMF) serves Filipinos through innovative and sustainable Corporate Social Responsibility (CSR) initiatives aligned with the Company's power distribution business, which is rapidly evolving to make it a total energy solutions provider. OMF rallies employees, business and government partners to carry out long-term and sustainable programs in four areas:

1. Community Electrification - To develop feasible alternatives to provide depressed communities with electricity, through socialized schemes, for these beneficiaries, in partnership with Local Government Units (LGUs), Non- Government Organizations (NGOs), and other community institutions.

2. Grassroots Partnerships - To create programs that build strong partnerships with various stakeholders in the communities for public safety, responsible stewardship and community development.

3. Youth and Sports Advocacy - To implement educational and sports program for disadvantaged youth to develop their life-long skills.

4. Emergency Preparedness and Disaster Response - To closely work with disaster management agencies of the government and partner organizations.

A more comprehensive report on the Company's CSR efforts is found on page 32 of this Annual Report and in a separate publication of OMF's 2012 Annual Report, entitled, "Dream, Believe, Achieve", which is available in www.meralco.com.ph.

Environment, Safety and Health (ESH) Policy

Further to its desire to address environmental concerns, the Company expressed its commitment to take action and responsibility on climate change by preventing pollution through the optimal use of natural resources, minimization of wastes generated by our processes and being an active partner in reforestation. It has also committed to continually improve its ESH management system to be at par with global best practices.

Compliance with ESH laws and Environment-Friendly Value Chain

Further to the Company's ESH Policy, it is committed both to implementing an environmentally-friendly value chain and to comply with all pertinent environmental laws. The programs which include solid waste management, water conservation, air pollution control, and wastewater management have been implemented by the Company. Another program is the proper management of treated wastewater, which are now being recycled for the cooling towers of the Company's main headquarters. The Company led the protection and management of the 927-hectare Meralco Tree Farm located in Rodriguez, Rizal. The Company also implements a Clean Fleet Management program, which has resulted in a total of 100 tons of CO_2 avoidance because of the improvement in vehicle fuel efficiency.

Be Right (Open Communication) Policy & Anti-Corruption Program

In 2010, the Company launched the BE RIGHT Communication Policy, which promotes responsible and free interaction between Management and its stakeholders, including its employees. The policy consists of two (2) programs.

1. E-suggest Mo – A program that harness employees bright ideas and suggestions that will save on operating costs, increase revenues, improve work and service quality, workplace efficiency and service to customer and other stakeholders. Recognitions and rewards are given to the viable and qualified ideas and suggestions.

2. E-Report Mo – A whistle-blowing program that provides a comprehensive channel for reporting any

violation or misconduct by the Company's directors, officers, employees and suppliers, through hotlines, emails, fax and the Company website. The Company provides appropriate protection for the whistle-blowers against retaliation. Any stakeholder may use the E-Report Mo reporting channel, prominently displayed in the Company website. The Corporate Governance Office immediately acts on the reports received through the E-report channel. The full details of this program are available in the Company website.

IV. DISCLOSURE AND TRANSPARENCY

In compliance with the principle of accurate, adequate and timely disclosure and transparency, the Company made the following disclosures in 2012, among others:

a) Annual certification and compliance with Corporate Governance policies, confirming the Company's full compliance with the Code of Corporate Governance. Non-compliant area, if any, was identified, clarified and explained. The Company's Revised Manual of Corporate Governance was filed with the SEC last March 30, 2011. Copies of such disclosures and other relevant corporate documents including BOD Committee Charters may be viewed at the Company website.

b) Shareholders' information, with the identities of beneficial owners with five percent (5%) or more shareholdings.

c) Direct and indirect shareholdings of major and/or substantial shareholders.

d) Direct and indirect shareholdings of the Company's directors, senior management and officers, including details of their trading of Company shares, if any.

e) Details of the subsidiaries, associates, joint ventures and special purpose enterprises/vehicles, as applicable.

f) Conduct of quarterly briefing for analysts and the media immediately after the approval by the BOD of the Company's consolidated financial report.

g) The first to third quarter unaudited financial statements, and full year Audited Financial Statements including Management's Discussion and Analysis, which were posted in the Company's website within one day after filing with the PSE and the SEC. Highlights of the Company's 2012 Audited Consolidated Financial Statements were released last February 25, 2013. The Management Responsibility Statement accompanying the Audited Consolidated Financial Statements was signed by the Chairman of the BOD, the President and Chief Executive Officer, and the Chief Finance Officer, a copy of which is presented on page 81 of this Annual Report.

h) Consolidated Operating and Financial Results of the Company, as well as changes in the Company's ownership structure and business group structure.

All the foregoing information were disclosed to and are available in the websites of the pertinent regulatory institutions, namely, the SEC (www.sec.gov.ph) and the PSE (www.pse.com.ph). The same information is available in the Company website (www.meralco.com.ph).

Interested parties may also visit or call the Company's Investors Relations Office or Stockholders Affairs Office or email them at investor.relations@meralco.com.ph regarding these matters. Details of the contact information and complete address are indicated on page 161 of this Annual Report.

V. BOARD RESPONSIBILITY

Our Company has adopted the SEC's Revised Code of Corporate Governance in defining the roles, duties and responsibilities of our BOD. The duties and responsibilities of the BOD include, but are not limited to the formulation, periodic review and approval of the Company vision, mission, strategic objectives, policies and procedures that guide its activities; the approval, adoption and pro active oversight of the execution of the corporate strategy; formulation, adoption and oversight power in the execution of corporate policy including corporate governance; oversight power on risk management; setting up of an accountability system with the inclusion of rewards, incentives and penalties; and the promotion of an ethical, social and good governance culture in the Company. A complete list of the BOD duties and responsibilities are detailed in the Revised Manual of Corporate Governance which is accessible to all interested parties at the Company website. Also, all matters brought to the BOD for approval which includes acquisitions, disposals, issuance of shares, financial restructuring, among others, are disclosed and filed with the PSE and the SEC.

VI. BOARD PROTOCOL

The Company's BOD follows a protocol, which contains clear and specific guidelines on internal BOD processes.

The following are the structure and composition of the Company's BOD:

1. The Board consists of eleven (11) directors who are elected by the stockholders during the AGM to serve for a period of one (1) year from election. The BOD consists of two (2) independent directors, eight (8) non-executive directors, and one (1) executive director. The BOD clearly delineates its responsibilities with that of Management, which are described in detail in the Company's Revised Manual of Corporate Governance.

2. **Qualification of Independent Director** - the Company complies with Rule 38 of the Implementing Rules of the SRC on the qualifications, nomination and election of independent directors. Independence is defined as having no business or other relationship with the Company that could reasonably be perceived to materially interfere with the exercise of independent director's judgment in carrying out his responsibilities as a director. The Company is also governed by SEC Circular No. 9, Series of 2011, which sets the term limits and qualifications in nominating an independent director and ensures that the nominee is independent of management and major/substantial stockholders. These qualifications and limitations include: (a) only individuals who exercise independent judgment and with no close relationship, either by blood (within the third degree of consanguinity) or marriage, with significant stockholders, the CEO or any member of our Company's top management team; (b) only individuals who have not served the Company as an officer or significant service provider (including that as the Company's external auditors), unless two (2) years have elapsed since the termination of that service; (c) only individuals who have not served as an independent director of the Company for more than five (5) consecutive years; no re-nomination as independent director within two (2) years after the expiration of the five (5) consecutive years of service; and a total term limit of ten (10) years of service as an independent director, after which he shall be perpetually barred from being elected as such in the Company. The identity of the Company's independent directors is clearly disclosed to the SEC and posted at the Company website immediately after their election at the AGM. No one among the Company's independent directors has served as such for more than nine (9) years. Please refer to the section on "Board of Directors" for details on the term of appointments of our independent directors.

3. The "skills and competencies" required of the BOD include:

a) At least one (1) non-executive director should have had prior work experience in the sector or broad industry group to which the Company belongs. In 2012, Ambassador Manuel M. Lopez was a non-executive director of the Company. He was the Chairman, President and CEO of the Company in different periods from 2001 to 2010. Please refer to the Board of Directors section on page 52 of this Annual Report for the complete profile of our directors.

b) Directors are required to attend an orientation program on corporate governance as well as continuing education programs on corporate directorship. Last November 19-20, 2012, the Company invited an internationally renowned speaker on corporate governance and ethics, Dr. Thomas Donaldson, a Mark O. Winkelman Professor and Director, of the Wharton Doctoral Program in Ethics and Law of the Wharton School, University of Pennsylvania, to talk on recent developments on ethics, strategy and reputation risk.

c) Newly elected directors are required to attend an orientation covering the Company's business and overall structure, overview of the power industry and industry regulations and the Company's corporate governance principles, policies and regulations. On July 20, 2012, the newly elected director, Mr. Jose Ma. K. Lim attended an orientation on the Company's human resources, corporate governance and regulatory management structures and practices.

4. The Company strictly complies with the its internal control policies concerning BOD processes as listed in the Revised Manual of Corporate Governance, By-Laws and Articles of Incorporation, which state:

a) The role and responsibilities of the Chairman of the BOD include, among others, addressing satisfactorily any governance-related issues that non-executive independent directors may raise. In particular, the Chairman of the BOD has the responsibility to ensure that the BOD exercises strong oversight over the Company and its management, such that any operational, financial or corporate reputation risk is addressed. His detailed roles and responsibilities are specified in the Company's Revised Manual of Corporate Governance which is accessible at the Company website.

b) The separate roles and responsibilities of the Chairman of the BOD from that of the CEO and provides that the same shall be held by two different persons. In 2012, Mr. Manuel V. Pangilinan, a non-executive director, was the elected Chairman of the Board and Mr. Oscar S. Reyes was elected as the President and CEO.

Board Nomination and Selection Criteria

As prescribed by the Company's By-laws, all members of the BOD are elected by the shareholders during the AGM meeting. The Nomination and Governance Committee (Nom&Gov) prepares the final list of candidates, which is made available to the SEC and to all stockholders through the filing and distribution of the Information Statements. Members of Nom&Gov are guided by the criteria set in the Company's Revised Manual of Corporate Governance in screening and selecting nominees for directors. In addition to the criteria mentioned under Board Protocol, the following qualifications are also considered: a) possesses college education or skills needed to effectively carry out his functions as director; b) possesses integrity/probity; c) has strong adherence to legal and moral principles, and; d) with practical understanding of the business in general and of the Company's business, in particular.

The Revised Manual of Corporate Governance, which is posted on the Company website, discloses the following: a) criteria used in the selection and nomination of members of the BOD; b) the process by which it considers candidates for nomination to the Company's BOD such as the proper profiling of the skills and competencies of the currently serving Directors, the gaps in skills and competencies identified, and the search for candidates to fill the gaps; c) the process it follows in selecting the CEO and in installing succession planning for the position of CEO and all key senior officer positions of the Company; d) the process and criteria for conducting an annual performance appraisal of the entire BOD, the BOD committees, and individual directors; and e) attendance of the members to the Committee meetings.

Board Meetings and Attendance

At the start of the year, the BOD and Board Committees set their schedule of meetings, following the schedules prescribed under the Company's By-

SUMMARY OF THE ATTENDANCE PERFORMANCE OF THE DIRECTORS				
Member	**Designation**	**Annual General Meeting**	**Organizational Meeting**	**Board Meetings**
Manuel V. Pangilinan[3]	Chairman	Present	Present	10/12
Ramon S. Ang	Vice-Chairman and Director	Present	Present	12/12
Manuel M. Lopez	Director	Present	Present	11/12
Jose Ma. K. Lim[5]	Director	N/A	Present	6/7
Ray C. Espinosa[4]	Director	Present	Present	12/12
Estelito P. Mendoza	Director	Not Present	Not Present	8/12
Artemio V. Panganiban[2]	Independent Director	Present	Present	12/12
Vicente L. Panlilio	Director	Present	Present	11/12
Eric O. Recto	Director	Present	Present	11/12
Oscar S. Reyes	Director	Present	Present	12/12
Pedro E. Roxas[1]	Independent Director	Present	Present	10/12
Napoleon L. Nazareno[5]	Director	Present	N/A	5/5

[1] Chairman, Nomination and Governance Committee
[2] Chairman, Audit and Risk Management Committee
[3] Chairman, Remuneration and Leadership Development Committee
[4] Chairman, Finance Committee
[5] Mr. Jose Ma. K. Lim was elected on May 29, 2012 vice Mr. Napoleon L. Nazareno

laws and Board Committee Charters. The schedule is then disseminated, in advance, to all directors for their guidance.
a) A total of twelve (12) board meetings were held in 2012, which were determined at the beginning of the year. Four (4) directors registered complete attendance and the remaining seven (7) Directors attended at least 83% of the said meetings.

b) Materials and related supporting documents to be used in the meetings of the BOD and BOD committees were distributed at least five (5) working days prior, to give sufficient time for the directors to review them.

c) Directors are required to be present in at least 50% of the regular and special meetings of the BOD. In 2012, none of the directors had attendance in BOD meetings below 75%.

d) The Company encourages and arranges for all of its non-executive directors to convene an executive sessin to discuss the performance of management and other related matters.

Performance Assessment

On February 25, 2013, an integrated Board and Board Committee assessment was performed to evaluate the specific, overall and committee performance of the individual directors, as a whole BOD, and various Committees for 2012.

As required under the Revised Code of Corporate Governance of the SEC and Meralco's Revised Manual of Corporate Governance, three (3) assessment instruments were accomplished by the directors:

1. Board Self-Assessment – each director assessed the board performance as a whole and their individual performance on the following categories:

a) Board Structure
b) Board Duties and Responsibilities
c) Duties and Responsibilities as an Individual Director

2. General Board Committee Performance Assessment – each director assessed the overall performance of the following committees, based on the provisions of the Board Committee Charters:
a) Nomination and Governance Committee
b) Audit and Risk Management Committee
c) Remuneration and Leadership Development Committee
d) Finance Committee

3. Board Committee Self-Assessment - each committee member assessed their performance vis-à-vis their respective charters and SEC Memo Circular No. 4, Series of 2012 "Guidelines for the Assessment of the Performance of Audit Committee of Companies Listed on the Exchange".

Details of the assessment instruments used are available in the Company website (http://www.meralco.com.ph/pdf/corporategovernance/Board_Assessment_Forms.pdf).

The BOD also regularly conducts performance reviews of the President and CEO, based on the attainment of key performance indicators and corporate goals. In 2012, the President and CEO's performance review was conducted in the January 28, 2013 BOD meeting.

Succession Planning for the President/CEO and Senior Management

The Meralco Board and the Board Remuneration and Leadership Development Committee are responsible for overall guidance and direction on succession planning and leadership development of the President/CEO and Senior Management. The President and CEO, working closely with the Head of Human Resources, drives the strategy for succession planning, leadership development and talent management. The Head of Human Resources develops and implements the processes and the tools to ensure robust pools of succession candidates for the President/CEO, Senior Management, Middle Management and First Line Management.

A key feature of Meralco's succession planning process are the talent reviews that are conducted at Senior Management and at various levels in the organization. Currently, this has resulted in a pool of about 30 candidates who, subject to the realization of their development plans, could become management committee level within the next 5 years.

The talent reviews have been a hallmark of our process and is a best in class talent management practice. The process deliverables are individual development plans designed to bring the key talent to their next level of growth and performance and/or realize their career aspirations. It involves authentic and extensive management discussions and deliberations by leaders of these key talents on their aspirations, strengths, development needs and challenges.

All of these have created a development mindset throughout the organization and have established a strong and robust leadership pipeline that will adequately meet Meralco's senior leadership requirements well into the future.

Board Remuneration

The Company's directors do not receive any compensation other than the BOD-approved per diem for their attendance in the BOD and Board Committee meetings. In 2012, there was no change in the remuneration package of directors which would require separate approval of the shareholders. Each director was entitled to a director's fee of One Hundred Twenty Thousand Pesos (PhP120,000) for each BOD meeting attended. Each member or advisor of the different committees (Nom&Gov, Rem&LD, Audit&Risk and Finance) was entitled to a fee of Twenty Thousand Pesos (PhP20,000) for every committee meeting attended.

VII. BOARD COMMITTEES

The BOD formed five (5) committees to ensure compliance with the principles of good corporate governance.

The members of the committees were appointed by the BOD during the organizational meeting held immediately after the AGM. All committees have approved charters defining and specifying the scope of their responsibilities. Copies of the Board Committee charters were disclosed to the SEC and are also available in the Company website.

The functions, authority and responsibilities of each BOD committee, their accomplishments and Board committee members' attendance are as follows:

A. Executive Committee or ExCom – This Committee is composed of five (5) directors, one of whom is an independent director. The ExCom may act, by majority vote of all its members, on such specific matters within the competence of the BOD, as may be delegated to it under the By-Laws, or upon a majority vote of the BOD, subject to the limitations provided by the Corporation Code of the Philippines.

The Executive Committee is composed of Manuel V. Pangilinan, Chairman; Ramon S. Ang, Vice Chairman; Members Eric O. Recto, Manuel M. Lopez, and Justice Artemio V. Panganiban, Independent Director. There were no corporate actions on matters that arose between scheduled BOD meetings which required the convening of the Executive Committee during 2012.

B. Remuneration and Leadership Development Committee or Rem&LD – This Committee is composed of four (4) directors, one of whom is an independent director. The duties and responsibilities of Rem&LD as defined in its charter include oversight and support to the BOD in the development of the Company's overall performance management, compensation, retirement and leadership development policies and programs based on the Company-approved philosophy and budget.

Rem&LD had four (4) meetings in 2012 as shown in the table below. In 2012, the Rem&LD: a) updated the BOD on the status of the employees' Long-Term Incentive Plan; b) evaluated the 2012 employee performance results, and proposals for the 2013 and 2015 performance management system and incentive plans; c) initiated the conduct of the 2012 performance evaluation of the President and CEO; d) reviewed and confirmed the appointment of officers, and; e) reviewed and confirmed the applicability of the existing Rem&LD Committee charter.

Summary of the Attendance Performance of the Rem&LD

Member	Designation	Attendance
Manuel V. Pangilinan	Chairman	4/4
Jose Ma. K. Lim[1]	Member	3/3
Eric O. Recto	Member	3/4
Pedro E. Roxas [2]	Member	4/4
Napoleon L. Nazareno[1]	Member	1/1

[1] Mr. Jose Ma. K. Lim was elected on May 29, 2012 vice Mr. Napoleon L. Nazareno
[2] Independent Director

Towers Watson was engaged by the Company to provide consultancy services and solutions in the areas of performance and rewards. Their work served as inputs to the Rem&LD. Towers Watson is an independent consultant i.e., they have no conflicts of interests with the Company or any of its BOD, Senior Management and Employees.

C. Nomination and Governance Committee or Nom&Gov – This Committee is composed of four (4) directors with an independent director as chairman. The duties and responsibilities of Nom&Gov as reflected in its charter includes screening qualified nominees for election as directors, assessing the independence of directors, introducing improvements on BOD organization and procedures, setting-up of mechanisms for performance evaluation of the BOD and Management, and providing programs for continuing education of the BOD.

The Nom&Gov Committee had three (3) meetings in 2012. Included among the 2012 accomplishment of Nom&Gov are: a)screened and selected the nominees for election as members of the BOD; b) reviewed the rules on nomination of candidates, validation of proxies, and appreciation of ballots; c) reviewed the charter of the different BOD committees; d) reviewed and endorsed to the BOD the revisions in the AuditCom charter; e) conducted the BOD and Board Committee self-assessment and evaluated its results; f) reviewed and endorsed for BOD approval the corporate governance compliance assessment of the Company; g) facilitated the conduct of annual corporate governance enhancement program for the BOD and Senior Management.

Summary of the Attendance Performance of the Nom&Gov

Member	Designation	Attendance
Pedro E. Roxas [1]	Chairman	3/3
Jose Ma. K. Lim[2]	Member	1/2
Ray C. Espinosa	Member	3/3
Estelito P. Mendoza	Member	1/3
Napoleon L. Nazareno[2]	Member	1/1

[1] *Independent Director*
[2] *Mr. Jose Ma. K. Lim was elected on May 29, 2012 vice Mr. Napoleon L. Nazareno*

D. Audit and Risk Management Committee or AuditCom – This Committee is composed of five (5) directors and one (1) non-director member. All of the six (6) members are non-executive directors, two (2) of whom are independent directors and majority of whom have background in finance and accounting. The AuditCom is chaired by an independent director. Ms. Annabelle L. Chua, Chief Finance Officer of Smart Communications, Inc. and Treasurer of Philippine Long Distance Telephone Company is a non-voting member of AuditCom to help in the performance of the Committee functions, given her expertise in finance, accounting and auditing process. Please refer to the section on BOD for the detailed profile of the members of AuditCom.

The primary role and responsibility of the AuditCom is to assist the BOD in its oversight responsibilities with respect to the financial reporting process, the system of internal control, the audit process, risk management process, and the Company's process of monitoring compliance with laws and regulations.

The AuditCom charter is reviewed and assessed annually, subject to BOD approval for proposed changes and appropriate disclosure as may be required by law or regulation. The terms of reference as set out in the Revised Manual of Corporate Governance and the Audit and Risk Management Charter are available in the Company's website.

The AuditCom had eight (8) meetings in 2012. Included in the 2012 accomplishment of AuditCom were: a) review of the Company's consolidated audited annual and unaudited quarterly financial statements, ensuring that no revisions are necessary for reasons other than mandated changes in accounting practices; b) review of risk management structure, systems and processes and activities; c) evaluation of the external auditor's performance, scope and work and fees; d) review of internal audit performance, audit plan and status report; e) review and assessment of management's process of monitoring compliance with relevant laws and regulations; f) approval of external quality assessment review for the internal audit activity; g) evaluation of BOD Committee self-assessment results; h) review of the AuditCom charter; and i) assessment of the Committee's performance for the year.

Summary of the Attendance Performance of the AuditCom

Member	Designation	Attendance
Artemio V. Panganiban [1]	Chairman	8/8
Jose Ma. K. Lim[2]	Member	2/3
Vicente L. Panlilio	Member	8/8
Eric O. Recto	Member	7/8
Pedro E. Roxas [1]	Member	7/8
Napoleon L. Nazareno[2]	Member	4/5
Anabelle L. Chua[3]	Member	6/8

[1] *Independent Director*
[2] *Mr. Jose Ma. K. Lim was elected on May 29, 2012 vice Mr. Napoleon L. Nazareno*
[3] *Non-voting member*

Details of the AuditCom structure, roles and responsibilities and activities for 2012 are in a separate section Audit and Risk Management Committee Report of this Annual Report.

E. Finance Committee or FinCom – This Committee is composed of four (4) directors, one of whom is an independent director, with the Chief Finance Officer (CFO) as ex-officio member. The Committee reviews the financial operations of the Company and matters regarding major purchase contracts, and acquisition and/or divestment of investments, businesses or ventures.

The FinCom had a total of ten (10) meetings in 2012. Some of its major accomplishments for 2012 are: a) reviewed and recommended the approval of the 2012 consolidated corporate budget; b) reviewed and recommended the approval of the medium-term financial plans; c) recommended the approval of cash dividend declarations for common and preferred shares; d) reviewed the quarterly cash projections and finance operations reports; e) recommended the redemption on the callable preferred shares; f) reviewed the proposals for new debts and refinancing of existing obligations; g) reviewed investment plans; h) reviewed and recommended the funding of the Meralco Pension Fund; i) recommended the approval of the divestment from the real estate business; j) reviewed and recommended major purchase contracts; k) approved the disposal of assets no longer needed in the operations; and l) recommended approval of bank accreditation and signing authorities.

Summary of the Attendance Performance of the FinCom

Member	Designation	Attendance
Ray C. Espinosa	Chairman	10/10
Manuel M. Lopez	Member	8/10
Eric O. Recto	Member	9/10
Pedro E. Roxas [1]	Member	6/10
Anabelle L. Chua[2]	Member	8/10
Ferdinand K. Constantino[2]	Member	6/10

[1] Independent Director
[2] Non-voting member

VIII. BOARD SECRETARY

The Office of the Corporate Secretary is tasked to provide adequate and reasonable assistance to the BOD and its members thereby playing a significant role in supporting the BOD in the discharge of its functions. Among the duties of the Office are the following: a) schedule and inform all members of the BOD ahead of the meetings and other related activities; b) provide the necessary BOD materials associated with items in the meeting agenda at least five business days prior to the BOD meetings; c) provide ready and reasonable access to information that directors may need for their deliberation on issues listed on the agenda of the Board; d) conduct orientation for new members of the BOD regarding the Company's organizational structures and business operations; e) attend all BOD meetings and maintain records of the same, ensuring proper safekeeping of all records; f) ensure that all BOD procedures, rules and regulations are faithfully followed; g) submit required reports and disclosures to the SEC, PSE and other regulatory agencies, and h) assist the Board in making business judgement in the performance of their duties.

Atty. Simeon Ken R. Ferrer, was re-appointed as Corporate Secretary for 2012. He meets the following qualifications and skills, all of which are required of the Company's Corporate Secretary: a) resident Filipino citizen of good moral character; b) with adequate legal, administrative, basic accountancy, company secretarial and interpersonal skills; c) with continuing education and regular update of the laws, rules and regulations necessary for his position; d) with working knowledge of the operations of the Company and loyal to the Company's mission, vision and objectives.

Atty. Ferrer has been serving as the Company's Corporate Secretary since May 29, 2009. His appointment was disclosed to the SEC and PSE immediately after the organizational meeting of the Board. Please refer to the section Corporate Officers of this Annual Report for the detailed profile of Atty. Ferrer.

IX. EXTERNAL AUDITOR

The Company's external auditors, SyCip, Gorres, Velayo & Co. (SGV) were evaluated, nominated and recommended for appointment including their audit fees by the AuditCom, and such recommendation was approved by the BOD. The re-appointment of SGV was thereafter confirmed by the shareholders in the AGM held on May 29, 2012.

Consolidated External Auditors' Fees (in million PhP)		
	2012	2011
Financial statements audit	6.3	9.2
Tax services	-	1.0
Total	6.3	10.2

X. INTERNAL AUDITOR

The internal audit of the Company is an independent activity within the organization. The Company's internal audit group led by Chief Audit Executive, Ms. Helen T. de Guzman, provides assurance and consulting services to the BOD and top management on the adequacy and effectiveness of internal control, risk management and governance processes through systematic and disciplined approach in their evaluation to help improve operations and enable the Company to achieve its goals. Internal audit services are performed in accordance with the International Standards for the Professional Practice of Internal Auditing.

To maintain independence of the internal audit group, the Chief Audit Executive reports functionally to the AuditCom and administratively, to the President and CEO in a manner outlined in the Internal Audit Charter. The Internal Audit Charter authorizes the internal audit group to have unrestricted access to all functions, records, property, and personnel for the specific purpose of the audit and have free and full access to the AuditCom. The appointment or replacement of the Chief Audit Executive is reviewed and confirmed by the AuditCom to ensure that the internal audit organization shall be free from interference by outside parties in the performance of its work.

XI. RISK OVERSIGHT

The Company believes that management of risks across the enterprise is an anticipatory, proactive process that has to be embedded in the corporate culture and is a key component of strategic planning, business planning and operational management. Enterprise-wide Risk Management is integrated into existing business processes, envisioned to become part of regular day-to-day activities of all business units, where practicable. The Company's risk management policy manual, approved in September 2009, provides a robust risk management framework aimed to help the Company grow shareholder value. This has been disclosed to the pertinent regulating authority and is available at the Company website. In 2011, the Company expanded its Risk Management function and scope to include the identification and verification of critical business risks of its subsidiaries.

In 2012, the Company engaged the services of KPMG – Manabat Sanagustin & Co. to conduct a high-level risk assessment to determine the significant risks of the Company. As a result, key business risks were identified, sourced and measured, and presented to the BOD for review and approval. The Company's risk profile and its customized risk dictionary were updated accordingly. The risk dictionary facilitated the understanding of identified risks and enabled the risk owners to speak a common language.

XII. RELATED PARTY TRANSACTIONS

The FinCom reviews and approves all major purchase contracts, and acquisitions and/or divestments of investments, businesses or ventures involving Fifty Million Pesos (PhP50,000,000) and above.
Any dealing with a related party is likewise done at an arm's-length basis in a manner similar to the transactions with third parties. The Company fully discloses its related party transactions (RPT) in accordance with the revised Philippine Financial Regulatory Standards (PFRS). The nature, extent and other material information of these transactions are disclosed to the SEC and PSE through the consolidated financial statements and annual report within prescribed schedules.

Please refer to page 132 of this Annual Report for the details of RPTs for 2012.

Board of Directors

MANUEL V. PANGILINAN, 66
Director (since May 26, 2009 – 3 years)
President and CEO (July 1, 2010 to May 28, 2012)
Chairman (since May 29, 2012)

Mr. Pangilinan is the Chairman of Philippine Long Distance Telephone Company*, Smart Communications, Inc., Metro Pacific Investments Corporation*, Beacon Electric Asset Holdings, Inc., Philippine Communications and Energy Ventures Inc., Landco Pacific Corporation Medical Doctors, Inc. and Colinas Verdes Corporation (operating Makati Medical Center and Cardinal Santos Medical Center, respectively), Davao Doctors Inc., Riverside Medical Center, Inc. in Bacolod City, Our Lady of Lourdes Hospital, Asian Hospital, Inc., Maynilad Water Services Corporation, Mediaquest, Inc., Associated Broadcasting Corporation (TV5), Philex Mining Corporation* and Manila North Tollways Corporation. He is the Chief Executive Officer and Managing Director of First Pacific Company Limited, a publicly-listed company in Hong Kong and Co-Chairman of the newly-organized US-Philippines Business Society. He was a member of the Board of Overseers of The Wharton School, University of Pennsylvania. He is the Chairman of the Board of Trustees of San Beda College and was Chairman of the Board of Trustees of the Ateneo de Manila University. Mr. Pangilinan holds a Bachelor of Arts degree, cum laude, in Economics from the Ateneo de Manila University and a Masters in Business Administration from Wharton School of Finance and Commerce, University of Pennsylvania, where he was a Procter & Gamble Fellow.

RAMON S. ANG, 58
Director and Vice Chairman
(since February 1, 2009 – 3 years)

Mr. Ang is the Vice Chairman, President and Chief Operating Officer of San Miguel Corporation*. He is the Chairman and Chief Executive Officer of Petron Corporation*, Petron Marketing Corporation and SMC Global Power Holdings Corporation. He is the President and Chief Operating Officer of PAL Holdings, Inc.* and Philippine Airlines, Inc. He is the Vice Chairman of Ginebra San Miguel, Inc.*, San Miguel Pure Foods Company, Inc.* and San Miguel Yamamura Haiphong Glass Co. Limited (Vietnam) and a Director of Air Philippines Corporation. He is the Chairman and President of San Miguel Properties, Inc., San Miguel Consolidated Power Corporation, San Miguel Electric Corporation, San Miguel Energy Corporation, SMC Consolidated Power Corporation, SMC Power Generation Corporation, SMC PowerGen Inc. and Cyber Bay Corporation*. He is the Chairman of San Miguel Brewery, Inc.* and Liberty Telecoms Holdings Inc.* and a Director of Philweb Corporation*. Mr. Ang is a Director of other subsidiaries and affiliates of the San Miguel Group of Companies in the Philippines and Southeast Asia. He holds a Bachelor of Science degree in Mechanical Engineering from Far Eastern University.

OSCAR S. REYES, 66
Director, (since July 1, 2010 - 2 years)
Chief Operating Officer (July 1, 2010 to May 28, 2012)
President and CEO (since May 29, 2012)

Mr. Reyes is a member of the Advisory Board of Philippine Long Distance Telephone Company* and of the Board of Directors of the Bank of the Philippine Islands*, Manila Water Company, Inc.*, Ayala Land, Inc.*, Smart Communications, Inc., Pepsi Cola Products Philippines, Inc.*, Sun Life Financial Phils, Inc., Basic Energy Corporation* and Alcorn Gold Resources Corporation*, among other firms. He is also the President of Meralco PowerGen Corporation and Chairman of Meralco Industrial Engineering Services Corporation (MIESCOR), CIS Bayad Center, Inc., Meralco Energy, Inc., Redondo Peninsula Energy, Inc. and Link Edge, Inc. He served as Country Chairman of the Shell Companies in the Philippines and concurrently President of Pilipinas Shell Petroleum Corporation and Managing Director of Shell Philippines Exploration B.V. He is a member of the Board of Trustees of One Meralco Foundation, Inc., Pilipinas Shell Foundation, Inc., SGV Foundation, Inc. and El Nido Foundation, Inc. He holds a Bachelor of Arts degree, cum laude, in Economics from the Ateneo de Manila University and finished post-graduate studies at the Ateneo Graduate School of Business Administration, Waterloo Lutheran University and the Harvard Business School.

RAY C. ESPINOSA, 56
Director (since May 26, 2009 - 3 years)

Atty. Espinosa is the President and Chief Executive Officer of Mediaquest Holdings, Inc., ABC Development Corporation (TV5), Mediascape, Inc. (Cignal TV), Nation Broadcasting Corporation, and other subsidiaries of Mediaquest Holdings Inc. He is a member of the Board of Directors of Meralco PowerGen Corporation, Beacon Electric Asset Holdings, Inc., Philippine Long Distance Telephone Company*, Metro Pacific Investments Corporation*, Lepanto Consolidated Mining Corporation* and Wolfpac Mobile, Inc., and Vice Chairman of Philweb Corporation*. Atty. Espinosa holds a Bachelor of Laws degree, salutatorian, from the Ateneo de Manila University and a Master of Laws degree from the University of Michigan Law School as a Clyde Alton Dewitt Fellow. He placed first in the Philippine Bar examinations in 1982.

JOSE MA. K. LIM, 60
Director (since May 29, 2012 - 6 months)

Mr. Lim is the President and Chief Executive Officer of Metro Pacific Investments Corporation*. He is the Chairman of Davao Doctors Hospital and Riverside Medical Center in Bacolod City. He is a member of the Board of Directors of of Meralco PowerGen Corporation, Beacon Electric Asset Holdings, Inc., Metro Pacific Tollways Corporation, Manila North Tollways Corporation, Tollways Management Corporation, Maynilad Water Services, Inc., Medical Doctors, Inc., Cardinal Santos Medical Center, Our Lady of Lourdes Hospital and Asian Hospital. He is a Founding Member and Treasurer of the Shareholders Association of the Philippines. Mr. Lim holds a Bachelor of Arts degree in Philosophy from the Ateneo de Manila University and a Masters in Business Administration from the Asian Institute of Management.

MANUEL M. LOPEZ, 70
Director (since April 14, 1986 - 26 years)
Chairman and CEO
(from July 1, 2001 to June 30, 2010)
Chairman (from July 1, 2010 to May 28, 2012)

Mr. Lopez is the Philippine Ambassador to Japan. He is concurrently the Chairman and CEO of Lopez Holdings Corporation* and is the Chairman of Indra Philippines, Inc., Bayan Telecommunications, Inc., Bayan Telecommunications Holdings Corporation, Rockwell Land Corporation* and Rockwell Leisure Club. He is the Vice Chairman of First Philippine Holdings Corporation* and a member of the Board of Directors of ABS-CBN Corporation*, ABS-CBN Holdings Corporation*, Sky Cable Corporation and First Philippine Realty Corporation.
He is also the President of Eugenio Lopez Foundation, Inc.

** Publicly-listed Company*

ESTELITO P. MENDOZA, 83

Director (since February 1, 2009- 3 years)

Atty. Mendoza is the Managing Partner of Estelito P. Mendoza and Associates. He is a member of the Board of Directors of San Miguel Corporation*, Petron Corporation*, Philippine National Bank* and Philippine Airlines, Inc. A practicing lawyer for more than 60 years, he was consistently listed as a "Leading Individual in Dispute Resolution" among lawyers in the Philippines in the following directories/journals: "The Asia Pacific Legal 500", "Chambers of Asia" and "Which Lawyer?" yearbooks for several years. He has also been a Professorial Lecturer of law at the University of the Philippines and served as Solicitor General, Minister of Justice, Member of the Batasang Pambansa and Provincial Governor of Pampanga. He was also the Chairman of the Sixth (Legal) Committee, 31st Session of the UN General Assembly and the Special Committee on the Charter of the United Nations and the Strengthening of the Role of the Organization. He holds a Bachelor of Laws degree from the University of the Philippines and Master of Laws degree from Harvard Law School.

ARTEMIO V. PANGANIBAN, 76

Independent Director
(since May 27, 2009 - 3 years)

Justice Panganiban was a former Chief Justice of the Supreme Court of the Philippines. He was a Chairperson of the Presidential Electoral Tribunal, Judicial and Bar Council and Philippine Judicial Academy. He is an Independent Director of Petron Corporation*, Bank of the Philippine Islands*, First Philippine Holdings Corporation*, Metro Pacific Investments Corporation*; Metro Pacific Tollways Corporation, Robinsons Land Corporation*, GMA Network, Inc.*, GMA Holdings, Inc.* and Asian Terminals, Inc.*; and Independent Adviser of Philippine Long Distance Telephone Company. He is a Director of Jollibee Foods Corporation*, a Senior Adviser of Metropolitan Bank and Trust Company, Chairman of the Board ofAdvisers of Metrobank Foundation and a columnist for the Philippine Daily Inquirer. He holds a Bachelor of Laws degree, cum laude, from the Far Eastern University and was awarded the degree of Doctor of Laws (Honoris Causa) by the University of Iloilo, Far Eastern University, University of Cebu, Angeles University and Bulacan State University. He placed sixth in the Philippine Bar Examinations in 1960.

VICENTE L. PANLILIO, 66

Independent Director (from May 27, 2008 to May 25, 2010)

Director (since June 28, 2010 - 2 years)

Mr. Panlilio is a member of the Board of Directors of San Fernando Electric Light and Power Company and Bank of Commerce. He was a Director of the Philippine Stock Exchange*, the Philippine Dealing Exchange Corporation, Equitable PCIBank and the Philippine National Bank. He was also Chief Operating Officer and a member of the Advisory Board of Far East Bank and Trust Company. Mr. Panlilio holds a Bachelor of Arts degree in Economics from the University of the Philippines and attended the Advanced Bank Management Program of the Asian Institute of Management.

ERIC O. RECTO, 49

Director (since June 28, 2010 -2 years)

Mr. Recto is the Chairman of Philippine Bank of Communications*; President of Petron Corporation*; Vice Chairman of Alphaland Corporation*, Atok-Big Wedge Co., Inc.* and Philweb Corporation*. He is a member of the Board of Directors of San Miguel Corporation*; and President and Director of Top Frontier Investment Holdings, Inc., ISM Communications Corporation* and Q-Tech Alliance Holdings, Inc. Mr. Recto holds a Bachelor of Science degree in Industrial Engineering from the University of the Philippines and a Masters in Business Administration from Cornell University, Johnson Graduate School of Management, Ithaca, New York, USA.

PEDRO E. ROXAS, 56

Independent Director (since May 25, 2010 - 2 years)

Mr. Roxas is the Chairman, President and Chief Executive Officer of Roxas and Company, Inc.*; Chairman and President of Roxaco Land Corporation; Chairman of Roxas Holdings, Inc.*, Central Azucarera Don Pedro, Inc., Central Azucarera de la Carlota, Inc., Roxol Bioenergy Corporation, Club Punta Fuego, Inc. and Fuego Land Corporation. He is a member of the Board of Directors of Philippine Long Distance Telephone Company*, BDO Private Bank and Brightnote Assets Corporation.
Mr. Roxas holds a Bachelor of Science degree in Business Administration from the University of Notre Dame in Indiana, USA.

** Publicly-listed Company*

Corporate Officers

ROBERTO R. ALMAZORA, 52
Senior Vice President
Energy Market Adviser
Meralco Local Retail Electricity Supplier

Mr. Almazora is a member of the Board of Directors of Indra Philippines, Inc. and a Trustee of the University of the Philippines Alumni Engineers. Mr. Almazora holds a Bachelor or Science degree in Electrical Engineering from the University of the Philippines and completed his Masters in Business Management at the Asian Institute of Management.

RAFAEL L. ANDRADA, 52
First Vice President and Treasurer
Head, Investment Management Group and Treasury

Mr. Andrada is a member of the Board of Directors of CIS Bayad Center, Inc., Clark Electric Distribution Corporation, General Electric Philippines Meter and Instrument Company, Inc., Republic Surety Insurance, Inc., Meralco Industrial Engineering Services Corporation, Lighthouse Overseas Insurance , Ltd., Inc., First Private Power Corporation and Bauang Private Power Corporation. He is the Treasurer of Clark Electric Distribution Corporation, Meralco PowerGen Corporation, Calamba Aero Power Corporation, Redondo Peninsula Energy Corporation, Atimonan Land Ventures Corporation and Luzon Natural Gas Energy Corporation. He holds a Bachelor of Science degree in Management from De La Salle University.

RUBEN B. BENOSA, 56
First Vice President and Head, Corporate Logistics Office

Mr. Benosa is the Chairman of Meralco Financial Services Corporation and a member of the Board of Directors of Miescorrail, Inc., Meralco Energy, Inc. and Radius Telecoms, Inc. Mr. Benosa holds a Bachelor of Science degree in Electrical Engineering from the Mapua Institute of Technology and completed his Masters in Management at the Asian Institute of Management.

RICARDO V. BUENCAMINO, 68
Senior Executive Vice President and Head, Networks

Mr. Buencamino is the Vice Chairman of General Electric Philippines Meter and Instrument Company, Inc. and a member of the Board of Directors of Clark Electric Distribution Corporation, Meralco Energy, Inc., Calamba Aero Power Corporation and Atimonan Land Ventures Development Corporation. Mr. Buencamino holds a Bachelor of Science degree in Electrical Engineering from the Mapua Institute of Technology. He completed his Masters in Management at the Asian Institute of Management and attended the General Management of Electric Utilities training program at the International Management Development Center in Texas, USA.

MARTHYN S. CUAN, 33
Vice President Chief Information Officer

Mr. Cuan is a member of the Board of Directors of Radius Telecoms, Inc. and Indra Philippines. He is a member of Intel's Enterprise Board of Advisors. He is the Vice-President and a founding member of IdeaSpace Foundation, a non-profit organization that offers business incubation and acceleration program for technology entrepreneurs. Mr. Cuan holds a Bachelor of Science degree in Management Information Systems from the Ateneo de Manila University with a Minor in Chinese Studies.

IVANNA G. DE LA PEÑA, 58
First Vice President and Head, Regulatory Management Office

Ms. de la Pena is a member of the Board of Directors of Clark Electric Distribution Corporation, Radius Telecoms, Inc., Share an Opportunity Philippines, Inc. and Medical Ambassadors Phils., Inc. She holds a Bachelor of Science degree in Statistics and a Masters in Business Administration from the University of the Philippines. She attended the Public Utility Research Center - World Bank Training Course on Utility Regulation and Strategy at the University of Florida and the General Management of Electric Utilities training program at the International Management Development Center in Texas, USA.

AARON A. DOMINGO, 49
Executive Vice President, General Manager and Director
Meralco PowerGen Corporation

Mr. Domingo is a member of the Board of Directors of GMR Energy (Singapore) Pte Ltd, Luzon Natural Gas Energy Corporation, Atimonan Land Ventures Development Corporation, Redondo Peninsula Energy, Inc. and Calamba Aero Power Corporation. He is the Managing Director of FPM Power Holdings Limited. Mr. Domingo holds a Bachelor of Science degree, summa cum laude, in Business Administration, from Syracuse University in New York , USA and completed his Masters in Business Administration at the University of Chicago Graduate School of Business in Illinois , USA .

SIMEON KEN R. FERRER, 56

Corporate Secretary (since May 26, 2009)

Atty. Ferrer is a member of the Board of Directors and Corporate Secretary of Habibi Cove Realty Corporation, Marbelene Realty Corporation and Park Lane Assets, Inc., among others. He is a Senior Partner of SyCip Salazar Hernandez & Gatmaitan, the largest law firm in the Philippines. He is a member of the Integrated Bar of the Philippines and the Philippine Bar Association and a Fellow of the Institute of Corporate Directors. He is also the International Alumni Contact for the Philippines of the University of Michigan Alumni Association. He completed his Bachelor of Science degree in Business Economics and Bachelor of Laws degree at the University of the Philippines. He holds a Master of Laws degree from the University of Michigan, USA as a DeWitt Fellow.

ALFREDO S. PANLILIO, 49

Senior Vice President and Head, Customer Retail Services and Corporate Communications

Mr. Panlilio is a member of the Board of Directors of CIS Bayad Center, Inc., Corporate Information Solutions, Inc., Customer Frontline Solutions, Inc., Meralco Energy, Inc., Miescorrail, Inc., Radius Telecoms, Inc., Paragon Vertical Corporation, Indra Philippines, Inc., PLDT Global Corporation and Mabuhay Satellite Corporation; Vice Chairman and Trustee, Meralco Management and Leadership Development Center Foundation, Inc.; and Trustee of One Meralco Foundation, Inc. and Loyola Meralco Sparks Football Club; President of MVP Sports Foundation. Mr. Panlilio holds a Bachelor of Science degree in Business Administration (Computer Information Systems) from the California State University – San Francisco State University and obtained his Masters in Business Administration at J. L. Kellogg School of Management of Northwestern University and The Hong Kong University of Science and Technology. He has 25 years of experience with telecommunications and information systems. Prior to joining Meralco, he was the President and CEO of PLDT Global based in Hong Kong.

RAYMOND B. RAVELO, 35

Vice President Head, Strategy and Corporate Development Office

Mr. Ravelo is concurrently the President/ Chief Executive Officer, and a member of the Board of Directors of Radius Telecoms, Inc. Prior to joining Meralco, he was part of McKinsey and Company's Washington DC office where he led strategy development efforts and operations performance transformations for top companies in North America, Latin America, Europe, Southeast Asia, and across a wide range of industries. Mr. Ravelo holds a Bachelor of Science degree, magna cum laude, in Management Engineering from the Ateneo de Manila University. He earned his Masters in Business Administration (with majors in Strategic Management and Marketing) at The Wharton School of the University of Pennsylvania where he was a Joseph Wharton Fellow and an Omnicom Communication Fellow. Mr. Ravelo is also a Trustee of the Wharton-Penn Alumni Association, Inc.

WILLIAM S. PAMINTUAN, 51
First Vice President and Deputy General Counsel
Assistant Corporate Secretary
& Chief Governance Officer

Atty. Pamintuan is the Corporate Secretary of Meralco PowerGen Corporation, Atimonan Land Ventures Development Corporation, Calamba Aero Power Corporation and RP Energy, Inc. He is a member of the Board of Directors of Miescorrail, Inc. and Assistant Corporate Secretary of Cebu Pacific, Inc. Atty. Pamintuan holds a Bachelor of Arts degree in Political Science and a Bachelor of Laws degree from the University of the Philippines.

RAMON B. SEGISMUNDO, 55
Senior Vice President and Head,
Human Resources and Corporate Services

Mr. Segismundo is the Chief Human Resources Officer. He is Vice-Chairman and Governor of the Philippine Basketball Association (PBA); Chairman of Customer Frontline Solutions, Inc; Trustee of the One Meralco Foundation, Inc., Meralco Pension Fund and the Loyola Meralco Sparks FC. He is also a member of the Board of Directors of Meralco Industrial Engineering Services Corporation, CIS Bayad Center, Inc., Miescorrail, Inc. and General Electric Philippines Meter and Instrument Company, Inc. Mr. Segismundo holds a Bachelor of Science degree in Industrial Engineering and completed his Masters in Business Administration, both at the University of the Philippines. While in the U.S., he was a member of the Society of Human Resources Management and acquired Senior Professional in HR (SPHR) and Global Professional in HR (GPHR) certifications. He has over 25 years of experience as Asia Pacific/ International human resources executive and business consulting in the Philippines, Singapore, United Kingdom, and the United States for major global companies such as GlaxoSmithKline, Arthur Andersen/ Sycip Gorres Velayo & Co., Wyeth Pharmaceuticals, SmithKline Beecham and Sterling Winthrop.

BETTY C. SIY-YAP, 51
Senior Vice President
Chief Finance Officer

Ms. Siy-Yap is a member of the Board of Directors of Republic Surety and Insurance Company, Inc., Meralco Industrial Engineering Services Corporation, Clark Electric Distribution Corporation, General Electric Philippines Meter and Instrument Company, Inc., CIS Bayad Center, Inc., Miescorrail Inc., Radius Telecoms, Inc., Indra Philippines, Inc., Philippine Commercial Capital, Inc., Meralco PowerGen Corporation, Redondo Peninsula Energy, Inc., MPG Holdings Phils., Inc. and MPG Asia Limited. She is the President of Lighthouse Overseas Insurance Limited. She is a Trustee of the Meralco Pension Fund, One Meralco Foundation, Inc. She is the Treasurer of the MVP Sports Foundation, Inc. and First Pacific Learning Academy, Inc. She was a Partner at SyCip Gorres Velayo & Co. (a Member Firm of Ernst & Young Global) before joining Meralco.

Ms. Siy-Yap holds a Bachelor of Science in Business Administration and Accountancy degree from the University of the Philippines and a Master in Business Administration at J.L.Kellogg School of Management at Northwestern University and the Hong Kong University of Science and Technology.

Our Subsidiaries

MERALCO POWERGEN CORPORATION (MGen)

MGen is a wholly-owned subsidiary of Meralco. MGen's mission is to develop highly cost competitive and reliable power plants, and ensure the provision of adequate, reliable and affordable power to residential, commercial and industrial customers in the Meralco franchise area and in other areas which may benefit from its supply of power.

On July 22, 2011, MGen signed a Shareholders' Agreement with ThermaPower Inc. or TPI, and Taiwan Cogeneration International Corporation–Philippine Branch (TCIC) for the construction and operation of a 2x300MW Circulating Fluidized Bed (CFB) coal-fired power plant in Subic Bay Freeport Zone. RP Energy is a partnership among TPI, MGen and TCIC for the development of the coal-fired power plant project. MGen has the largest shareholding in RP Energy with the Meralco Employees' Retirement Fund holding a relatively small interest, and TPI and TCIC owning the remaining stake equally.

At present, site preparation works for the RP Energy project is almost complete. Likewise, it has commenced negotiations for the engineering, procurement and construction of the power plant. MGen is also in the process of developing other power generation projects for the planned portfolio of potentially up to 2,700 MW total power generation capacity.

MANUEL V. PANGILINAN, Chairman
OSCAR S. REYES, President and Director
AARON A. DOMINGO, Executive Vice President, General Manager and Director

MERALCO MGEN POWER GENERATION

CLARK ELECTRIC DISTRIBUTION CORPORATION (CEDC)

CEDC is 65%-owned by Meralco and 35%-owned by J Ten Equities, Inc., the holding company of Angeles Electric Corporation. It is the exclusive franchised distribution company in the Clark Economic Zone (CEZ). CEDC distributes power within CEZ through its three substations with a total capacity of 131 MVA. Its present distribution network consists of 1,306 distribution transformers, 129-km. linear length of primary lines and 51.35-km of secondary lines. Its system loss has continuously improved from 7.01% in 2002 to 3.75% in 2012. Its supply rates are one of the lowest in Luzon. CEDC aspires to be a world-class electric distribution utility and CEZ's partner towards the nation's progress. CEDC's application for the translation into distribution rates of different customer classes under Performance Based Regulation for the Regulatory Period October 1, 2011 to September 30, 2015 was approved on April 10, 2012 and implemented in June 2012.

PETER G. NEPOMUCENO, Chairman
JESUS P. FRANCISCO, President and Director

CLARK ELECTRIC

CORPORATE INFORMATION SOLUTIONS, INC. (CIS)

CIS, Inc. is a wholly-owned subsidiary of Meralco, incorporated in 1974 to provide information technology services and integrated business solutions to enterprise clients.

In 1997, CIS engaged in the business of bills payment collection, which spun off as CIS Bayad Center, Inc. (CBCI) in 2006. CBCI offers the largest network of bills payment collection service, operating nationwide under brand name "Bayad Center."

Bayad Center is the country's trailblazer and brand leader in outsourced over-the-counter payment collection and is now looking forward to becoming a borderless, multi-channel payment gateway.

Trusted by top multinational and local organizations with their payment collection requirements, it accepts payments for 162 industry-leading biller brands through its more than 2,000-strong, strategically-located branches nationwide, and US-based online payment facility. To complement its bills payment business, Bayad Center now offers electronic wallet services (vehicle insurance), prepaid loading, service applications acceptance, and remittance pay-out.

Aside from strategic partnerships with PhilPost and LBC for nationwide presence, Bayad Center enhanced its payment system, the Bayad Center Integrated Operations System (BIOS) which is currently being piloted across several sites. This system, which is expected to roll out by the end of 2013, extends Bayad Center's capability to accommodate more biller partners and ultimately provide more flexibility to better serve its current bills payment clients.

OSCAR S. REYES, Chairman
MANUEL LORENZO L. TUASON, President CEO and Director

BAYAD CENTER A MERALCO COMPANY

LIGHTHOUSE OVERSEAS INSURANCE LIMITED (LOIL)

LOIL, Meralco's wholly-owned subsidiary and captive reinsurer, is registered as a Class 1 insurer under The Bermuda Insurance Act 1978 and Related Regulations. LOIL was incorporated in Bermuda in 2007 and received its license to operate in the territory in 2008. Together with Republic Surety and Insurance Company, Inc., LOIL plays a major role in Meralco's business risk management model. LOIL serves as the vehicle to reinsure Meralco's major catastrophic risk exposure.

As in previous calamities that hit the Meralco franchise area, LOIL helped mitigate the losses for Meralco brought about by the Habagat (monsoon rains) in 2012.

OSCAR S. REYES, Chairman
BETTY C. SIY-YAP, President and Director

MERALCO ENERGY, INC. (MEI)

MEI, operating as MSERV, is a wholly-owned subsidiary of Meralco established in June 2000 to provide beyond the meter (customer-owned facilities) energy services to Meralco's key accounts.

MSERV aims to be the country's premier Energy Service Company (ESCO) by providing energy efficiency products, power quality solutions, innovative systems in advanced metering infrastructure and management of electrical facilities to help clients responsibly grow their business. MSERV services include Power Factor and Quality Improvement, Advanced Metering Infrastructure installation, Efficiency audits and retrofitting for Lighting, HVAC (Heating, Ventilation & Air Conditioning) & Motors, Power Facilities Operation & Maintenance, and Renewable Energy solutions such as E-Vehicle Operations and Maintenance.

In 2012, MSERV launched its Managed Services targeting customers who need high levels of power quality and reliability. This new business line offers MSERV customers the ability to outsource all their load side electricity requirements so they can focus on their core business. MSERV provides "Best in Class" Service Levels such as guaranteed continuous power, 24 hours replacement of critical equipment including transformers and 24/7 technical support.

OSCAR S. REYES, Chairman
JESUS P. FRANCISCO, Vice Chairman
(since December 4, 2012)
President and CEO (until December 4, 2012)

DEXTER C. LEE, President and CEO
(since December 4, 2012)

MERALCO FINANCIAL SERVICES CORPORATION (FINSERVE)

Finserve is a wholly-owned subsidiary of Meralco which aims to enhance Meralco's shareholder value creation and expand customer service through innovative consumer and customer-based products and services that support Meralco's core business. In 2007, Finserve embarked on investing and managing commercial center operations with The Strip along Ortigas Avenue as its flagship project. At present, this two-storey building with a leasable space of 1,030 square meters houses several retail establishments.

MONICO V. JACOB, Chairman and President

MERALCO INDUSTRIAL ENGINEERING SERVICES CORPORATION (MIESCOR)

Miescor is 99%-owned by Meralco with the remaining 1% by the Miescor Provident Fund. Miescor, a holder of the highest contractor license Category AAA since 1982, is a contractor– specialist engaged in engineering, construction and maintenance activities related to power generation, transmission and distribution, as well as industrial plants, water resources and telecommunications. Miescor is Meralco's most reliable service provider in electro-mechanical works, engineering, distribution and technical services. It also handles telecommunication projects for Meralco, its affiliates and third parties.

In 2012, MIESCOR bagged major projects from Clark Development Corp., Chevron Philippines, Inc., Metro Manila Development Authority, Alternergy Wind One Corporation, Maibarara Geothermal, Inc., Energy Development Corp., First Gen Corporation, and Maynilad Water Services, Inc. In the same year, the Company achieved a major milestone in safety by attaining 10 million safe man-hours and receiving various awards from the Safety Organization of the Philippines, the Department of Energy and the Department of Labor and Employment.

To support Miescor in achieving its aspirations of becoming the top-of-mind electromechanical service provider and a preferred Engineering, Procurement and Construction (EPC) contractor in power generation, transmission and distribution are its subsidiaries Miescor Builders, Inc., Miescor Logistics, Inc., and Miescorrail, Inc.

OSCAR S. REYES, Chairman
JESUS P. FRANCISCO, Vice Chairman (since December 17, 2012)
President (until December 17, 2012)
ANGELITO D. BERMUDO, President and Director (since December 17, 2012)

RADIUS TELECOMS, INC.

In 2012, e-Meralco Ventures, Inc. (e-MVI) a wholly-owned subsidiary of Meralco, operationalized Radius Telecoms, Inc. (Radius) to operate and maintain its fiber-based telecommunications infrastructure. Radius has since expanded this network to more than 2,000 kilometers across the MERALCO franchise area, while improving its capabilities to adhere to global telecommunications standards.

Radius is a premium data transport provider to the biggest names in the country and the region. It delivers world-class data connectivity solutions, high capacity services, and managed services to local and international carriers, internet service providers, data centers, and corporate clients in select industries. In 2012, Metro Ethernet Forum (MEF), an international organization of Carrier Ethernet users, certified Radius' Carrier Ethernet service as compliant to strict Global standards. Radius is only the third Filipino company to earn such a distinction.

Radius Telecoms, Inc. aims to become the country's leading fiber-based connectivity provider, empowering clients and their customers with the most reliable data communications solutions.

FELIPE B. ALFONSO, Chairman+
RAYMOND B. RAVELO, President and CEO and Director

REPUBLIC SURETY AND INSURANCE COMPANY, INC. (RSIC)

RSIC is a wholly-owned subsidiary of Meralco. It is a professional non-life insurance company acquired in 2007 to align with Meralco's recognition of the imperative for a disciplined approach in managing its risk exposures. RSIC continues to renew an insurance program that provides coverage to Meralco's transmission and distribution assets. It aims to be the most dynamic, pro active risk management and underwriting company – not just for Meralco, its subsidiaries and affiliated companies in terms of synergistic opportunities, but for the insurance industry as a whole, with a commitment to implement risk management methods with emphasis on risk analysis and mitigation, loss control management and general insurance management. True to this commitment, RSIC hosted the very first Risk Management Summit in the Philippines on September 12, 2012 with the theme "Developing Tools to Transform Threats into Opportunities through Strategic Management of Risks."

During the Philippine Insurers and Reinsurers Association Awards in October 2012, RSIC won the *Best Green Company, Best in Corporate Social Responsibility*, and finalist for *Best in Innovation*.

On November 2012, the stockholders of the Company approved a resolution of the Board of Directors increasing the Company's authorized capital stock to PhP600 million and the paid-up capital stock to PhP250 million. The increase in the paid-up capital to PhP250 million was made to be compliant with the minimum capitalization requirement per Department of Finance Order 27-06.

MONICO V. JACOB, Chairman
PEDRO P. BENEDICTO, JR., President and Director

Manila Electric Company and Subsidiaries

Management's Discussion and Analysis of Financial Position and Results of Operations

The following discussion and analysis of financial position and results of operations of Manila Electric Company or *MERALCO* and its subsidiaries, collectively referred to as the "*MERALCO Group*" should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2012. The audited consolidated financial statements have been prepared in compliance with the Philippine Financial Reporting Standards or *PFRS*. *PFRS* includes statements named *PFRS* and Philippine Accounting Standards, including Interpretations issued by the *PFRS* Council.

The financial information appearing in this report and in the accompanying audited consolidated financial statements is presented in Philippine pesos, *MERALCO Group's* functional and presentation currency, as defined under *PFRS*. All values are rounded to the nearest million peso, except when otherwise indicated. The exchange rate used to translate U.S. dollars to Philippine peso in this report and in the accompanying consolidated financial statements is US$1.00 to ₱41.050, the closing rate as at December 28, 2012 (the last trading day in December 2012) quoted through the Philippine Dealing System.

Financial Highlights and Key Performance Indicators

(Amounts in millions, except financial ratios, earnings per share, and operational data)	As at December 31 2012	2011	2010	% Change 2012 vs. 2011	2011 vs. 2010
Condensed Statements of Financial Position					
Total assets	₱217,073	₱210,388	₱178,968	3.2	17.6
Current assets:					
Continuing operations	92,243	77,424	60,003	19.1	29.0
Discontinued operations	–	18,349	–	(100)	–
Cash and cash equivalents	60,500	44,141	24,370	37.1	81.1
Equity attributable to equity holders of the parent	67,479	63,788	58,969	5.8	8.2
Total debt	24,613	24,443	21,221	0.7	15.2
Current liabilities:					
Continuing operations	59,518	53,042	45,146	12.2	17.5
Discontinued operations	–	9,113	–	(100)	–
Financial Ratios					
Debt to equity	0.36	0.36	0.36		
Current ratio - continuing operations	1.55	1.46	1.33		
Operational Data					
Number of customers (in thousands):					
Residential	4,735	4,580	4,412	3.4	3.8
Commercial	440	433	421	1.6	2.9
Industrial	10	10	10	–	–
Streetlights	4	4	4	–	–

	Years ended December 31 2012	2011	2010	% Change 2012 vs. 2011	2011 vs. 2010
Condensed Statements of Income					
Revenues	₱285,270	₱256,808	₱240,933	11.1	6.6
Costs and expenses	266,307	239,016	228,640	11.4	4.5
Other income, net of expenses	2,914	907	1,025	221.3	(11.5)
Income before income tax from continuing operations	21,877	18,699	13,318	17.0	40.4
Income from discontinued operations, net of income tax	978	966	822	1.2	17.5
Net income	17,158	13,726	10,117	25.0	35.7
Net income attributable to equity holders of the parent	17,016	13,227	9,685	28.6	36.6
Earnings per share					
Basic and diluted - attributable to equity holders of the parent	15.10	11.73	8.59	28.7	36.6
Basic and diluted - attributable to equity holders of parent for continuing operations	15.01	11.28	8.21	33.1	37.4
Condensed Statements of Cash Flows					
Cash from operating activities	36,244	31,934	20,358	13.5	56.9
Cash used in investing activities	(9,549)	(6,816)	(6,292)	40.1	8.3
Capital expenditures	10,321	8,997	9,053	14.7	(0.6)
Cash used in financing activities	(10,336)	(4,578)	(6,764)	125.8	(32.3)
Financial Ratios					
Profit margin	6%	5%	4%	20.0	25.0
Return on equity	25%	20%	16%	19.0	31.3
Asset turnover	1.31	1.22	1.35	7.4	(9.6)
Operational Data					
Electricity sales volume (in GWh)	32,771	30,592	30,247	7.1	1.1
System loss (in percentage)[1]:					
MERALCO	7.04%	7.35%	7.94%	(4.2)	(7.4)
CEDC	3.75%	3.96%	3.81%	(5.3)	3.9

[1] Based on 12-month moving average

OVERVIEW

MERALCO is the Philippines' largest electric power distribution company, with franchise service area covering 9,337 square kilometers. It provides power to over five million customers in 34 cities and 77 municipalities, which include Metro Manila, the provinces of Rizal, Cavite and Bulacan, and parts of the provinces of Pampanga, Batangas, Laguna and Quezon. Turnover of business establishments in the franchise area accounts for almost 50% of the country's Gross Domestic Product or *GDP*.

Through Clark Electric Distribution Corporation or *CEDC*, a 65%-subsidiary, it holds the power distribution franchise for the Clark Special Economic Zone or *CSEZ* in Clark, Pampanga. *CEDC* franchise area covers 44 square kilometers and services 1,724 customers. *CEDC* is registered with Clark Development Corporation or *CDC* under *RA* No. 9400, *Bases Conversion Development Act of 1992*, as a *CSEZ*-enterprise primarily engaged in owning, operating, and maintaining a power distribution system within the zone.

MERALCO Group's business is divided into two segments, namely, power and, services and others. The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, *CEDC*.

- Power

  The Power segment consists of (a) electricity distribution, (b) power generation and (c) Retail Electricity Supply or *RES*. In 2010, the *MERALCO Group* declared its strategic decision to re-enter into the power generation business. In 2011, *MERALCO* obtained a local *RES* license to participate in the forthcoming Retail Competition and Open Access or *RCOA*.

  Electricity distribution – This is principally electricity distribution and supply of power on a pass-through basis covering the *MERALCO* franchise area and the *CEDC* franchise area in the Luzon Grid. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s service area covers the *CSEZ*.

  Power generation – The *MERALCO Group's* strategic decision to re-enter into power generation through MERALCO PowerGen Corporation or *MGen* is through its investment in *RP Energy*. Redondo Peninsula Energy, Inc. or *RP Energy* is undertaking the ongoing development of a 2 x 300*MW* Circulating Fluidized Bed or *CFB,* coal-fired power generation plant in the Subic Freeport Zone. Simultaneously, *MGen* is in various stages of pre-development of other power generation projects.

  RES – This covers the sourcing and supply of electricity to qualified contestable customers upon the start of *RCOA*. The *MERALCO Group* will serve as a local *RES* only within its franchise area under the brand *MPower*. *MPower* has been assisting customers in preparing for the commencement of *RCOA*.

- Services and Others

  The services segment is involved principally in electricity-related services such as electro-mechanical engineering, construction, consulting and related manpower as well as light rail-related maintenance services, e-transaction and bills collection, insurance and e-business development and energy systems management. These services are provided by Meralco Industrial and Engineering Services Corporation or *MIESCOR*, Miescor Builders, Inc. or *MBI,* Miescor Logistics, Inc. or *MLI* and Miescorrail, Inc. or *Miescorrail* (collectively known as "*MIESCOR Group*"), Corporate Information Solutions, Inc. or CIS, Bayad Center, Inc. or *Bayad Center* and Customer Frontline Solutions, Inc. or *CFSI* (collectively referred to as "*CIS Group*"), Republic Surety and Insurance Corporaiton or *RSIC*, Lighthouse Overseas Insurance Limited or *LOIL,* Meralco Financial Services, Inc. or *Finserve*, e-Meralco Ventures, Inc. or *e-MVI* and Miescor Energy, Inc. or *MEI*.

MERALCO's Real Estate segment, which was provided by Rockwell Land Corporation or *Rockwell Land*, is involved in luxury residential and commercial real estate development and leasing. In 2012, the accounts of *Rockwell Land* were deconsolidated from those of *MERALCO*. On February 27, 2012, *MERALCO*'s investment in common equity shares in *Rockwell Land* has been declared as property dividends to *MERALCO* stockholders of record as at March 23, 2012, except for foreign common shareholders who were paid the cash equivalent of the property dividends on May 14, 2012. This resulted in the presentation of the financial information of *Rockwell Land* as discontinued operations. In 2011, the accounts of *Rockwell Land* were included in the services and other business segments up to 2010. Consequently, *MERALCO* reclassified the related assets, liabilities and accumulated other comprehensive income of *Rockwell Land* as "Assets of discontinued operations", "Liabilities of discontinued operations" and "Unrealized fair value gains on *AFS* investments of discontinued operations", respectively, in the 2011 consolidated statement of financial position. On April 25, 2012, the Securities and Exchange Commission or *SEC* approved the declaration of *Rockwell Land* as property dividends.

Below is the summary of *MERALCO Group*'s business segments:

BUSINESS SEGMENTS	
Power	**Services and Others**
Electricity distribution • *MERALCO* • *CEDC* Power generation • *MGen* and subsidiaries Retail electricity supply • *MERALCO* through *MPower* business unit	• *MIESCOR and subsidiaries* • *Finserve* • *LOIL* • *RSIC* • *CIS and subsidiaries* • *e-MVI and subsidiary* • *MEI*

RESULTS OF OPERATIONS

The table below summarizes the consolidated results of operations and the contribution of each business segment to *MERALCO Group*'s revenues, costs and expenses, and net income for each of the three years in the period ended December 31, 2012.

	2012			
	Power[2]	**Services and Others**	**Inter-segment Transactions**	**Consolidated**
		(Amounts in millions)		
Revenues	₱282,991	₱3,829	(₱1,550)	₱285,270
Costs and expenses	264,981	2,876	(1,550)	266,307
Other expenses (income)	(2,358)	(818)	262	(2,914)
Net income attributable to equity holders of the parent	15,738	1,682	(404)	17,016

	2011			
	Power[3]	**Services and Others**	**Inter-segment Transactions**	**Consolidated**
		(Amounts in millions)		
Revenues	₱253,989	₱3,923	(₱1,104)	₱256,808
Costs and expenses	237,351	2,769	(1,104)	239,016
Other expenses (income)	(1,689)	(99)	881	(907)
Net income attributable to equity holders of the parent	12,752	1,906	(1,431)	13,227

	2010			
	Power[4]	**Services and Others**	**Inter-segment Transactions**	**Consolidated**
		(Amounts in millions)		
Revenues	₱239,077	₱3,444	(₱1,588)	₱240,933
Costs and expenses	227,716	2,512	(1,588)	228,640
Other expenses (income)	(1,811)	21	765	(1,025)
Net income attributable to equity holders of the parent	9,442	1,403	(1,160)	9,685

2012 compared with 2011

On a Consolidated Basis

Revenues

Revenues from electricity represent *MERALCO* and *CEDC*'s sales of electricity, which include generation, transmission, distribution charges and subsidies. *MERALCO* and *CEDC* distribute electricity to industrial, commercial and residential customers. For the year ended December 31, 2012, revenues from electricity sales of ₱282,991 million made up 99% of the total consolidated revenues and improved by 11% from ₱253,989 million in 2011. The increase in revenues was on account of the 7% growth in volume of energy sold, which reflected the broad-based growth of the economy, fuelled by the services, real estate and manufacturing sectors. This was further supported by the notable increase in remittances sent home by some 10 million overseas Filipino workers, which provided the impetus for increased domestic consumption and consequently, the growth in residential and commercial energy volume. In addition, the warmer temperature in 2012 resulted in higher energy sales, which offset the impact of 6 weather disturbances within the franchise area during the year. The foregoing was complemented by earlier energization of new customers, shorter forced- and planned service interruption time and the recovery of self-generating and directly-connected customers, resulted in higher revenues.

[2] *Principally electricity distribution*

[3] *Ibid*

[4] *Ibid*

Total energy sold for the year ended December 31, 2012 was 32,771 GigaWatt-hours or *GWh* or 7% higher than the 30,592 *GWh* in 2011. Sales across all customer classes reflected increases in 2012 compared with 2011. Sales to industrial customers increased by 11% to 10,111 *GWh*, which is largely attributable to the semiconductor, non-metallic and food and beverage manufacturers. Energy sold to commercial customers registered an increase of 6% to 12,749 *GWh* in 2012. Sales to residential customers increased by 5% to 9,779 *GWh* in 2012.

Billed customers steadily grew, with 163 thousand new customers representing an increase of 3% to almost 5.2 million as at December 31, 2012. Residential customers, while accounting 29.8% of the total energy sold, represents 91.3% of the total 5.2 million customers. Commercial customers totaling 440 thousand, account for 38.9% of the total energy sold. Approximately, 10 thousand industrial customers account for 30.9% of total energy sold.

Pass-through charges account for 82% of total electricity revenue (excluding other bill components namely, value added and local franchise taxes and universal charges which are non-revenue items), with generation charges accounting for 65%, transmission representing 11% and system loss at 6%. Distribution revenues, excluding billings for taxes, lifeline and inter-class subsidy under-recoveries, comprise 18% of the total power bill.

MERALCO continues to reap the benefits of its institutionalized system loss management programs resulting in further improvements in performance. The 12-month moving average system loss rate in 2012 was 7.04%, surpassing the record rate of 7.35% in 2011. With the system loss rate below the regulatory cap of 8.5%, a total of ₱3.4 billion savings in 2012 or a cumulative ₱8.7 billion over the last 5 years, have been realized and passed on to the customers. *CEDC*'s system loss rate is at 3.75%.

Revenues from sale of services and others pertain mostly to the revenues generated by *MIESCOR*, a construction and electro-mechanical engineering company with expertise in the fields of power and industrial plants, transmission and distribution, waterworks and telecommunications. *MIESCOR* is a subsidiary of *MERALCO*.

The following table shows the composition of *MERALCO Group*'s consolidated revenues for the years ended December 31, 2012 and 2011 by business segment:

					Increase/Decrease	
	2012	**%**	**2011**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[5]	₱282,991	99	₱253,989	99	₱29,002	11
Services and others	3,829	1	3,923	1	(94)	(2)
Inter-segment transactions	(1,550)	–	(1,104)	–	(446)	40
Total	**₱285,270**	**100**	**₱256,808**	**100**	**₱28,462**	**11**

Costs and Expenses

Consolidated costs and expenses for the year ended December 31, 2012 amounted to ₱266,307 million, 11% higher compared with ₱239,016 million in 2011. Purchased power cost is the biggest component of *MERALCO*'s costs and expenses. *MERALCO* does not operate its own generation capacity and purchases all of the electricity that it distributes from the National Power Corporation or *NPC* and its Successor Generating Companies or *SGC*s, the Wholesale Electricity Spot Market or *WESM* and Independent Power Producers or *IPP*s. The increase in costs and expenses was due to higher purchased power cost, depreciation and amortization, salaries, wages and employee benefits, other expenses, and provisions for probable charges and expenses from claims which were largely attributed to the power segment. Further increase was mitigated by the decrease in provisions for doubtful accounts and contracted services. Purchased power costs, which comprised 87% of the total cost and expenses, increased by 13% mainly due to 6% increase in average purchased power rate and 6% increase in the total volume of electricity purchased.

The following table shows the breakdown of *MERALCO Group*'s consolidated costs and expenses for the years ended December 31, 2012 and 2011 by business segment:

					Increase/Decrease	
	2012	**%**	**2011**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[6]	₱264,981	100	₱237,351	99	₱27,630	12
Services and others	2,876	1	2,769	1	107	4
Inter-segment transactions	(1,550)	(1)	(1,104)	–	(446)	40
Total	**₱266,307**	**100**	**₱239,016**	**100**	**₱27,291**	**11**

Other Expenses (Income)

Consolidated other income, net of expenses for the year ended December 31, 2012 amounted to ₱2,914 million, 221% higher compared with ₱907 million in 2011. The ₱2,007 million increase was mainly from the recognition of the local franchise tax or *LFT* recovery of ₱1,571 million and related carrying charges of ₱730 million in 2012.

In a Decision dated February 27, 2012, the Energy Regulatory Commission or *ERC* released its Order approving with modifications *MERALCO*'s application for recovery of such taxes previously paid. As directed by the *ERC*, the recovery was reflected as a separate item in *MERALCO* bills to customers beginning April 2012.

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[5] *Ibid.*

[6] *Ibid.*

The following table shows the breakdown of *MERALCO Group*'s consolidated other income, net of expenses, for the years ended December 31, 2012 and 2011 by business segment:

	2012	%	2011	%	Increase/Decrease Amount	%
			(Amounts in Millions)			
Power[7]	(₱2,358)	81	(₱1,689)	186	(₱669)	40
Services and others	(818)	28	(99)	11	(719)	726
Inter-segment transactions	262	(9)	881	(97)	(619)	(70)
Total	**(₱2,914)**	**100**	**(₱907)**	**100**	**(₱2,007)**	**221**

Net Income Attributable to Equity Holders of the Parent

Consolidated net income attributable to equity holders of the parent increased by 29% amounting to ₱17,016 million for the year ended December 31, 2012 from ₱13,227 million for the same period last year. The higher net income attributable to equity holders of the parent was mainly due to power segment's growth in energy sales and income from the divestment of *Rockwell Land* and *LFT* recovery.

The following table shows the breakdown of *MERALCO*'s consolidated net income attributable to the equity holders of *MERALCO* for the years ended December 31, 2012 and 2011 by business segment:

	2012	%	2011	%	Increase/Decrease Amount	%
			(Amounts in Millions)			
Power[8]	₱15,738	92	₱12,752	96	₱2,986	23
Services and others	1,682	10	1,906	14	(224)	(12)
Inter-segment transactions	(404)	(2)	(1,431)	(10)	1,027	(72)
Total	**₱17,016**	**100**	**(₱13,227)**	**100**	**(₱3,789)**	**29**

By Business Segment Basis

Power

Revenues

Revenue from the power segment, which is generated from electricity distribution, increased by 11% from ₱253,989 million this year to ₱282,991 million same period last year. The composition of revenues from electricity distribution for the years ended December 31, 2012 and 2011 is summarized as follows:

	2012	%	2011	%	Increase/Decrease Amount	%
			(Amounts in millions)			
Electric revenues						
Pass-through charges:						
Generation charge	₱183,708	65	₱157,850	62	₱25,858	16
Transmission charge	31,971	11	32,340	13	(369)	(1)
System loss charge	16,411	6	15,500	6	911	6
Power act reduction	(25)	–	(106)	–	81	(76)
Inter-class, lifeline subsidies and others	34	–	(201)	–	235	(117)
	232,099	82	205,383	81	26,716	13
Distribution service charges	50,892	18	48,606	19	2,286	5
Total	**₱282,991**	**100**	**₱253,989**	**100**	**₱29,002**	**11**

Pass-Through Charges

Of the total revenue of ₱282,991 million, 82% pertains to pass-through charges, which increased by 13% to ₱232,099 million in 2012 from ₱205,383 million in 2011. The higher amount of pass-through charges is mainly due to (i) the growth in sales volume of 7.1% to 32,771 GWh, (ii) higher generation charges from ₱5.12 per *kWh* in 2011 to ₱5.61 per *kWh* in 2012 and (iii) net increase in taxes and system loss charges from ₱1.37 per *kWh* in 2011 to ₱1.49 per *kWh* in 2012.

Trading prices at the *WESM* peaked at ₱20.73 per *kWh* in July 2012, inclusive of line rental charges. The average *WESM* charge in 2012 was ₱12.58 per *kWh*, 50% higher compared with the ₱8.38 per *kWh* average charge in 2011. The lowest pass-through generation charge came from one of five (5) new competitively-priced Power Supply Agreements or *PSA*s, which *MERALCO* negotiated, arranged and contracted in late 2011 and early 2012. These *PSA*s were implemented earlier than the then scheduled expiry date of the Transition Supply Contracts or *TSC*s with Power Sector Assets and Liabilities Management Corporation or *PSALM/NPC* and the start date of *RCOA* originally scheduled last December 26, 2012.

[7] *Ibid.*

[8] *Ibid.*

Pass-through charges account for 82% of total electricity revenue (excluding charges for taxes and universal charges which are non-revenue items), with generation charges accounting for 65%, transmission representing 11% and system loss at 6%. Distribution revenues, excluding billings for taxes, lifeline and inter-class subsidy under-recoveries, comprise 18% of the total power bill.

MERALCO's 12-month moving average system loss rate as December 31, 2012 was at 7.04%, 0.31 percentage points lower compared with the 7.35% for the same period last year and outperforming the *ERC*-imposed 8.5% cap by 1.46 percentage points. *CEDC*'s 12-month moving average system loss rate as at December 31, 2012 was at 3.75%.

Distribution Service Charges

Total distribution service charges for the year ended December 31, 2012 amounted to ₱50,892 million, reflecting a 5% increase compared with 2011. The modest growth despite the 7.1% increase in sales volume was mainly due to the lower average distribution rate of ₱1.55 per *kWh* in 2012 compared with ₱1.58 per *kWh* in 2011. The lower average rate is the result of customer mix realized in 2012, which saw higher growth in industrial and commercial volume compared with 2011. Growth in the industrial sector was driven by higher output of semiconductor, food and beverage, and basic metals industries coupled with the recovery of automotive industry. Commercial volume is driven by the expansion of the services segment, largely coming from real estate, private services, and transport, storage, and communication businesses. Residential customers' volume also reflected an increase, although lower than the industrial volume, which was driven by the continuing inflow of remittances and benign inflation. In 2011, the increase in residential volume is due to the significantly warmer temperature. Overall, the increases in volume realized in 2012 were 11%, 6% and 5% for industrial, commercial and residential customers, respectively.

The following table summarizes the customer count as at December 31, 2012 and 2011 and the corresponding electric consumption per customer class for the years ended December 31, 2012 and 2011:

	No. of Customers *(in thousands)*		**Electricity Sales** *(in GWh)*		**% Change**	
Customer Class	**2012**	**2011**	**2012**	**2011**	**No. of Customers**	**Electricity Sales**
Residential	4,735	4,580	9,779	9,344	3	5
Commercial	440	433	12,749	12,027	2	6
Industrial	10	10	10,111	9,080	-	11
Streetlights	4	4	132	141	-	(6)
Total	**5,189**	**5,027**	**32,771**	**30,592**	**3**	**7**

Costs and Expenses

The details of costs and expenses are summarized in the following table:

	2012	**%**	**2011**	**%**	**Increase/Decrease Amount**	**%**
			(Amounts in millions)			
Purchased power	₱232,068	88	₱205,674	87	₱26,394	13
Salaries, wages, employee benefits and contracted services	14,103	5	13,671	6	432	3
Depreciation and amortization	5,401	2	5,360	2	41	1
Others	13,409	5	12,646	5	763	6
Total	**₱264,981**	**100**	**₱237,351**	**100**	**₱27,630**	**12**

Costs and expenses of the power segment for the year ended December 31, 2012 amounted to ₱264,981 million, 12% higher compared with the ₱237,351 million in 2011. Purchased power accounted for 88% of the total cost and expenses. Increase in purchased power was mainly due to (i) higher average purchased power cost which was at ₱6.60 per *kWh* in 2012 compared with ₱6.22 per *kWh* in 2011, and (ii) higher purchases in 2012 which totalled to 35,176 GWh, 6% higher than the 33,081 GWh purchased in 2011. Power purchased rate of the *WESM* is ₱12.56 per *kWh* in 2012 compared with ₱8.38 per *kWh* in 2011.

The volume of energy purchased under long-term power supply contracts with *IPPs*, First Gas Corporation or the *Sta. Rita Power Plant*, FGP Corp. or the *San Lorenzo Power Plant* and Quezon Power (Philippines) Limited Co. or *QPPL*, Sem-Calaca Power Corporation or *Sem-Calaca Power Plant* and other *IPP*s, represent 45% of *MERALCO*'s Net Systems Input. Purchases from the *NPC SGC*s and *IPP* Administrators under the *TSC* with *PSALM/NPC* account for 48%, while the balance was sourced from the *WESM*.

Depreciation and amortization increased by 1% to ₱5,401 million in 2012 from ₱5,360 million last 2011. This is mainly due to additional depreciation from completed construction and newly installed capital assets.

Other expenses consist of taxes and permits (other than income taxes paid), provisions for doubtful accounts, costs of materials, transportation, and other corporate expenses. The 6% increase in other expenses is mainly due to higher provision for probable charges and expenses from claims.

Other Expenses (Income)

Breakdown of other expenses (income) is summarized in the following table:

	2012	%	2011	%	Increase/Decrease Amount	%
			(Amounts in millions)			
Interest and other financial income	(₱2,519)	107	(₱2,186)	129	(₱333)	15
Interest and other financial charges	1,518	(64)	1,435	(85)	83	6
Equity in net earnings of associates and joint ventures	(247)	10	(914)	54	667	(73)
Derivative mark-to-market loss (gain)	(40)	2	16	(1)	(56)	350
Foreign exchange loss	2	–	9	–	(7)	(78)
Others	(1,072)	45	(49)	3	(1,023)	2,088
Total	**(₱2,358)**	**100**	**(₱1,689)**	**100**	**(₱669)**	**40**

Two major factors contributed to a higher other income in 2012, namely; (i) increase in other financial income as a result of the recognition of ₱730 million carrying charges on *LFT* recovery approved by the *ERC* and (ii) increase in other income due to the approval of local franchise tax recovery of ₱1,571 million.

Interest and other financial charges increased in 2012 mainly due to higher effective interest rates in 2012 and higher average outstanding balance of interest-bearing liabilities.

Net Income Attributable to Equity Holders of the Parent

Net income attributable to equity holders of the parent for the power segment for the year ended December 31, 2012 was at ₱15,738 million, 23% higher than the ₱12,752 million generated in 2011. The increase is attributable to the (i) net increase in income from power distribution as a result of higher volume sold, net of lower average distribution rate; and (ii) recognition of the *ERC*-approved recovery of *LFT* amounting to ₱2,301 million, inclusive of carrying charge of ₱730 million.

Services and Others

Revenues

Revenues generated from services and others decreased to ₱3,829 million in 2012 from ₱3,923 million in 2011 as a result of a decline in construction contract services which was partly offset by an increase in third party payment service volume.

Costs and Expenses

The cost and expenses of services and others business segment for the year ended December 31, 2012 amounted to ₱2,876 million, 4% higher compared with ₱2,769 million in 2011. The details are as follows:

	2012	%	2011	%	Increase/Decrease Amount	%
			(Amounts in millions)			
Salaries, wages, employee benefits and contracted services	₱1,868	65	₱1,677	61	₱191	11
Depreciation and amortization	176	6	144	5	32	22
Others	832	29	948	34	(116)	(12)
Total	**₱2,876**	**100**	**₱2,769**	**100**	**₱107**	**4**

Total cost and expenses in 2012 amounted to ₱2,876 million, 4% higher compared with 2011, mainly due to higher salaries and other employee benefits, contracted services, depreciation and amortization, provision for doubtful accounts, and taxes and other permits.

Contracted services and salaries, wages and other employee benefits which represent 65% of total costs and expenses increased by 11% in 2012 to ₱1,868 million. This is due to the adjustments as a result of (i) provisions of the Collective Bargaining Agreement and (ii) implementation of the government-mandated wage adjustment.

Depreciation and amortization in 2012 amounted to ₱176 million, 22% higher compared with 2011 as a result of asset acquisitions of e-MVI and Miescor Logistics, Inc.

Other expenses, which accounted for 29% of the total costs and expenses, decreased by 12% from ₱948 million last year to ₱832 million this year. This is mainly due to lower corporate expenses (e.g materials, transportation, utilities) which are slightly mitigated by higher provision for doubtful accounts and taxes and other permit fees.

Other Expenses (Income)

Other income net of other expenses increased by ₱719 million mainly due to the ₱780 million gain recognized from *MERALCO*'s divestment of *Rockwell Land*.

Net Income Attributable to Equity Holders of the Parent

Net income from services and others business segment attributable to the equity holders of the parent was 12% lower at ₱1,682 million in 2012 compared with ₱1,906 million in 2011. The decrease is mainly attributed to the divestment of the *MERALCO* from *Rockwell Land* in May of 2012 deconsolidation effect of Rockwell Land offset by the ₱780 million one-time gain and higher service income generated by *MIESCOR* in 2011 compared with 2012.

2011 compared with 2010

On a Consolidated Basis

Revenues

For the year ended December 31, 2011, *MERALCO Group* generated consolidated revenues of ₱256,808 million, 7% higher compared with ₱240,933 million in 2010 due to improvement in the revenues of both business segments led by the power segment. Revenues from the power segment, of which sales of electricity comprised 99% of the total consolidated revenues, increased by ₱14,912 from ₱239,077 million in 2010 to ₱253,989 million in 2011 brought about by the (i) increase in volume of energy sold of 1% in 2011, (ii) increase in the number of billed customers to 5 million, and (iii) slightly higher distribution rate.

The following table shows the composition of *MERALCO Group's* consolidated revenues for the years ended December 31, 2011 and 2010 by business segment:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[9]	₱253,989	99	₱239,077	99	₱14,912	6
Services and others	3,923	1	3,444	1	479	14
Inter-segment transactions	(1,104)	–	(1,588)	–	484	(30)
Total	**₱256,808**	**100**	**₱240,933**	**100**	**₱15,875**	**7**

Costs and Expenses

Consolidated costs and expenses for the year ended December 31, 2011 amounted to ₱239,016 million, 5% higher compared with ₱228,640 million in 2010. Higher costs and expenses are attributable to increases in purchased power, salaries and employee benefits, provisions for probable charges and expenses from claims, contracted services and provision for doubtful accounts, all mainly attributable to the power segment.

The following table shows the breakdown of *MERALCO Group*'s consolidated costs and expenses for the years ended December 31, 2011 and 2010 by business segment:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[10]	₱237,351	99	₱227,716	99	₱9,635	4
Services and others	2,769	1	2,512	1	257	10
Inter-segment transactions	(1,104)	–	(1,588)	–	484	(30)
Total	**₱239,016**	**100**	**₱228,640**	**100**	**₱10,376**	**5**

Other Expenses (Income)

Consolidated other income, net of expenses for the year ended December 31, 2011 amounted to ₱907 million, 12% lower compared with ₱1,025 million in 2010 due to increase in borrowings costs brought about by additional long term loans drawn in 2011, absence of approvals of under-recoveries with carrying charge, and reversal of interest from bill deposits as a result of reduction of interest rate in 2010.

The following table shows the breakdown of *MERALCO Group*'s consolidated other income, net of expenses, for years ended December 31, 2011 and 2010 by business segment:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[11]	(₱1,689)	186	(₱1,811)	177	₱122	(7)
Services and others	(99)	11	21	(2)	(120)	(571)
Inter-segment transactions	881	(97)	765	(75)	116	15
Total	**(₱907)**	**100**	**(₱1,025)**	**100**	**₱118**	**(12)**

[9] *Ibid.*

[10] *Ibid.*

[11] *Ibid.*

Net Income Attributable to Equity Holders of the Parent
Consolidated net income attributable to equity holders of the parent increased by 37% to ₱13,227 million for the year ended December 31, 2011 from ₱9,685 million last year. It is largely due to the higher sales volume, slightly higher distribution rate up to October 2011, and improvement in the subsidiaries' contribution brought by increased third party business volume.

The following table shows the breakdown of *MERALCO*'s consolidated net income attributable to the equity holders of *MERALCO* for the years ended December 31, 2011 and 2010 by business segment:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in Millions)			
Power[12]	₱12,752	96	₱9,442	97	₱3,310	35
Services and others	1,906	14	1,403	14	503	36
Inter-segment transactions	(1,431)	(10)	(1,160)	(11)	(271)	23
Total	**₱13,227**	**100**	**₱9,685**	**100**	**₱3,542**	**37**

By Business Segment Basis

Power

Revenues

Revenue from the power segment, which is substantially generated from electric distribution, amounted to ₱253,989 million for the year ended December 31, 2011, 6% higher compared with ₱239,077 million in 2010. The composition of revenues from power distribution for the years ended December 31, 2011 and 2010 is summarized as follows:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in millions)			
Electric revenues						
Pass-through charges:						
Generation charge	₱157,850	62	₱158,850	66	(₱1,000)	(1)
Transmission charge	32,340	13	25,456	11	6,884	27
System loss charge	15,500	6	11,567	5	3,933	34
Power act reduction	(106)	–	(219)	–	113	(52)
Inter-class, lifeline subsidies and others	(201)	–	(233)	–	32	(14)
	205,383	81	195,421	82	9,962	5
Distribution service charges	48,606	19	43,656	18	4,950	11
Total	**₱253,989**	**100**	**₱239,077**	**100**	**₱14,912**	**6**

Pass-Through Charges

Of the total consolidated revenues from electric distribution, 81% or ₱205,383 million of such amount pertained to pass-through charges, 5% higher compared with ₱195,421 million in 2010. Generation, transmission, and system loss charges represented 77%, 16%, and at 8% of the total pass-through charges. The higher pass-through charges are attributable to (i) 1% increase in electric sales volume from 30,247 GWh in 2010 to 30,592 GWh in 2011, (ii) higher average transmission charge per *kWh* from ₱0.84 in 2010 to ₱1.06 in 2011 brought about by the approval of the Maximum Allowable Revenue or MAR of the National Grid Corporation of the Philippines or NGCP for 2011, offset by the decrease in average generation charge per *kWh* from ₱5.24 in 2010 to ₱5.16 in 2011 due to lower volume purchased from the WESM.

MERALCO's 12-month moving average system loss rate as at December 31, 2011 was at 7.35%, 0.59 percentage points lower compared with the 7.94% for the same period last year and outperforming the *ERC*-imposed 8.5% cap by 1.15 percentage points.

Distribution Service Charges

Total distribution service charges amounted to ₱48,606 million for the year ended December 31, 2011, 11% higher compared with ₱43,656 million in 2010. The rate for 4th Regulatory Year or RY, of the 2nd Regulatory Period or RP, was implemented only in January 2011 through October 2011. For the year ended December 31, 2011, the average distribution rate was ₱1.58 per *kWh*, 10% higher compared with ₱1.43 per *kWh* in 2010. As at December 31, 2011, the number of billed customers exceeded 5.0 million, 3.7% higher than the 4.8 million at the end of 2010. Energy sales to the industrial sector was up by 4% to 9,080 GWh from 8,734 GWh in 2010 due to businesses gained from Cavite Export Zone, International Rice Research Institute, Toshiba Information Equipment (Philippines),Inc. and Chevron Philippines Inc., among others, and higher sales to the semiconductor and cement industries. Sales to commercial sector increases to 12,027 GWh from 11,830 GWh in 2010 due to higher sales to the transportation, storage and communication and real estate sectors.

[12] *Ibid.*

The following table summarizes the customer count as at December 31, 2011 and 2010 and the corresponding electric consumption per customer class for the years ended December 31, 2011 and 2010:

	No. of Customers (in thousands)		Electricity Sales (in GWh)		% Change	
Customer Class	**2011**	**2010**	**2011**	**2010**	**No. of Customers**	**Electricity Sales**
Residential	4,580	4,412	9,344	9,540	4	(2)
Commercial	433	421	12,027	11,830	3	2
Industrial	10	10	9,080	8,734	-	4
Streetlights	4	4	141	143	-	(1)
Total	**5,027**	**4,847**	**30,592**	**30,247**	**4**	**1**

Costs and Expenses

Costs and expenses of the power segment for the year ended December 31, 2011 amounted to ₱237,351 million, 4% higher compared with ₱227,716 million in 2010 due to increase in purchase power, salaries, wages and employee benefits, contracted services, and provision for doubtful accounts.

The details of costs and expenses are summarized in the following table:

	2011	%	2010	%	Increase/Decrease Amount	%
			(Amounts in millions)			
Purchased power	₱205,674	87	₱200,916	88	₱4,758	2
Salaries, wages, employee benefits and contracted services	13,671	6	11,858	5	1,813	15
Depreciation and amortization	5,360	2	5,795	3	(435)	(8)
Others	12,646	5	9,147	4	3,499	38
Total	**₱237,351**	**100**	**₱227,716**	**100**	**₱9,635**	**4**

For the year ended December 31, 2011, purchased power cost increased by ₱4,758 million or 2% to ₱205,674 million from ₱200,916 million in 2010. The increase in purchase power cost is due to higher electricity volume purchased in 2011 at 33,081 GWh from 32,925 GWh in 2010, offset by the lower average purchased power cost of ₱6.22 per *kWh* or 2% lower than in 2010. The volume of energy purchased under long-term power supply contracts with IPPs, First Gas Corporation, FGP Corp. QPPL, represent 47% of *MERALCO's* Net Systems Input. The volume purchased from the NPC's SGCs, and IPP Administrators account for 46%. The balance was sourced from the Whole Electricity Spot Market or WESM, and other IPPs. The average WESM charge in 2011 was at ₱9.70, 2% higher compared with 2012.

Salaries, wages, and employee benefits amounted to ₱9,836 million for the year ended December 31, 2011, 20% higher compared with ₱8,180 million in 2010. The increase is attributed to the regular annual salary adjustment, bonuses and incentives.

Contracted services amounted to ₱3,835 million for the year ended December 31, 2011, 4% higher compared with ₱3,678 million in 2010 due to higher professional services costs, legal expenses and contractors for outsourced services.

Other expenses consist of provisions for doubtful accounts, provision for probable charges and expenses from claims, taxes other than income tax, and other corporate expenses such as rent, utilities, materials, and transportation. Provision for doubtful accounts for the year ended December 31, 2011 increased to ₱2,239 million, or 135% from ₱952 million in 2010. Provision for probable charges and expenses from claims increased to ₱8,066 for the year ended December 31, 2011 from ₱4,120 million in 2010. The provisions represented legacy issues and commercial claims. Taxes other than income tax decreased by ₱442 million from ₱817 million for the year ended December 31, 2010 to ₱375 million in 2011 due to decrease in ERC regulation and supervision fees and permits. In 2010, the ERC assessed *MERALCO* for additional regulation and supervision fees to include the amount of outstanding preferred shares in the base.

Other Expenses (Income)

For the year ended December 31, 2011, other income, net of expenses of the power segment amounted to ₱1,689 million, 7% lower compared with ₱1,811 million in 2010 mainly due to higher interest and financial charges despite of higher interest and other financial income.

Breakdown of other expenses (income) is summarized in the following table:

	2011	%	2010	%	Increase/Decrease Amount	%
			(Amounts in millions)			
Interest and other financial income	(₱2,186)	129	(₱1,596)	88	(₱590)	37
Interest and other financial charges	1,435	(85)	534	(29)	901	169
Equity in net earnings of associates and joint ventures	(914)	54	(1,012)	56	98	(10)
Derivative mark-to-market loss	16	(1)	7	–	9	129
Foreign exchange loss	9	-	29	(2)	(20)	(69)
Others	(49)	3	227	(13)	(276)	(122)
Total	**(₱1,689)**	**100**	**(₱1,811)**	**100**	**122**	**(7)**

Interest and other financial income amounted to ₱2,186 million for the year ended December 31, 2011, 37% higher compared with ₱1,596 million in 2010 due to higher interest income earned brought by higher cash placements in banks.

Interest and other financial charges increased by ₱901 million to ₱1,435 million for the year ended December 31, 2011 from ₱534 million in 2010. In 2010, *MERALCO* adjusted the interest on customers' deposit based on the applicable interest rate on customers' bill deposits, which was at the Land Bank of the Philippines savings account rate of 0.5% beginning January 2011, consistent with the provisions of the amended Distribution Services and Open Access Rules or *DSOAR*.

Net Income Attributable to Equity Holders of the Parent

Net income from the power segment attributable to equity holders of the parent for the year ended December 31, 2011 amounted to ₱12,752 million, 35% higher compared with ₱9,442 million in 2010. The increase is largely due to the delayed implementation of rate adjustments for the 4th *RY* of the 2nd *RP* and lower generation cost and system loss charges. The distribution rates were lower beginning October 2011 with the implementation of the rates for the 1st *RY* of the 3rd *RP*.

Services and Others

Revenues

Revenues generated from services and others business segment increased to ₱3,923 million, or 14% higher compared with ₱3,444 million in 2010. The increase is due to higher *MIESCOR's* transmission lines/substation maintenance contracts executed in 2011 and higher volume of payment services business of *CIS Bayad Center, Inc.*

Costs and Expenses

The cost and expenses of services and others business segment for the years ended December 31, 2011 amounted to ₱2,876 million, 4% higher compared with ₱2,770 million in 2011. The details are as follows:

					Increase/Decrease	
	2011	**%**	**2010**	**%**	**Amount**	**%**
			(Amounts in millions)			
Salaries, wages, employee benefits and contracted services	₱1,677	61	₱1,516	60	₱161	11
Depreciation and amortization	144	5	116	5	28	24
Others	948	34	880	35	68	8
Total	**₱2,769**	**100**	**₱2,512**	**100**	**₱257**	**10**

Salaries, wages, and employee benefits amounted to ₱1,075 million for the year ended December 31, 2011, 11% higher compared with ₱972 million in 2010 due to regular adjustment of salaries, wages, and employee benefits of subsidiaries. Contracted services for the year ended December 31, 2011 amounted to ₱602 million, 11% increase from last year's ₱544 million.

Depreciation and amortization for the year ended December 31, 2011 amounted to ₱144 million, 24% higher compared with ₱116 million in 2010 attributed to amortization of leasehold improvements related to the lease of a new office and facilities of *e-MVI* .

Net Income Attributable to Equity Holders of the Parent

Net income from services and others business segment attributable to the equity holders of the parent is ₱1,906 million, 36% higher compared with ₱1,403 million in 2010 due to *MIESCOR*'s additional revenues from new contracts and increase in service income of *CIS Bayad Center, Inc.*

LIQUIDITY AND CAPITAL RESOURCES

The following table shows *MERALCO*'s consolidated cash flows for each of the three years in the period ended December 31, 2012, as well as the consolidated capitalization and other consolidated selected financial data as at December 31, 2012:

	Year Ended December 31		
	2012	**2011**	**2010**
		(Amounts in millions)	
Cash Flows			
Net cash provided by operating activities	₱36,244	₱31,934	₱20,358
Net cash used in investing activities	(9,549)	(6,816)	(6,292)
Net cash used in financing activities	(10,336)	(4,578)	(6,764)
Net increase in cash and cash equivalents	16,359	20,540	7,302
Capital Expenditures	10,321	8,997	9,053

	As at December 31		
	2012	2011	2010
		(Amounts in millions)	
Capitalization			
Interest-bearing long-term financial liabilities			
Current portion	₱2,360	₱4,560	₱5,574
Noncurrent portion	20,466	19,816	15,498
Notes payable	1,787	67	149
Equity attributable to equity holders of the parent	67,479	63,788	58,969
Other Selected Financial Data			
Total assets	216,914	210,388	178,968
Utility plant and others - net	109,312	105,510	103,250
Cash and cash equivalents	60,500	44,141	24,370

As at December 31, 2012, *MERALCO Group*'s consolidated cash and cash equivalents totalled ₱60,500 million, ₱16,359 million higher compared with ₱44,141 million as at December 31, 2011. Following are the significant sources and uses of consolidated cash and cash equivalents in 2012: cash flows from operating activities of ₱36,244 million, proceeds from borrowings (long-term debt of ₱3,000 million and short-term notes payable of ₱1,720 million), proceeds from subscription receivable of ₱310 million, payment of cash dividends amounting to ₱8,890 million, settlement of debt principal and interest of ₱7,447 million and, capital expenditures of ₱9,668 million.

These cash related activities are mainly driven by (i) higher pass-through charges which are included in the amount collected to consumers but will be paid within the following month to the generation and transmission companies, (ii) amount of deposits related to higher consumptions and increase in customer accounts, (iii) collection of billed under-recoveries approved by the *ERC* and, (iv) increasing amount of dividends.

Operating Activities

Consolidated net cash provided by operating activities for the year ended December 31, 2012 of ₱36,244 million is 13.5% higher than that of 2011 mainly due to higher operating revenues.

Investing Activities

Consolidated net cash flows used in investing activities for the year ended December 31, 2012 totalled ₱9,549 million, ₱2,733 million higher compared with ₱6,816 million used in 2011. This is mainly due to higher capital expenditures and increase in noncurrent assets because of the approval of LFT recovery in 2012.

Financing Activities

Consolidated net cash used in financing activities amounted to ₱10,336 million for the year ended December 31, 2012, compared to ₱4,578 million in 2011. This is mainly attributable to payment of cash dividends amounting to ₱8,890 million, payment of interest and other financial charges from deposits and loans amounting to ₱2,882 million, and settlement of long-term debt principal of ₱4,565 million. The Company availed interest-bearing financial liabilities of ₱11,720 million in 2011 and ₱3,000 million in 2012.

Debt Financing

On January 5, 2012, *MERALCO* signed a ₱3,000 million Fixed Rate Note Facility Agreement for its ₱1,000 million, 7-year notes and ₱2,000 million, 10-year notes due in 2019 and 2022, respectively. The notes were priced off the relevant 7-year and 10-year benchmarks plus a spread and issued on January 9, 2012. Principal repayments are through annual nominal amortizations and a balloon payment on maturity date.

In December 2012, *MERALCO* availed of a ₱1.7 billion unsecured short-term notes payable from a local bank, with annual interest rate of 3.85%.

In January 2011, *MERALCO* drew a ₱2,500 million 7-year floating rate term loan from a local bank. Interest rate is repriced every six months based on 6-month *PDST-F* plus a spread. The principal is payable in nominal annual amortizations with a balloon payment on maturity date.

In June 2011, *MERALCO* entered into a Fixed Rate Note Facility Agreement for its ₱500 million 7-Year Notes and ₱4,500 million 10-Year Notes due in 2018 and 2021, respectively. The principal is payable in nominal annual amortizations with a balloon payment on maturity date.

MERALCO's loan agreements require compliance with certain financial ratios such as debt service coverage of 1.2 times calculated at specific measurement dates. The agreements also contain restrictions with respect to the creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at December 31, 2012, *MERALCO* is in compliance with all covenants of the loan agreements.

Equity Financing

Consistent with the provisions of *PAS* 32, "Financial Instruments: Disclosure and Presentation", *MERALCO*'s preferred shares are presented as debt while the dividends declared are recorded as interest expense. Accumulated and unpaid dividends were accrued and classified as accrued interest payable. Coupon rate on such preferred share is fixed at 10%. The preferred shares were issued to service applications, which would require extension or new distribution facilities beyond a specific distance. Beginning April 8, 2005, such requirement was discontinued. Instead, as provided in the "Implementing Guidelines of the Magna Carta for Residential Electricity Consumers", customers were required to advance the costs of extension of lines and installation of additional facilities. All of the redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The unpaid dividends amounted to ₱256 million and ₱261 million as at December 31, 2012 and December 31, 2011, respectively. Interest is no longer accrued on the preferred shares, which have been called for redemption.

As at December 31, 2012 and 2011, *MERALCO*'s capital stock consists of:

(Amounts in millions, except par value and number of shares)	2012	2011
Common stock – 10 par value		
Authorized – 1,250,000,000 shares	₱12,500	₱12,500
Issued – 1,127,271,117 shares	11,273	11,273
Treasury – 171,853 shares in 2012 and 146,023 shares in 2011	(11)	(9)

On March 28, 2011, the Board of Directors or *BOD* approved the acquisition into treasury shares, including related rights of employees who have opted to withdraw from the Employee Stock Purchase Plan or *ESPP* in accordance with the provisions of the *ESPP*. As at December 31, 2012, a total of 171,853 shares were acquired from the cancellation of employee participation in the *ESPP*.

Consolidated cash dividends declared to shareholders for the years ended December 31, 2012 and December 31, 2011 amounted to ₱9,129 million and ₱8,791 million, respectively.

The table below summarizes the cash dividends declared in 2012 and 2011:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
February 27, 2012	March 23, 2012	April 23, 2012	₱4.10	₱4,621
July 30, 2012	August 29, 2012	September 24, 2012	4.00	4,508
				₱9,129
February 28, 2011	March 28,2011	April 20, 2011	2.65	₱2,987
July 25, 2011	August 17,2011	September 13, 2011	3.45	3,888
November 2, 2011	December 2,2011	December 27, 2011	1.70	1,916
				₱ 8,791

On February 27, 2012, the *BOD* of *MERALCO* approved the declaration of its investment in common shares of *Rockwell Land* as property dividends in favor of common stockholders as of March 23, 2012, except for foreign common stockholders who will be paid the cash equivalent of the property dividends. Such property dividends were paid on May 14, 2012, within five trading days after approval of the property dividends by the *SEC* and registration of the *Rockwell Land* shares under the Securities Regulation Code and the listing thereof with the *PSE* on May 11, 2012. On April 25, 2012, the *SEC* approved the property dividend declaration.

Manila Electric Company and Subsidiaries

Audit and Risk Management Committee Report

The primary role and responsibility of the Audit and Risk Management Committee is to assist the MERALCO Board of Directors in fulfilling its oversight functions in the financial reporting process, the system of internal control, the audit process, the risk management process, and the process of complying with laws and regulations.

The Committee operates under a written Charter adopted by the Board of Directors. The Charter empowers the Committee to:

i. Have adequate resources and authority to discharge the responsibilities set out in the Charter, including the authority to engage external auditors for special audits, reviews and other procedures and to obtain advice from special counsel and other experts or consultants to assist it in the conduct of its review or investigation, without need to obtain prior Board approval;
ii. Seek and require any director, officer, agent, advisor, employee and/or all such persons it may need to assist it in discharging its functions and responsibilities.
iii. Meet separately with any company officer, the chief audit executive, the external auditors or outside counsel to discuss any matter that the Committee or any of the foregoing persons or firms believe should be discussed privately; and
iv. Resolve disagreements, if any, between management and the internal and external auditors regarding financial reporting.

The Audit and Risk Management Committee Charter is reviewed and assessed annually, and may request board approval for changes and disclosures as may be required by law or regulation. The terms of reference set out in the Manual of Corporate Governance and the Audit and Risk Management Committee Charter are posted in the MERALCO website.

The Committee is composed of five (5) non-executive directors and one non-director. Two (2) of them are independent directors and the majority have background in finance and accounting. It is chaired by an independent director.

Activities for the calendar year 2012

The Committee had eight (8) meetings during the year with an average attendance of 90 percent. An annual calendar of agenda items had been developed. Accomplishments and work-in-progress are monitored to ensure the full discharge of all its functions.

For the calendar year 2012, the Committee:

- Reviewed and discussed the unaudited consolidated quarterly financial statements and the audited consolidated annual financial statements of the Company, including management's significant judgments and estimates. Responsibility for financial reporting is divided as follows:
  > Management bears the primary responsibility for preparing the financial statements and the financial reporting process; while

  > The external auditors assume the responsibility of expressing an opinion on whether the Company's consolidated audited financial statements conform with relevant Philippine Financial Reporting Standards;
- Reviewed and discussed updates from management on risk management activities;
- Assessed the independence and effectiveness of the external auditors, SGV & Co. CPAs and nominated them as the external auditors for 2012 to the Board of Directors;
- Reviewed and approved the scope of work and fees of the external auditor;
- Reviewed the performance of internal auditors;
- Reviewed and approved the annual plan of the Company's Internal Audit for 2012 and the audit plan of the external auditors for the consolidated financial statements of MERALCO for the period ending on December 31, 2012;
- Reviewed the results of audits and recommendations of the internal and external auditors and their assessment of the Company's internal controls and the overall quality of the financial reporting process;
- Reviewed the applicable reports of the internal auditors and regulatory agencies, ensuring that management takes timely and appropriate corrective actions, including those involving internal control and compliance issues;
- Reviewed and assessed management's processes of monitoring compliance with laws and regulations particularly those issued by the Energy Regulatory Commission (ERC) and other regulators concerned with environment and safety;
- Performed self-assessments and reviewed the overall effectiveness of the Committee vis-à-vis its Charter, following the guidelines set by the Securities and Exchange Commission regulating the performance of Audit Committees of companies listed on the Philippine Stock Exchange; and
- Enhanced the Audit and Risk Management Committee Charter by adopting leading good governance practices.

Based on the reviews and discussions undertaken, and subject to the limitations on the roles and responsibilities referred to above, the Audit and Risk Management Committee recommended to the Board of Directors the approval of the Audited Consolidated Financial Statements of the Company for the year ended December 31, 2012 and their consequent filing with the Securities and Exchange Commission and other regulatory bodies.

February 20, 2013

On behalf of the Audit and Risk Management Committee:

Retired Chief Justice ARTEMIO V. PANGANIBAN
Chairman, Audit and Risk Management Committee

Manila Electric Company and Subsidiaries

Statement of Management's Responsibility

The management of Manila Electric Company is responsible for the preparation and fair presentation of the consolidated financial statements as at December 31, 2012 and 2011 and for each of the three years in the period ended December 31, 2012, including the following components attached therein: Retained Earnings Available for Dividend Declaration, Tabular Schedule of Standards and Interpretations, Supplementary Schedules required by Annex 68-E, and Map of the Relationships of the Companies within the Group, in accordance with the prescribed financial reporting framework indicated therein. This responsibility includes designing and implementing internal controls relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

The Board of Directors reviews and approves the consolidated financial statements and submits the same to the stockholders.

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

MANUEL V. PANGILINAN Chairman of the Board	OSCAR S. REYES President and Chief Executive Officer	BETTY C. SIY-YAP Chief Finance Officer

Manila Electric Company and Subsidiaries
Independent Auditors' Report

The Stockholders and the Board of Directors
Manila Electric Company

We have audited the accompanying consolidated financial statements of Manila Electric Company and Subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of income, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2012, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Manila Electric Company and Subsidiaries as at December 31, 2012 and 2011, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2012 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Gemilo J. San Pedro
Partner
CPA Certificate No. 32614
SEC Accreditation No. 0094-AR-3 (Group A),
February 4, 2013, valid until February 3, 2016
Tax Identification No. 102-096-610
BIR Accreditation No. 08-001998-34-2012,
April 11, 2012, valid until April 10, 2015
PTR No. 3670020, January 2, 2013, Makati City

February 25, 2013

Manila Electric Company and Subsidiaries

Consolidated Statements of Financial Position

	Note	December 31 2012	2011
		(Amounts in Millions)	
ASSETS			
Noncurrent Assets			
Utility plant and others - net	*8 and 16*	**₱109,312**	₱105,510
Investments in associates and joint ventures	*9*	**1,815**	844
Investment properties - net	*10 and 16*	**1,634**	1,642
Deferred tax assets - net	*29*	**3,232**	25
Other noncurrent assets - net	*2, 11, 13, 28 and 31*	**8,837**	6,594
Total Noncurrent Assets		**124,830**	114,615
Current Assets			
Cash and cash equivalents	*12 and 28*	**60,500**	44,141
Trade and other receivables - net	*2, 11, 13, 19, 24 and 28*	**28,077**	29,108
Inventories - at lower of cost or net realizable value	*14*	**1,371**	1,675
Other current assets	*15 and 28*	**2,295**	2,500
		92,243	77,424
Assets of discontinued operations	*6*	**–**	18,349
Total Current Assets		**92,243**	95,773
		₱217,073	₱210,388
EQUITY AND LIABILITIES			
Equity Attributable to Equity Holders of the Parent			
Common stock	*16*	**₱11,273**	₱11,273
Subscriptions receivable		**(211)**	(521)
Additional paid-in capital		**4,111**	4,111
Excess of acquisition cost over carrying value of non-controlling interest acquired		**(328)**	(328)
Employee stock purchase plan	*17*	**1,049**	915
Unrealized fair value gains on available-for-sale or *AFS* investments	*11*	**120**	85
Unrealized fair value gains on *AFS* investments of discontinued operations	*6*	**–**	14
Cumulative translation adjustments of a subsidiary and an associate	*9*	**3**	12
Cost of treasury shares held	*16*	**(11)**	(9)
Retained earnings:	*6 and 16*		
Appropriated		**6,000**	6,000
Unappropriated		**45,473**	42,236
Equity Attributable to Equity Holders of the Parent		**67,479**	63,788
Non-controlling Interests		**248**	4,713
Total Equity (Total Carried Forward)		**67,727**	68,501
Noncurrent Liabilities			
Interest-bearing long-term financial liabilities - net of current portion	*18, 26 and 28*	**20,466**	19,816
Customers' deposits - net of current portion	*13, 19, 23, 26 and 28*	**23,313**	24,080
Provisions	*20 and 30*	**19,411**	16,919
Long-term employee benefits	*27*	**9,438**	8,226
Refundable service extension costs - net of current portion	*23 and 28*	**4,357**	3,794
Deferred tax liabilities - net	*29*	**–**	595
Other noncurrent liabilities	*25 and 28*	**12,843**	6,302
Total Noncurrent Liabilities		**89,828**	79,732
Current Liabilities			
Notes payable	*22, 26 and 28*	**1,787**	67
Trade payables and other current liabilities	*16, 18, 19, 23, 24 and 28*	**47,576**	40,011
Customers' refund	*2, 21 and 28*	**6,127**	6,250
Income tax payable		**1,668**	2,154
Current portion of interest-bearing long-term financial liabilities	*18, 26 and 28*	**2,360**	4,560
		59,518	53,042
Liabilities of discontinued operations	*6*	**–**	9,113
Total Current Liabilities		**59,518**	62,155
Total Liabilities		**149,346**	141,887
		₱217,073	₱210,388

See accompanying Notes to Consolidated Financial Statements.

Manila Electric Company and Subsidiaries
Consolidated Statements of Income

	Note	2012	2011	2010
		Years Ended December 31		
			(Amounts in Millions)	
REVENUES				
Sale of electricity	*2, 5, 24, 25 and 31*	**₱282,991**	₱253,989	₱239,077
Sale of services and others	*10*	**2,279**	2,819	1,856
		285,270	256,808	240,933
COSTS AND EXPENSES				
Purchased power	*24, 25 and 31*	**232,068**	205,674	200,916
Salaries, wages and employee benefits	*17, 26 and 27*	**11,750**	10,911	9,152
Provision for probable charges and expenses from claims	*20 and 30*	**9,226**	8,065	4,119
Depreciation and amortization	*8, 10 and 11*	**5,576**	5,504	5,911
Contracted services		**2,702**	3,333	2,877
Provision for doubtful accounts - net	*13*	**832**	2,243	961
Taxes, fees and permits		**403**	399	844
Other expenses	*24 and 26*	**3,750**	2,887	3,860
		266,307	239,016	228,640
OTHER EXPENSES (INCOME)				
Interest and other financial income	*2 and 26*	**(2,569)**	(2,264)	(1,605)
Interest and other financial charges	*18, 19, 22 and 26*	**1,528**	1,445	561
Equity in net losses (earnings) of associates and joint ventures	*9*	**15**	(67)	(283)
Derivative mark-to-market loss (gain)	*28*	**(40)**	16	7
Foreign exchange loss		**4**	7	32
Others	*2*	**(1,852)**	(44)	263
		(2,914)	(907)	(1,025)
INCOME BEFORE INCOME TAX FROM CONTINUING OPERATIONS		**21,877**	18,699	13,318
PROVISION FOR (BENEFIT FROM) INCOME TAX	*29*			
Current		**9,490**	8,454	4,960
Deferred		**(3,793)**	(2,515)	(937)
		5,697	5,939	4,023
INCOME FROM CONTINUING OPERATIONS		**16,180**	12,760	9,295
INCOME FROM DISCONTINUED OPERATIONS, NET OF INCOME TAX	*6*	**978**	966	822
NET INCOME		**₱17,158**	₱13,726	₱10,117
Attributable To				
Equity holders of the Parent		**₱17,016**	₱13,227	₱9,685
Non-controlling interests		**142**	499	432
		₱17,158	₱13,726	₱10,117
Earnings Per Share Attributable to Equity Holders of the Parent	*32*			
Basic		**₱15.10**	₱11.73	₱8.59
Diluted		**15.10**	11.73	8.59
Earnings Per Share Attributable to Equity Holders of the Parent of Continuing Operations	*32*			
Basic		**₱15.01**	₱11.28	₱8.21
Diluted		**15.01**	11.28	8.21

See accompanying Notes to Consolidated Financial Statements.

Manila Electric Company and Subsidiaries

Consolidated Statements of Comprehensive Income

	Note	2012	2011	2010
		Years Ended December 31 (Amounts in Millions)		
NET INCOME FOR THE YEAR		**₱17,158**	₱13,726	₱10,117
OTHER COMPREHENSIVE INCOME				
Unrealized fair value gains on available-for-sale investments	*11*	**39**	4	44
Income tax effect		**(4)**	(1)	(4)
		35	3	40
Share in cumulative translation adjustments of a subsidiary and an associate	*9*	**(9)**	–	(672)
OTHER COMPREHENSIVE INCOME (LOSS) FOR THE YEAR, NET OF INCOME TAX		**26**	3	(632)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR, NET OF INCOME TAX		**₱17,184**	₱13,729	₱9,485
Attributable To				
Equity holders of the Parent		**₱17,042**	₱13,230	₱9,038
Non-controlling interests		**142**	499	447
		₱17,184	₱13,729	₱9,485

Manila Electric Company and Subsidiaries

Consolidated Statements of Changes in Equity

	Equity Attributable to Equity Holders of the Parent													
	Common Stock (Note 16)	Subscriptions Receivable	Additional Paid-in Capital	Excess of Acquisition Cost Over Carrying Value of Non-controlling Interest Acquired	Employee Stock Purchase Plan (Note 17)	Unrealized Fair Value Gains on Available-for-Sale Investments (Note 11)	Unrealized Fair Value Gains on Available-for-Sale Investments of Discontinued Operations (Note 6)	Cumulative Translation Adjustments of a Subsidiary and an Associate (Note 9)	Cost of Treasury shares Held (Note 16)	Appropriated Retained Earnings (Note 16)	Unappropriated Retained Earnings (Notes 6 and 16)	Equity Attributable to Equity Holders of the Parent	Non-controlling Interests (Note 6)	Total Equity
At January 1, 2012	**₱11,273**	**(₱521)**	**₱4,111**	**(₱328)**	**₱915**	**₱85**	**₱14**	**₱12**	**(₱9)**	**₱6,000**	**₱42,236**	**₱63,788**	**₱4,713**	**₱68,501**
Net income	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**17,016**	**17,016**	**142**	**17,158**
Other comprehensive income	**–**	**–**	**–**	**–**	**–**	**35**	**–**	**(9)**	**–**	**–**	**–**	**26**	**–**	**26**
Total comprehensive income	**–**	**–**	**–**	**–**	**–**	**35**	**–**	**(9)**	**–**	**–**	**17,016**	**17,042**	**142**	**17,184**
Treasury shares	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(2)**	**–**	**–**	**(2)**	**–**	**(2)**
Collection of subscriptions receivable	**–**	**310**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**310**	**–**	**310**
Share-based payments	**–**	**–**	**–**	**–**	**134**	**–**	**–**	**–**	**–**	**–**	**–**	**134**	**–**	**134**
Cash dividends	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(9,129)**	**(9,129)**	**(15)**	**(9,144)**
Deconsolidation of a subsidiary through property dividends	**–**	**–**	**–**	**–**	**–**	**–**	**(14)**	**–**	**–**	**–**	**(4,650)**	**(4,664)**	**(4,592)**	**(9,256)**
	–	**310**	**–**	**–**	**134**	**–**	**(14)**	**–**	**(2)**	**–**	**(13,779)**	**(13,351)**	**(4,607)**	**(17,958)**
At December 31, 2012	**₱11,273**	**(₱211)**	**₱4,111**	**(₱328)**	**₱1,049**	**₱120**	**₱–**	**₱3**	**(₱11)**	**₱6,000**	**₱45,473**	**₱67,479**	**₱248**	**₱67,727**
At January 1, 2011	₱11,273	(₱738)	₱4,111	(₱328)	₱743	₱96	₱–	₱12	₱–	₱6,000	₱37,800	₱58,969	₱4,227	₱63,196
Net income	–	–	–	–	–	–	–	–	–	–	13,227	13,227	499	13,726
Other comprehensive income	–	–	–	–	–	3	–	–	–	–	–	3	–	3
Total comprehensive income	–	–	–	–	–	3	–	–	–	–	13,227	13,230	499	13,729
Treasury shares	–	–	–	–	–	–	–	–	(9)	–	–	(9)	–	(9)
Collection of subscriptions receivable	–	217	–	–	–	–	–	–	–	–	–	217	–	217
Share-based payments	–	–	–	–	172	–	–	–	–	–	–	172	–	172
Discontinued operations	–	–	–	–	–	(14)	14	–	–	–	–	–	–	–
Cash dividends	–	–	–	–	–	–	–	–	–	–	(8,791)	(8,791)	(13)	(8,804)
	–	217	–	–	172	(14)	14	–	(9)	–	(8,791)	(8,411)	(13)	(8,424)
At December 31, 2011	₱11,273	(₱521)	₱4,111	(₱328)	₱915	₱85	₱14	₱12	(₱9)	₱6,000	₱42,236	₱63,788	₱4,713	₱68,501
At January 1, 2010	₱11,273	(₱960)	₱4,112	(₱328)	₱569	₱71	₱–	₱684	₱–	₱4,198	₱37,750	₱57,369	₱3,777	₱61,146
Net income	–	–	–	–	–	–	–	–	–	–	9,685	9,685	432	10,117
Other comprehensive income	–	–	–	–	–	25	–	(672)	–	–	–	(647)	15	(632)
Total comprehensive income	–	–	–	–	–	25	–	(672)	–	–	9,685	9,038	447	9,485
Appropriations - net of reversal	–	–	–	–	–	–	–	–	–	1,802	(1,802)	–	–	–
Collection of subscriptions receivable	–	222	(1)	–	–	–	–	–	–	–	–	221	–	221
Share-based payments	–	–	–	–	174	–	–	–	–	–	–	174	–	174
Cash dividends	–	–	–	–	–	–	–	–	–	–	(7,833)	(7,833)	3	(7,830)
	–	222	(1)	–	174	–	–	–	–	1,802	(9,635)	(7,438)	3	(7,435)
At December 31, 2010	₱11,273	(₱738)	₱4,111	(₱328)	₱743	₱96	₱–	₱12	₱–	₱6,000	₱37,800	₱58,969	₱4,227	₱63,196

See accompanying Notes to Consolidated Financial Statements.

Manila Electric Company and Subsidiaries

Consolidated Statements of Cash Flows

	Note	2012	2011	2010
		Years Ended December 31		
		(Amounts in Millions)		
CASH FLOWS FROM OPERATING ACTIVITIES				
Income before income tax of continuing operations		**₱21,877**	₱18,699	₱13,318
Income before income tax of discontinued operations	*6*	**1,061**	1,288	1,119
Income before income tax		**22,938**	19,987	14,437
Adjustments for:				
Depreciation and amortization	*8, 10 and 11*	**5,731**	5,637	6,219
Provisions, net of settlement	*20 and 30*	**8,948**	7,869	3,979
Interest and other financial income	*6 and 26*	**(2,683)**	(2,784)	(2,176)
Interest and other financial charges	*6 and 26*	**1,599**	1,628	714
Provision for doubtful accounts - net	*13*	**832**	2,243	961
Gain on disposal of investment	*6 and 26*	**(780)**	(24)	(355)
Reversal of write-down of inventory to net realizable value		**(45)**	(18)	(3)
Loss (gain) on disposal of utility plant and others		**(12)**	461	1,033
Employee share-based payments	*17*	**134**	172	174
Equity in net (earnings) losses of associates and joint ventures	*9*	**15**	(67)	(283)
Others		**89**	578	792
Operating income before working capital changes		**36,766**	35,682	25,492
Decrease (increase) in:				
Trade and other receivables		**(2,134)**	(4,964)	(503)
Inventories		**357**	323	(130)
Land and development costs		**–**	(3,331)	(517)
Deferred pass-through fuel costs		**–**	1,222	1,939
Other current assets		**285**	(2,180)	955
Increase (decrease) in:				
Trade payables and other current liabilities		**4,622**	11,163	44
Customers' refund		**(123)**	(881)	(2,241)
Customers' deposits		**2,487**	1,967	1,298
Deposits from pre-selling of condominium units		**–**	(457)	398
Long-term employee benefits		**1,212**	(1,301)	(1,424)
Net cash generated from operations		**43,472**	37,243	25,311
Income tax paid		**(7,228)**	(5,309)	(4,953)
Net cash flows from operating activities		**36,244**	31,934	20,358
CASH FLOWS FROM INVESTING ACTIVITIES				
Additions to:				
Utility plant and others	*8*	**(₱9,353)**	(₱8,343)	(₱8,510)
Intangibles	*11*	**(315)**	(209)	(300)
Investment properties	*10*	**–**	(42)	(110)
Investment in an associate	*9*	**(198)**	(517)	–
Interest and other financial income received		**2,174**	1,450	1,058
Proceeds from:				
Disposal of utility plant and others		**155**	107	82
Return of investment		**30**	65	752
Disposal of investment property		**–**	–	28
Settlement of deliverable currency forwards		**–**	–	5
Dividends received from associates	*9*	**33**	20	96
Dividends paid by subsidiaries attributable to non-controlling interests		**–**	–	(15)
Decrease (increase) in other noncurrent assets		**(2,075)**	653	622
Net cash flows used in investing activities		**(9,549)**	(6,816)	(6,292)
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from:				
Interest-bearing long-term financial liabilities, net of issue costs		**3,000**	11,720	10,528
Notes payable		**1,720**	2,150	380
Collection of subscriptions receivable		**310**	217	221
Payments of:				
Dividends	*16*	**(8,890)**	(9,866)	(6,187)
Interest-bearing long-term financial liabilities		**(4,565)**	(5,620)	(10,748)
Interest and other financial charges		**(2,882)**	(1,960)	(2,044)
Notes payable		**–**	(2,082)	(744)
Acquisition of treasury shares		**(2)**	(9)	–
Increase in other noncurrent liabilities		**973**	872	1,830
Net cash flows used in financing activities		**(10,336)**	(4,578)	(6,764)
NET INCREASE IN CASH AND CASH EQUIVALENTS		**16,359**	20,540	7,302
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		**44,141**	24,370	17,068
CASH AND CASH EQUIVALENTS OF DISCONTINUED OPERATIONS AT END OF YEAR		**–**	(769)	–
CASH AND CASH EQUIVALENTS AT END OF YEAR	*12*	**₱60,500**	₱44,141	₱24,370

See accompanying Notes to Consolidated Financial Statements.

Manila Electric Company and Subsidiaries
Notes to Consolidated Financial Statements

1. Corporate Information

Manila Electric Company or *MERALCO,* holds a congressional franchise under Republic Act or *RA* No. 9209 effective June 28, 2003. *RA* No. 9209 grants *MERALCO* a 25-year franchise valid through June 28, 2028 to construct, operate, and maintain the electric distribution system in the cities and municipalities of Bulacan, Cavite, Metro Manila, and Rizal and certain cities, municipalities, and barangays in the provinces of Batangas, Laguna, Pampanga, and Quezon. On October 20, 2008, the Energy Regulatory Commission or *ERC*, granted *MERALCO* a consolidated Certificate of Public Convenience and Necessity for the operation of electric service within its franchise coverage, effective until the end of *MERALCO*'s congressional franchise. *MERALCO* is the largest power distribution utility or *DU*, in the Philippines.

The power segment, primarily power distribution, consists of operations of *MERALCO* and its subsidiary, Clark Electric Distribution Corporation or *CEDC*. *CEDC* is registered with Clark Development Corporation or *CDC*, under *RA* No. 9400, *Bases Conversion Development Act of 1992*, as a Clark Special Economic Zone or *CSEZ,* enterprise, primarily engaged in owning, operating, and maintaining a power distribution system within *CSEZ*.

Separately, *MERALCO* organized a subsidiary for its re-entry into power generation through its wholly-owned subsidiary, MERALCO PowerGen Corporation or *MGen*, and another unit for its entry into retail electricity supply or *RES*. The *MERALCO* local *RES*, otherwise known as *MPower,* is a business unit within *MERALCO*. Through several other subsidiaries, its other business segments provide engineering, construction and consulting services, bill collection services, energy management services and information systems and technology services. *MERALCO*'s investment in common equity shares of Rockwell Land Corporation or *Rockwell Land*, was declared as property dividends on February 27, 2012 to stockholders of record as at March 23, 2012. On April 25, 2012, the Securities and Exchange Commission or *SEC,* approved the property dividend declaration. Consequently, *MERALCO* distributed and paid out the property dividends on May 11, 2012. The details of the declaration are in *Note 6 – Discontinued Operations*. *MERALCO* and its subsidiaries are collectively referred to as *MERALCO Group*.

MERALCO is owned by three major shareholder groups and the public. As at December 31, 2012, Beacon Electric Asset Holdings, Inc. or *Beacon Electric,* owns 48.30% of the common shares. *Beacon Electric* is jointly owned by Metro Pacific Investments Corporation or *Metro Pacific* and PLDT Communications and Energy Ventures, Inc., or *PCEV,* both of which are domestic corporations and are affiliates of First Pacific Company Limited, a Hong Kong-based investment and management company. San Miguel Corporation or *SMC*, together with its subsidiaries, San Miguel Purefoods Company Inc. and San Miguel Global Power Holdings, owns 32.83% of the outstanding shares of *MERALCO*. First Philippine Holdings Corporation or *First Holdings*, and First Philippine Utilities Corporation, collectively own 3.94%. The balance of *MERALCO*'s common shares is held by the public.

The common shares of *MERALCO* are listed on and traded in the Philippine Stock Exchange or *PSE*, with security symbol *MER*.

The registered office address of *MERALCO* is Lopez Building, Ortigas Avenue, Pasig City, Philippines.

The accompanying consolidated financial statements as at December 31, 2012 and 2011 and for each of the three years in the period ended December 31, 2012, were reviewed and recommended for approval to the Board of Directors or *BOD* by the Audit and Risk Management Committee on February 20, 2013. On February 25, 2013, these consolidated financial statements were approved and authorized for issue by the *BOD*.

2. Rate Regulations

As *DU*s, *MERALCO* and *CEDC* are subject to the rate-making regulations and regulatory policies of the *ERC*. Billings of *MERALCO* and *CEDC* to customers are itemized or "unbundled" into a number of bill components that reflect the various activities and costs incurred in providing electric service. The adjustment to each bill component is governed by mechanisms promulgated and enforced by the *ERC*, mainly: [i] the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities," which govern the recovery of pass-through costs, including over- or under-recoveries of the bill components, namely, (a) generation charge, (b) transmission charge, (c) system loss or *SL*, charge, (d) lifeline subsidy, and (e) local franchise tax or *LFT*, and business tax; and [ii] the "Rules for the Setting of Distribution Wheeling Rates or *RDWR*," as modified by *ERC* Resolution No. 20, Series of 2008, which govern the determination of *MERALCO*'s distribution, supply, and metering charges.

The rate-setting mechanism of *CEDC* is likewise in accordance with the *ERC* regulations. The following is a discussion of matters related to rate-setting of *MERALCO* and *CEDC*:

Rate Application

CEDC Rate Unbundling

On August 19, 2011, *CEDC* received an *ERC* Order to implement certain revisions of its schedule of rates effective on its August 2010 billing cycle, after the *ERC* approved *CEDC*'s unbundling application pursuant to Section 36 of *RA* No. 9136, *Electric Power Industry Reform Act of 2001* or *EPIRA*.

Thereafter, on June 21, 2012, *CEDC* received an Order from the *ERC* (docketed on May 28, 2012) directing *CEDC* to refund to its customers the amount of ₱804,587 (the difference between its then existing rates and the rates approved by the *ERC*) at a rate equivalent to ₱0.0067 per kilowatt hour or *kWh*, for a period of five (5) months or until the said amount shall have been fully refunded. The refund process was completed by *CEDC* in October 2012.

Performance-Based Regulations or PBR

MERALCO

MERALCO was among the Group A entrants to the *PBR*, together with Dagupan Electric Corporation and Cagayan Electric Power and Light Company, Inc.

Rate-setting under *PBR* is governed by the *RDWR*. The *PBR* scheme sets tariffs based on the regulated asset base of the *DU*s, and the required operating and capital expenditures once every regulatory period or *RP*, to meet operational performance and service level requirements responsive to the needs for adequate, reliable and quality power, efficient service, and growth of all customer classes in the franchise area as approved by the *ERC*. The *PBR* also employs a mechanism that penalizes or rewards a *DU* depending on its network and service performance.

As part of the *PBR*, *MERALCO* implements payouts to customers for instances when its performance is beyond the guaranteed service levels or *GSL*. See *Note 23 – Trade Payables and Other Current Liabilities*.

Rate filings and settings are done on a *RP* basis. One (1) *RP* consists of four (4) Regulatory Years or *RYs*. An *RY* for *MERALCO* begins on July 1 and ends on June 30 of the following year. As at December 31, 2012, *MERALCO* is operating in the first half of the second *RY* of the third *RP*. The third *RP* is from July 1, 2011 to June 30, 2015.

Maximum Average Price or MAP for RY 2008 and RY 2009

On January 11 and April 1, 2008, *MERALCO* filed separate applications for the approval of its proposed translation of the *MAP* for *RY* 2008 and *RY* 2009, respectively, into different rate schedules for its various customer segments. A portion of the distribution charge under-recoveries as a result of the delayed implementation of the *PBR* was incorporated in the proposed *MAP* for *RY* 2009.

In April 2009, the *ERC* approved the implementation of *MERALCO*'s average distribution rate of ₱1.2227 per *kWh* effective billing period of May 2009. This rate is inclusive of the under-recoveries for calendar year 2007 of ₱0.1285 per *kWh*.

On May 28, 2009, certain electricity consumer groups filed a Petition with the Court of Appeals, or *CA*, questioning the decision and Order of the *ERC* on *MERALCO*'s rate translation application for *RY* 2008 and *RY* 2009. In a decision dated January 27, 2010, the *CA* denied the Petition. Consequently, the consumer groups brought the case to the Supreme Court of the Philippines or *SC*. Comments and responses were filed by both parties with a Manifestation filed by *MERALCO* on January 26, 2011. As at February 25, 2013, the *SC* has yet to render its decision on this case.

MAP for RY 2010

In accordance with the *ERC*'s Guidelines for *RY* 2010 Rate Reset for First Entrant Distribution Utilities, the *MAP* for *RY* 2010 was computed at ₱1.4917 per *kWh*. In a Decision dated December 14, 2009, the *ERC* approved the said calculated *MAP* for *RY* 2010. Subsequently, however, on January 26, 2010, *MERALCO* filed a manifestation with the *ERC* voluntarily suspending the implementation of the *ERC*'s December 14, 2009 decision on the petition, to allow the regulator time to resolve issues raised by an intervenor. On March 10, 2010, the *ERC* resolved the Motion for Reconsideration and approved a new rate schedule affirming that there is no rate distortion and no cross-subsidies, other than the lifeline subsidy, in *MERALCO*'s rates. Consequently, *MERALCO* implemented the new rate schedule beginning with its April 2010 billing cycle.

Certain electricity consumer groups filed a Petition for Certiorari with the *SC* questioning the decision rendered by the *ERC*. On July 6, 2011, the *SC* dismissed the petition. Thereafter, on December 14, 2011, a motion for reconsideration filed by the same intervenors was denied with finality by the *SC*.

MAP for RY 2011

On December 6, 2010, the *ERC* approved *MERALCO*'s application for *MAP* for *RY* 2011 of ₱1.6464 per *kWh* and ordered *MERALCO* to implement, starting with its January 2011 billing cycle, the approved distribution, supply and metering charges. The 2011 *MAP* rates were implemented until September 2011.

Third RP Reset Application

On June 18, 2010, *MERALCO* filed an application for the approval of its proposed Annual Revenue Requirement or *ARR* and Performance Incentive Scheme or *PIS* for the third *RP*, the Final Determination of which was approved on June 6, 2011. The *PIS*, which sets the performance measures and targets that apply throughout the third *RP*, was also approved. A Petition for Certiorari of the *ERC*'s decision was filed by an intervenor with the *CA*.

On February 3, 2012, the *CA* denied such petition. This prompted the same intervenor to file a motion for reconsideration on such Resolution, which motion was likewise denied by the *CA* on June 28, 2012. Hence, said intervenor filed a Petition for Review on Certiorari of the *CA*'s resolutions with the *SC*.

On August 29, 2012, the *SC* denied such petition. The motion for reconsideration of such Resolution filed by the same intervenor was denied with finality by the *SC* on November 26, 2012.

MAP for RY 2012

On June 21, 2011, *MERALCO* filed its application for the approval of its *MAP* for *RY* 2012 and its translation into rate tariffs by customer category. On October 6, 2011, the *ERC* provisionally approved the *MAP* for *RY* 2012 of ₱1.6012 per *kWh* and the rate translation per customer class was reflected commencing with the October 2011 customer bills. As at February 25, 2013, hearings for the final approval of the application have been completed and all parties have submitted their respective memoranda. The application is pending approval by the *ERC*.

MAP for RY 2013

On June 11, 2012, the *ERC* provisionally approved the *MAP* for *RY* 2013 of ₱1.6303 per *kWh* which was reflected starting with the July 2012 customer bills. Hearings on this case have been completed and *MERALCO* is awaiting the final decision of the *ERC*.

CEDC

CEDC was among the four Group D entrants to the *PBR*. Similar to *MERALCO*, it is subject to operational performance and service level requirements approved by the *ERC*. The *RP* of *CEDC* began on October 1, 2011 and ends on September 30, 2015.

Reset Application and MAP for RY 2012

In compliance with the *ERC*'s *PBR* rate setting mechanism, *CEDC* filed a reset application for the approval of its *ARR* and *PIS* with the *ERC*. *CEDC* filed its revised application on November 3, 2010, which underwent a series of hearings and public consultations in 2011. The *ERC* issued *CEDC*'s Final Determination on August 5, 2011. Subsequently, *CEDC* filed with the *ERC* its application for *RY* 2012 Rate Translation into the different customer classes.

On April 10, 2012, the *ERC* approved with modification, *CEDC*'s application for the approval of the translation into distribution rates of different customer classes for the first *RY* of the approved *ARR* under the *PBR* for the *RP* October 1, 2011 to September 30, 2015. *CEDC* implemented the approved distribution, supply and metering charges of ₱0.8527 per *kWh* and the new customer segments in its June 2012 billing.

MAP for RY 2013

On August 30, 2012, *CEDC* filed its application for the approval of its *MAP* for RY 2013. The *ERC*, on December 17, 2012, approved a *MAP* of ₱0.8953 per *kWh*. The revised rates based on the approved *MAP* 2013 were implemented by *CEDC* starting January 2013.

SC Decision on Unbundling Rate Case

On May 30, 2003, the *ERC* issued an Order approving *MERALCO*'s unbundled tariffs that resulted in a total increase of ₱0.17 per *kWh* over the May 2003 tariff levels. However, on August 4, 2003, certain consumer and civil society groups filed a Petition for Review of the *ERC*'s ruling with the *CA*. On July 22, 2004, the *CA* set aside the *ERC*'s ruling on *MERALCO*'s rate unbundling and remanded the case to the *ERC*. Further, the *CA* opined that the *ERC* should have asked the Commission on Audit or *COA*, to audit the books of *MERALCO*. The *ERC* and *MERALCO* subsequently filed separate motions asking the *CA* to reconsider its decision. On January 24, 2005, as a result of the denial by the *CA* of the motions, the *ERC* and *MERALCO* elevated the case to the *SC*.

In an En Banc decision promulgated on December 6, 2006, the *SC* set aside and reversed the *CA* ruling saying that a *COA* audit was not a prerequisite in the determination of a utility's rates. However, while the *SC* affirmed *ERC*'s authority in rate-fixing, the *SC* directed the *ERC* to request *COA* to undertake a complete audit of the books, records and accounts of *MERALCO*. On January 15, 2007, in compliance with the directive of the *SC*, the *ERC* requested *COA* to conduct an audit of the books, records and accounts of *MERALCO* using calendar years 2004 and 2007 as test years.

The *COA* audit, which began in September 2008, was completed in August 2009.

On February 17, 2010, the *ERC* issued its Order directing *MERALCO* and all intervenors in the case to submit, within 15 days from receipt of the Order, their respective comments on the *COA*'s "Report No. 2009-01 Rate Audit Unbundled Charges."

On July 1, 2011, the *ERC* maintained and affirmed its findings and conclusions in its Order dated March 20, 2003. The *ERC* stated that the *COA* recommendation to apply disallowances under *PBR* to rate unbundling violates the principle against retroactive rate-making. An intervenor group filed a motion for reconsideration of the said Order. On September 5, 2011, *MERALCO* filed its comment to the intervenor's motion for reconsideration. On February 4, 2013, the *ERC* denied the intervenor's motion for reconsideration. A petition for Review of the *ERC*'s order was filed by an intervenor group with the *CA*.

Applications for the Recovery of Generation Costs and SL Charges

MERALCO filed separate applications for the full recovery of generation costs, including value-added tax or *VAT*, incurred for the supply months of August 2006 to May 2007 or total under-recoveries of ₱12,679 million for generation charges and ₱1,295 million for *SL* charges.

The separate applications for the full recovery of generation charges have been approved by the *ERC* in its decisions released on January 18, 2008, September 3, 2008 and August 16, 2010.

As at December 31, 2012, the remaining balance of ₱1,162 million of such unrecovered generation costs will be billed in 2013 at the rate of ₱0.0314 per *kWh* until fully recovered. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

With respect to the ₱1,295 million *SL* charge under-recoveries, the *ERC* ordered *MERALCO* to file a separate application for the recovery of *SL* adjustments after the *ERC* confirms the transmission rate to be used in the calculation of the *SL* rate in accordance with the *SL* rate formula of the Automatic Generation Rate Adjustments Guidelines. *MERALCO* has filed the application for recovery of the ₱1,295 million *SL* charge under-recoveries with the *ERC*. This was included in the Consolidated Application of under/over recoveries in generation, transmission, *SL* and lifeline charges filed on March 31, 2011 with the *ERC*. Hearings were completed on October 25, 2011. On December 12, 2011, *MERALCO* filed for the admission of its Supplemental Application. An expository hearing was conducted on February 1, 2012. As at February 25, 2013, *MERALCO* has already filed its Formal Offer of Evidence or *FOE* and is awaiting the final resolution by the *ERC*.

Inter-Class Cross Subsidies and Lifeline Subsidies

MERALCO filed separate applications to recover inter-class cross subsidies (on November 14, 2007) and lifeline subsidies (on February 19, 2008).

In a decision dated November 16, 2009, the *ERC* authorized *MERALCO* to recover the inter-class cross subsidy under-recoveries covering the period June 2003 to October 2006 amounting to ₱1,049 million and total lifeline subsidy under-recoveries covering the period June 2003 to December 2007 amounting to ₱856 million.

In December 2009, *MERALCO* implemented the decisions of the *ERC* on the inter-class cross and lifeline subsidies. As at December 31, 2012, the total amount of billed inter-class cross subsidies and lifeline subsidies amounted to ₱963 million and ₱638 million, respectively. The unbilled balance of inter-class cross subsidies is ₱86 million and is expected to be recovered within the next 3 months from January 1, 2013. The balance of lifeline subsidies is ₱218 million and will be billed within the next 13 months from January 1, 2013. The amount recoverable within 12 months is included in the "Trade and other receivables" account while the long-term portion is included in the "Other noncurrent assets" account.

Consolidated Applications for the Confirmation of Over/Under-recoveries of Pass-through Charges

On August 12, 2009, the *ERC* issued Resolution No. 16, Series of 2009, adopting the "Rules Governing the Automatic Cost Adjustment and True-up Mechanisms and Corresponding Confirmation Process for Distribution Utilities." These rules govern the recovery of pass-through costs, including over- or under-recoveries with respect to the following bill components: generation charge, transmission charge, *SL* charge, lifeline and interclass rate subsidies, *LFT* and business tax. On October 18, 2010, the *ERC* promulgated *ERC* Resolution No. 21, Series of 2010, amending certain formula contained in *ERC* Resolution No. 16, Series of 2009, and setting March 31, 2011 (covering adjustments implemented until the billing month of December 2010) and March 31, 2014 (covering adjustments from January 2011 to December 2013) as the new deadlines for *DU*s in Luzon to file their respective applications. Subsequent filings shall be made every three years thereafter.

On March 31, 2011, *MERALCO* filed a consolidated application with the *ERC* to confirm its under- or over-recoveries accumulated from June 2003 to December 2010 in compliance with Resolution No. 16, Series of 2009, as subsequently amended by Resolution No. 21, Series of 2010. Hearings were completed on October 25, 2011. On December 8, 2011, *MERALCO* filed an Omnibus Motion praying, among other things, for the admission of the Supplemental Application. In an Order dated December 12, 2011, the *ERC* granted *MERALCO*'s Omnibus Motion and admitted its Supplemental Application. Accordingly, hearings on the Supplemental Application were conducted where *MERALCO* presented additional evidence. *MERALCO* filed its *FOE* on September 13, 2012. The consolidated filing includes net generation charge under-recoveries of ₱1,000 million, net transmission charge over-recoveries of ₱111 million, net lifeline subsidy under-recoveries of ₱9 million and net *SL* over-recoveries of ₱425 million, excluding any applicable carrying charges.

On July 6, 2012, *MERALCO* filed a consolidated application with the *ERC* to confirm its under- or over-recoveries for the calendar year 2011. The consolidated filing includes net generation charge under-recoveries of ₱1,826 million, transmission charge under-recoveries of ₱253 million, net lifeline subsidy under-recoveries of ₱39 million and SL over-recoveries of ₱445 million, excluding any applicable carrying charges. As at February 25, 2013, hearings on the application have been terminated and *MERALCO* has submitted its *FOE* on January 25, 2013. The application is pending approval by the *ERC*.

Petition to Implement a Lower Generation Charge for the February 2010 Supply Month

MERALCO's generation cost abruptly increased to ₱15,934 million for the supply month of February 2010. This translated to a generation charge of ₱6.76 per *kWh* to its customers for the March 2010 billing. The sharp increase in generation cost was mainly due to abnormally high prices in the Wholesale Electricity Spot Market or *WESM*. A Petition was filed by *MERALCO* to mitigate the effects of the abrupt increase in generation cost through a voluntary deferral of a portion of generation costs, with the differential to be recovered over a period, which shall be approved by the *ERC*. In an Order dated March 10, 2010, the *ERC* provisionally approved a lower generation charge of ₱5.8417 per *kWh* representing ₱13,773 million generation cost for the subject month. *MERALCO* was also provisionally allowed to charge over a six month period starting April 2010 the generation charge at the rate of ₱0.07 per *kWh*, corresponding to the incremental costs of the condensate fuel used by First Gas Corporation or *FGC*'s Sta. Rita and FGP Corp. or *FGP*'s San Lorenzo power plants during the said month. In its decision dated July 25, 2011, the *ERC* authorized *MERALCO* to collect the additional generation cost for the period January 26, 2010 to February 25, 2010 including carrying charges. The approved recovery was implemented starting with its September 2011 billing cycle. The amount was fully recovered in October 2012.

Deferred PPA

On October 14, 2009, the *ERC* released its findings on *MERALCO*'s implementation of the collection of the approved pass-through cost under-recoveries in 2004. *ERC* directed *MERALCO* to refund ₱268 million of deferred *PPA* transmission line costs related to Quezon Power (Philippines) Limited Company or *QPPL* and deferred accounting adjustments or *DAA* incurred to customers, along with ₱184 million in carrying charges, or an equivalent of ₱0.0169 per *kWh*. *MERALCO* implemented the refund beginning November 2009 until September 2010. However, the *ERC* has yet to rule on *MERALCO*'s deferred *PPA* under-recoveries of ₱106 million, which does not represent the transmission line fee. As at February 25, 2013, *MERALCO* has filed a Motion for Reconsideration, which is pending decision by the *ERC*.

Application for Recovery of Local Franchise Taxes or LFT

On March 25, 2011, *MERALCO* filed with the *ERC* an application for recovery of *LFT* paid but not yet billed to customers for the period beginning first quarter of 1993 up to the second quarter of 2004 for five provinces, namely: Bulacan, Batangas, Cavite, Laguna and Rizal; and 14 cities, namely: San Jose Del Monte, Batangas, San Pablo, Tagaytay, Lucena, Mandaluyong, Marikina, Quezon, Caloocan, Pasay, Las Piñas, Manila, Pasig and Calamba. The *LFT* is recognized as a legitimate and reasonable *DU* expense in the *ERC*'s unbundling decision.

In a Decision dated February 27, 2012, the *ERC* released its Order approving with modifications *MERALCO*'s application. The *ERC* approved recovery of *LFT* amounting to ₱1,571 million plus carrying charges of ₱730 million. The recovery of *LFT* and carrying charges were recognized as part of "Other income" account and "Interest and other financial income" account, respectively, in the 2012 consolidated statement of income. As directed by the *ERC*, the recovery was reflected as a separate item in the *MERALCO* billing statement to its customers beginning April 2012. As at December 31, 2012, a total of ₱393 million *LFT* and carrying charges have been billed to affected customers.

SC Decision on the ₱0.167 per kWh Refund

Following the *SC*'s final ruling that directed *MERALCO* to refund affected customers ₱0.167 per *kWh* for billings made from February 1994 to April 2003, the *ERC* approved the release of the refund in four phases. The refund is still ongoing. See *Note 21 – Customers' Refund*.

3. Basis of Preparation and Statement of Compliance

The accompanying consolidated financial statements have been prepared on a historical cost basis, except for *MERALCO*'s utility plant and others and investment properties acquired before January 1, 2004, which are carried at deemed cost and for derivative financial instruments and available-for-sale, or *AFS*, financial assets, which are measured at fair value. Derivative financial instruments are shown as part of "Other current assets" or "Trade payables and other current liabilities" accounts, as applicable, in the consolidated statement of financial position. *AFS* financial assets are included as part of "Other noncurrent assets" account in the consolidated statement of financial position.

The accompanying consolidated financial statements are presented in Philippine peso, the *MERALCO Group*'s functional and presentation currency. All values are rounded to the nearest million peso, except when otherwise indicated.

Statement of Compliance

The consolidated financial statements of *MERALCO* and its subsidiaries have been prepared in compliance with Philippine Financial Reporting Standards or *PFRS*. *PFRS* includes statements named *PFRS* and Philippine Accounting Standards or *PAS*, including Interpretations issued by the Philippine Financial Reporting Standards Council or *PFRSC*.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of *MERALCO* and its subsidiaries as at December 31 of each year, except for Meralco Industrial Engineering Services Corporation or *MIESCOR*, whose financial reporting date ends on September 30. Adjustments and disclosures are made for the effects of significant transactions or events that occurred between the date of *MIESCOR*'s financial statements and the date of *MERALCO Group*'s consolidated financial statements.

The *SEC* and the Bureau of Internal Revenue or *BIR* approved the change in reporting period for *MIESCOR* (January 2013), Miescor Logistics, Inc. or *MLI (*October 2012 and November, respectively) and Miescor Builders, Inc. or *MBI* (October 2012 and December 2012, respectively), from fiscal year ending September 30 to calendar year ending December 31.

The consolidated financial statements include the financial statements of *MERALCO* and the following directly and indirectly-owned subsidiaries:

			2012		2011	
			Percentage of Ownership			
Subsidiaries	Place of Incorporation	Principal Business Activity	Direct	Indirect	Direct	Indirect
Corporate Information Solutions, Inc., or *CIS*	Philippines	e-Transactions	**100**	**–**	100	–
CIS Bayad Center, Inc., or Bayad Center	Philippines	Bills payment collection	**–**	**100**	–	100
Customer Frontline Solutions, Inc. or CFSI	Philippines	Tellering services	**–**	**100**	–	100
Meralco Energy, Inc., or *MEI*	Philippines	Energy systems management	**100**	**–**	100	–
eMERALCO Ventures, Inc., or *e-MVI*	Philippines	e-Business development	**100**	**–**	100	–
Paragon Vertical Corporation	Philippines	Information technology and multi-media services	**–**	**100**	–	100
MGen	Philippines	Development of power generation plants	**100**	**–**	100	–
Calamba Aero Power Corporation[1]	Philippines	Power generation	**–**	**100**	–	100
Atimonan Land Ventures Development	Philippines	Real estate	**–**	**100**	–	100
Meralco Financial Services Corporation or *Finserve*	Philippines	Financial services provider	**100**	**–**	100	–
Republic Surety and Insurance Company, Inc. or *RSIC*	Philippines	Insurance	**100**	**–**	100	–
Lighthouse Overseas Insurance Limited or *LOIL*	Bermuda	Insurance	**100**	**–**	100	–
MIESCOR	Philippines	Engineering, construction and consulting services	**99**	**–**	99	–
MBI	Philippines	Electric transmission and distribution operation and maintenance	**–**	**99**	–	99
MLI	Philippines	General services, manpower/maintenance	**–**	**99**	–	99
Miescorrail, Inc. or Miescorrail[3]	Philippines	Engineering, construction and maintenance of mass transit system	**–**	**99**	–	60
CEDC	Philippines	Power distribution	**65**	**–**	65	–
Rockwell Land[4]	Philippines	Real estate	**–**	**–**	51	–

[1] *Incorporated February 15, 2011 and has not started commercial operations as at December 31 2012.*
[2] *Incorporated December 7, 2011 and has not started commercial operations as at December 31, 2012.*
[3] *On May 14, 2012, Miescor acquired the minority share from its joint venture partner.*
[4] *Presented as discontinued operations. See Note 6 – Discontinued Operations.*

Subsidiaries are fully consolidated from the date of acquisition, being the date at which *MERALCO* obtains control, and continue to be consolidated until the date that such control ceases. Control is the power to govern the financial and operating policies of the entity.

The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events with similar circumstances. All intra-group balances, income and expenses, unrealized gains and losses and dividends resulting from intra-group transactions are eliminated in full.

Non-controlling interests represent the portion of profit or loss and net assets in *CEDC* and *MIESCOR* and its subsidiaries not held by *MERALCO* and are presented separately in the consolidated statement of income, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from equity attributable to equity holders of the parent.

Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if that results in a deficit.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction.

If the *MERALCO Group* loses control over a subsidiary, it: (a) derecognizes the assets (including goodwill) and liabilities of the subsidiary; (b) derecognizes the carrying amount of any non-controlling interest; (c) derecognizes the cumulative translation adjustments deferred in equity; (d) recognizes the fair value of the consideration received; (e) recognizes the fair value of any investment retained; (f) recognizes any surplus or deficit in profit or loss; and (g) reclassifies *MERALCO*'s share of components previously recognized in the consolidated statement of comprehensive income to the consolidated statement of income.

4. Significant Accounting Policies, Changes and Improvements

Changes in Accounting Policies and Disclosures

The accounting policies adopted in the preparation of consolidated financial statements are consistent with those of the previous financial year except for the adoption of the following amendments and improvements to existing standards, which were effective beginning January 1, 2012. The adoption of these changes and improvements did not have any significant effect on the consolidated financial statements.

- *PFRS* 7, *Financial Instruments: Disclosures - Enhanced Derecognition and Transfer of Financial Assets Disclosure Requirements* – The amended standard requires additional disclosure on financial assets that have been transferred but not derecognized and an entity's continuing involvement in the derecognized assets. This disclosure is required to enable the user of the financial statements to evaluate the related risks.

- *PAS* 12, *Income Taxes - Deferred Taxes: Recovery of Underlying Assets* (Amended) – The amendment clarifies that the deferred tax on investment property measured using the fair value model in *PAS* 40, *Investment Property* should be determined considering that its carrying value will be recovered through sale. Deferred tax on non-depreciable assets that are measured using the revaluation model in *PAS* 16, *Property, Plant and Equipment* should also be measured on a sale basis.

New Accounting Standards and Interpretations to Existing Standards Effective Subsequent to December 31, 2012

The *MERALCO Group* will adopt the following revised standards and interpretations enumerated below, which are relevant when these become effective. Except as otherwise indicated, the *MERALCO Group* does not expect the adoption of these revised standards and amendments to *PFRS* to have a significant impact on the *MERALCO Group's* consolidated financial statements.

Effective 2013

PFRS 7, Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities

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

a) The gross amounts of those recognized financial assets and recognized financial liabilities;
b) The amounts that are set off in accordance with the criteria in *PAS 32* when determining the net amounts presented in the statement of financial position;
c) The net amounts presented in the statement of financial position;
d) The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:
    i. Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in *PAS 32*; and
    ii. Amounts related to financial collateral (including cash collateral); and
e) The net amount after deducting the amounts in (d) from the amounts in (c) above.

The amendments to *PFRS 7* are to be applied retrospectively and are effective for annual periods beginning on or after January 1, 2013. The amendments affect disclosures only and have no impact on *MERALCO Group*'s financial position or performance.

PFRS 10, Consolidated Financial Statements

PFRS 10 replaces the portion of *PAS 27, Consolidated and Separate Financial Statements*, that addresses the accounting for consolidated financial statements. It also includes the issues raised in Standing Interpretations Committee or *SIC* 12, *Consolidation - Special Purpose Entities. PFRS 10* establishes a single control model that applies to all entities including special purpose entities. The changes introduced by *PFRS 10* will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in *PAS 27*. The standard becomes effective for annual periods beginning on or after January 1, 2013.

A reassessment of control was performed by *MERALCO* on all its subsidiaries and associates in accordance with the provisions of *PFRS 10*. Based on the reassessment made, *MERALCO* has not determined any change in the control in any of its subsidiaries and associates.

PFRS 11, Joint Arrangements

PFRS 11 replaces *PAS 31, Interests in Joint Ventures*, and *SIC 13, Jointly Controlled Entities - Non-Monetary Contributions by Venturers*. *PFRS 11* removes the option to account for jointly controlled entities using proportionate consolidation. Instead, jointly controlled entities that meet the definition of a joint venture must be accounted for using the equity method. The standard becomes effective for annual periods beginning on or after January 1, 2013. The application of this new standard will have no impact in the consolidated financial statements of the *MERALCO Group*.

PFRS 12, Disclosure of Interests in Other Entities

PFRS 12 includes all of the disclosures related to consolidated financial statements that were previously in *PAS 27*, as well as all the disclosures that were previously included in *PAS 31* and *PAS 28, Investments in Associates*. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. The standard becomes effective for annual periods beginning on or after January 1, 2013.

The adoption of *PFRS 12* will affect disclosures only and will have no impact on the *MERALCO Group*'s financial position or performance.

PFRS 13, Fair Value Measurement

PFRS 13 establishes a single source of guidance under *PFRS* for all fair value measurements. *PFRS 13* does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under *PFRS* when fair value is required or permitted. This standard should be applied prospectively as of the beginning of the annual period in which it is initially applied. Its disclosure requirements need not be applied in comparative information provided for periods before initial application of *PFRS 13*. The standard becomes effective for annual periods beginning on or after January 1, 2013.

The *MERALCO Group* does not anticipate that the adoption of this standard will have any significant impact on its financial position and performance.

PAS 27, Separate Financial Statements (as revised in 2011)

As a consequence of the issuance of the new *PFRS 10* and *PFRS 12*, what remains of *PAS 27* is limited to accounting for subsidiaries, jointly controlled entities, and associates in the separate financial statements. The adoption of the amended *PAS 27* will not have any significant impact on the separate financial statements of the entities in the *MERALCO Group*. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 28, Investments in Associates and Joint Ventures (as revised in 2011)

As a consequence of the issuance of the new *PFRS 11* and *PFRS 12*, *PAS 28* has been renamed *PAS 28, Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The adoption of the amended *PAS 28* will not have a significant impact on the consolidated financial statements of the *MERALCO Group*. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 1, Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income or OCI

The amendments to *PAS 1* change the grouping of items presented in *OCI*. Items that can be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) will be presented separately from items that will never be recycled. The amendments affect presentation only and have no impact on the *MERALCO Group*'s financial position or performance. The amendment becomes effective for annual periods beginning on or after July 1, 2012. The amendments will be applied retrospectively and will result in the modification of the presentation of items of *OCI*.

PAS 19, Employee Benefits (Amendments)

Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and rewording. The revised standard also requires new disclosures such as, among others, a sensitivity analysis for each significant actuarial assumption, information on asset-liability matching strategies, duration of the defined benefit obligation, and disaggregation of plan assets by nature and risk. The amendments become effective for annual periods beginning on or after January 1, 2013. Once effective, the *MERALCO Group* shall apply the amendments retroactively to the earliest period presented.

The *MERALCO Group* reviewed its existing employee benefits and determined that the amended standard will have a significant impact on its accounting for retirement benefits. The *MERALCO Group* obtained the services of an external actuary to compute the impact on the consolidated financial statements upon adoption of the standard. The effects are detailed below:

	As at December 31, 2012	As at December 31, 2011	As at January 1, 2011
		(In Millions)	
Consolidated statements of financial position			
Increase (decrease) in:			
Net defined benefit liability	**(₱565)**	₱2,356	₱3,072
Deferred tax assets	**(170)**	707	922
Other comprehensive income	**262**	(1,682)	(2,151)
Retained earnings	**135**	33	–

	For the years ended December 31	
	2012	2011
	(In Millions)	
Consolidated statements of income		
Increase (decrease) in:		
Net benefit cost	**(₱145)**	(₱47)
Provision for income tax	**43**	14
Profit for the year attributable to:		
Equity holders of the Parent	**102**	33
Non-controlling interests	**-**	–

Philippine Interpretation *IFRIC 29, Stripping Costs in the Production Phase of a Surface Mine*

This interpretation applies to waste removal (stripping) costs incurred in surface mining activity, during the production phase of the mine. The interpretation addresses the accounting for the benefit from the stripping activity. The interpretation is effective for annual periods beginning on or after January 1, 2013. This new interpretation is not relevant to the *MERALCO* Group.

Effective 2014

PAS 32, Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities

The amendments clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the *PAS 32* offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments affect presentation only and have no impact on the *MERALCO Group*'s financial position or performance. The amendments to *PAS 32* are to be applied retrospectively for annual periods beginning on or after January 1, 2014.

Effective 2015

PFRS 9, Financial Instruments: Classification and Measurement

PFRS 9, as issued, reflects the first phase on the replacement of *PAS 39* and applies to the classification and measurement of financial assets and liabilities as defined in PAS 39, *Financial Instruments: Recognition and Measurement*. Work on impairment of financial instruments and hedge accounting is still ongoing, with a view to replacing *PAS 39* in its entirety. *PFRS 9* requires all financial assets to be measured at fair value at initial recognition. A debt financial asset may, if the fair value option *or FVO* is not invoked, be subsequently measured at amortized cost if it is held within a business model that has the objective to hold the assets to collect the contractual cash flows and its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. All other debt instruments are subsequently measured at fair value through profit or loss. All equity financial assets are measured at fair value either through other *OCI* or profit or loss. Equity financial assets held for trading must be measured at fair value through profit or loss. For *FVO* liabilities, the amount of change in the fair value of a liability that is attributable to changes in credit risk must be presented in *OCI*. The remainder of the change in fair value is presented in profit or loss, unless presentation of the fair value change in respect of the liability's credit risk in *OCI* would create or enlarge an accounting mismatch in profit or loss. All other *PAS 39* classification and measurement requirements for financial liabilities have been carried forward into *PFRS 9*, including the embedded derivative separation rules and the criteria for using the *FVO*. *MERALCO Group* conducted an evaluation of the early adoption of *PFRS* 9 and has assessed that the first phase of *PFRS 9* will have an effect on the classification and measurement of financial assets. The *MERALCO Group* will quantify the effect on the consolidated financial statements in conjunction with the other phases, when issued, to present a comprehensive picture.

PFRS 9 is effective for annual periods beginning on or after January 1, 2015.

Deferred Effectivity

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

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

Annual Improvements to PFRS (2009-2011 cycle)

The *Annual Improvements to PFRS* (2009-2011 cycle) contain non-urgent but necessary amendments to *PFRS*. The amendments are effective for annual periods beginning on or after January 1, 2013 and to be applied retrospectively. Earlier application is permitted.

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

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

PAS 1, Presentation of Financial Statements - Clarification of the requirements for comparative information

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

PAS 16, Property, Plant and Equipment - Classification of servicing equipment

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

PAS 32, Financial Instruments: Presentation - Tax effect of distribution to holders of equity instruments

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

PAS 34, Interim Financial Reporting - Interim financial reporting and segment information for total assets and liabilities

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

Significant Accounting Policies

The principal accounting policies adopted in the preparation of the consolidated financial statements are as follows:

Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition-date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the *MERALCO Group* elects whether to measure the non-controlling interest in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs in a business combination are expensed.

When a business is acquired, an assessment is made of the identifiable assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic and other pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquirer's previously held equity interest in the acquiree is remeasured at fair value as at acquisition date and any resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration, which is deemed to be an asset or liability will be recognized in accordance with *PAS 39,* either in profit or loss or other comprehensive income. If the contingent consideration is classified as equity, it shall not be remeasured until it is finally settled within equity.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the previously held equity interest in the acquiree, over the fair value of net identifiable assets acquired. If the difference is negative, such difference is recognized as gain in the consolidated statement of income.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from acquisition date, allocated to each of the cash generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units, beginning on the acquisition date.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in such circumstance is measured based on relative values of the operation disposed and the portion of the cash-generating unit retained.

Business combinations involving entities under common control are accounted for similar to the pooling-of-interest method. The assets and liabilities of the combining entities are reflected at their carrying amounts reported in the consolidated financial statements of the controlling holding company. Any difference between the consideration paid and the share capital of the "acquired" entity is reflected within equity as additional paid-in capital. The consolidated statement of income reflects the results of the combining entities for the full year, irrespective of when the combination takes place. Comparatives are presented as if the entities had always been combined since the date the entities were under common control.

Utility Plant and Others

Utility plant and others, except land, are stated at cost, net of accumulated depreciation and amortization and accumulated impairment loss, if any. Costs include the cost of replacing part of such utility plant and other properties when such cost is incurred, if the recognition criteria are met. All other repair and maintenance costs are recognized as incurred in the consolidated statement of income. The present value of the expected cost for the decommissioning of the asset after use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Land is stated at cost less any impairment in value.

MERALCO's utility plant and others are stated at deemed cost. The revalued amount recorded as at January 1, 2004 was adopted as deemed cost as allowed by the transitional provisions of *PFRS 1.* The balance of revaluation increment was closed to retained earnings. See *Note 16 – Equity* for the related discussion.

Depreciation and amortization of utility plant and others are computed using the straight-line method (except for certain subtransmission and distribution assets, which use straight-line functional group method) over the following estimated useful lives:

Asset Type	Estimated Useful Lives
Subtransmission and distribution	10–50 years, depending on the life of the significant parts
Others:	
Buildings and improvements	15–40 years
Communication equipment	10 years
Office furniture, fixtures and other equipment	5 years
Transportation equipment	5–10 years
Others	5–20 years

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

The asset's residual values, useful lives and methods of depreciation and amortization are reviewed, and adjusted prospectively if appropriate, at each financial year-end to ensure that the residual values, periods and methods of depreciation and amortization are consistent with the expected pattern of economic benefits from items of utility plant and others.

Construction in Progress

Construction in progress is stated at cost, which includes cost of construction, plant and equipment, capitalized borrowing costs and other direct costs. Construction in progress is not depreciated until such time that the relevant assets are substantially completed and available for their intended use.

Borrowing Costs

Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Capitalization of borrowing costs commences when the activities necessary to prepare the asset for its intended use or sale have been undertaken and expenditures and borrowing costs have been incurred. Borrowing costs are capitalized until the asset is substantially available for its intended use.

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as any exchange differences arising from any foreign currency- denominated borrowings used to finance the projects, to the extent that they are regarded as an adjustment to interest costs.

All other borrowing costs are expensed as incurred.

Investment Properties

Investment properties, except land, are stated at cost, net of accumulated depreciation and accumulated impairment loss, if any. The carrying amount includes transaction costs and costs of replacing part of an existing investment property at the time such costs are incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property.

Investment properties include properties that are being constructed or developed for future use as investment property.

Land classified as investment property is carried at cost less any impairment in value.

MERALCO's investment properties acquired before January 1, 2004 are stated at deemed cost. See *Note 16 – Equity* for the related discussions.

Investment properties, except land, are being depreciated on a straight-line basis over the useful life of five to 35 years.

Investment properties are derecognized either when they have been disposed of or when these are permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gain or loss from the derecognition of the investment properties are recognized in the consolidated statement of income in the year these are disposed or retired.

Transfers are made to investment property when and only when there is a change in use, evidenced by ending of owner-occupation or commencement of an operating lease to another party. If owner-occupied property becomes an investment property, the *MERALCO Group* accounts for such property in accordance with the policy stated under utility plant and others up to the date of the change in use. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale. Transfers from investment property are recorded using the carrying amount of the investment property at the date of change in use.

Asset Retirement Obligations

Under the terms of certain lease contracts, the *MERALCO Group* is required to dismantle the installations made in leased sites and restore such sites to their original condition at the end of the term of the lease contracts. The *MERALCO Group* recognizes a liability measured at the present value of the estimated costs of these obligations and capitalizes such costs as part of the balance of the related item of utility plant and others and investment properties. The amount of asset retirement obligations is accreted and such accretion is recognized as interest expense.

Intangible Assets

Intangible assets acquired separately are initially measured at cost. Following initial recognition, intangible assets are carried at cost less accumulated amortization and any accumulated impairment loss. The useful lives of intangible assets are assessed at the individual asset level as having either finite or indefinite useful lives.

Intangible assets with finite lives are amortized over the useful economic lives of five years using the straight-line method and assessed for impairment whenever there is an indication that the intangible assets may be impaired. At a minimum, the amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at each reporting date. Changes in the expected useful life or the expected consumption pattern of future economic benefit embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and treated as change in accounting estimates. The amortization expense of intangible assets with finite lives is recognized in the consolidated statement of income.

Intangible assets with indefinite useful lives are not amortized, but are assessed for impairment annually either individually or at the cash-generating unit level. The assessment of indefinite useful life is done annually at every reporting date to determine whether such indefinite useful life continues to exist. Otherwise, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

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

Intangible assets generated within the business are not capitalized and expenditures are charged to profit or loss in the year these are incurred.

Investments in Associates

An associate is an entity over which *MERALCO* has significant influence and which is neither a subsidiary nor a joint venture. Investments in associates are accounted for using the equity method of accounting and are initially recognized at cost.

Under the equity method, investment in an associate is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the *MERALCO Group*'s share of net assets of the associate, less any impairment in value. Any goodwill relating to an associate is included in the carrying amount of the investment and is not amortized nor individually tested for impairment. The consolidated statement of income reflects the *MERALCO Group*'s share of the results of operations of the associates. Where there has been a change recognized directly in the equity of the associate, the *MERALCO Group* recognizes its share in any change and discloses this, when applicable, in the consolidated statement of comprehensive income and changes in equity. Unrealized gains and losses resulting from transactions between and among the *MERALCO Group* and the associates are eliminated to the extent of the interest in those associates.

The share in profits and losses of associates is shown on the face of the consolidated statement of income. This is the profit or loss attributable to equity holders of the associate and is therefore profit or loss after tax and net of non-controlling interest in the subsidiaries of the associates.

The reporting date of the associates and that of the *MERALCO Group* are identical and the associates' accounting policies conform with those used by the *MERALCO Group* for like transactions and events in similar circumstances.

After application of the equity method, the *MERALCO Group* determines whether it is necessary to recognize an impairment loss on the investments in associates. At the end of each reporting date, the *MERALCO Group* determines whether there is any objective evidence that each of the investments in associates is impaired. If this is the case, the *MERALCO Group* calculates the amount of impairment as the difference between the recoverable amount of the investment in associate and its carrying value and recognizes the amount in the consolidated statement of income.

Upon loss of significant influence over the associate, the *MERALCO Group* measures and recognizes any remaining investment at its fair value. Any difference between the carrying amount of the investment in associate upon loss of significant influence, and the aggregate of the fair value of the remaining investment and proceeds from disposal, is recognized in the consolidated statement of income.

Investments in Joint Ventures

The *MERALCO Group*'s ownership interests in Indra Philippines, Inc. or *Indra Philippines,* and *Rockwell Business Center*, both jointly controlled entities, are accounted for using the equity method of accounting in the consolidated financial statements. The interests in joint ventures are carried at cost plus post-acquisition changes in the *MERALCO Group*'s share in the net assets of the joint ventures, less any impairment in value. The *MERALCO Group*'s share in the results of operations of the joint ventures is recognized in the consolidated statement of income.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. A jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest. The financial statements of the joint ventures are prepared for the same reporting year as that of the *MERALCO Group*, using consistent accounting policies.

Adjustments are made in the consolidated financial statements to eliminate the *MERALCO Group*'s share of unrealized gains and losses on transactions between the *MERALCO Group* and the jointly controlled entities. The joint venture is carried at equity method until the date on which the *MERALCO Group* ceases to have joint control over the jointly controlled entity.

The *MERALCO Group* measures and recognizes the remaining investment at fair value upon loss of control and provided the jointly controlled entity does not become a subsidiary or associate. Any difference between the carrying amount of the jointly controlled entity upon loss of joint control, and the aggregate of the fair value of the remaining investment and proceeds from disposal, is recognized in the consolidated statement of income. When the remaining investment constitutes significant influence, it is accounted for as investment in an associate.

Impairment of Nonfinancial Assets

The *MERALCO Group* assesses at each reporting date whether there is an indication that a nonfinancial asset (utility plant and others, investment properties, investments in associates and joint ventures, pass-through *VAT*, deferred input *VAT*, receivable from the *BIR* and intangible assets), other than goodwill and intangible assets with indefinite useful life, may be impaired. If any such indication exists, the *MERALCO Group* makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an individual asset's or a cash-generating unit's fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The fair value is the amount obtainable from the sale of the asset in an arm's-length transaction. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation factors/parameters, quoted share prices for publicly traded securities or other available fair value indicators. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the consolidated statement of income.

An assessment is also made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the *MERALCO Group* estimates the individual asset's or cash-generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If a reversal of impairment loss is to be recognized, the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income. After such reversal, the depreciation and amortization expense are adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Intangible assets with indefinite useful lives are tested for impairment annually at every reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired, either individually or at the cash-generating unit level, as appropriate. The amount of impairment is calculated as the difference between the recoverable amount of the intangible asset and its carrying amount. The impairment loss is recognized in the consolidated statement of income. Impairment losses relating to intangible assets may be reversed in future periods.

Goodwill is reviewed for impairment annually at every reporting date or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount of the cash-generating unit or group of cash-generating units to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

If there is incomplete allocation of goodwill acquired in a business combination to cash-generating units or group of cash-generating units, an impairment testing of goodwill is only carried out when impairment indicators exist. Where impairment indicators exist, impairment testing of goodwill is performed at a level at which the acquirer can reliably test for impairment.

Inventories

Materials and supplies are stated at the lower of cost or net realizable value. Costs of acquiring materials and supplies including costs incurred in bringing each item to their present location and condition are accounted using the moving average cost method. Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost to sell or the current replacement cost of the asset.

Financial Assets

Initial Recognition

Financial assets are classified as at *FVPL*, loans and receivables, held-to-maturity or *HTM* investments, *AFS* financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of financial assets is determined at initial recognition and, where allowed and appropriate, re-evaluated at each reporting date.

Financial assets are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets, except for financial instruments measured at *FVPL*.

Purchases or sales of financial assets that require delivery of assets within a timeframe established by regulation or convention in the market place (regular way purchase) are recognized on the trade date, which is the date the *MERALCO Group* commits to purchase or sell the asset.

The *MERALCO Group*'s financial assets include cash and cash equivalents, trade and non-trade receivables, advance payments to a supplier, quoted and unquoted equity securities and embedded derivatives that are not accounted for as effective accounting hedges.

Subsequent Measurement

The subsequent measurement of financial assets depends on the classification as follows:

Financial Assets at FVPL

Financial assets at *FVPL* include financial assets held-for-trading and financial assets designated upon initial recognition as at *FVPL*. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Derivative assets, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial assets designated as at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses on fair value changes recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" account, respectively. Interest earned and dividends received from investment designated as at *FVPL* are also recognized in the consolidated statement of income under "Interest and other financial income" account.

Financial assets may be designated at initial recognition as at *FVPL* if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different basis; (ii) the financial assets are part of a group, which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial assets contain one or more embedded derivatives that would need to be recorded separately.

Derivatives embedded in host contracts are accounted for as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value. These embedded derivatives are measured at fair value with gains and losses arising from changes in fair value recognized in the consolidated statement of income. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the contract.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such financial assets are carried at amortized cost using the effective interest method. This method uses an effective interest rate that discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset. Gains or losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as when these are amortized. Interest earned or incurred is recorded in "Interest and other financial income" or "Interest and other financial charges" account, respectively, in the consolidated statement of income. Assets in this category are included under current assets except for assets with maturities beyond 12 months from the reporting date, which are classified as noncurrent assets.

HTM Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as *HTM* when the *MERALCO Group* has the positive intention and ability to hold these assets to maturity. After initial measurement, *HTM* investments are measured at amortized cost using the effective interest method. Gains or losses are recognized in the consolidated statement of income. Assets in this category are included in the current assets except for maturities beyond 12 months from the reporting date, which are classified as noncurrent assets.

AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as *AFS* or are not classified in any of the three foregoing categories. They are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions. After initial measurement, *AFS* financial assets are measured at fair value with unrealized gains or losses recognized in other comprehensive income until the investment is derecognized, at which time the cumulative gain or loss recorded in other comprehensive income is recognized in the consolidated statement of income, or determined to be impaired, at which time the cumulative loss recorded in other comprehensive income is recognized in the consolidated statement of income. Interest earned on holding *AFS* debt securities are included under "Interest and other financial income" account in the consolidated statement of income. Dividends earned on holding *AFS* equity are recognized in the consolidated statement of income under "Interest and other financial income" account when the right of the payment has been established. These are included under noncurrent assets unless there is an intention to dispose of the investment within 12 months from the reporting date.

Financial Liabilities

Initial Recognition

Financial liabilities are classified as financial liabilities at *FVPL*, other financial liabilities, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The classification of the financial liability is determined at initial recognition.

Financial liabilities are recognized initially at fair value inclusive of directly attributable transaction costs, except for financial liabilities at *FVPL*.

The *MERALCO Group*'s financial liabilities include notes payable, interest-bearing long-term financial liabilities, trade payables and other current liabilities (excluding output *VAT*, accrued taxes, reinsurance liability and deferred lease income), customers' deposits, refundable service extension costs, customers' refund, other noncurrent liabilities and derivatives that are not accounted for as effective accounting hedges.

Subsequent Measurement

The subsequent measurement of financial liabilities depends on their classification as follows:

Financial Liabilities at FVPL

Financial liabilities at *FVPL* include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as at *FVPL*. Financial liabilities are classified as held-for-trading if they are incurred for the purpose of repurchasing in the near term. Derivative liabilities, including separated embedded liabilities are also classified as held-for-trading unless they are designated as effective hedging instruments. Financial liabilities at *FVPL* are carried in the consolidated statement of financial position at fair value with gains or losses recognized in the consolidated statement of income under "Interest and other financial income" or "Interest and other financial charges" account, respectively. Interest incurred on financial liabilities designated as at *FVPL* is recognized in the consolidated statement of income under "Interest and other financial charges" account.

Financial liabilities may be designated at initial recognition as at *FVPL*, if any of the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different bases; (ii) the financial liabilities are part of a group which are managed and their performance are evaluated on a fair value basis, in accordance with a documented risk management strategy; or (iii) the financial liabilities contain one or more embedded derivatives that would need to be recorded separately. The *MERALCO Group* does not have financial liabilities designated as at *FVPL* as at December 31, 2012 and 2011.

Other Financial Liabilities

After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as when these are amortized. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are integral part of the effective interest rate. The effective interest amortization is included either under "Interest and other financial charges" or "Interest and other financial income" account in the consolidated statement of income.

Derivative Financial Instruments

Initial Recognition and Subsequent Measurement

MERALCO has separated embedded foreign currency forwards which are derivative financial instruments used to hedge risks associated with foreign currency fluctuations.

Derivative instruments, including separated embedded derivatives, are initially recognized at fair value on the date at which a derivative transaction is entered into or separated, and are subsequently re-measured at fair value. Changes in fair value of derivative instruments, other than those accounted for as effective hedges, are recognized immediately in the consolidated statement of income. Changes in fair value of derivative instruments accounted as effective hedges are recognized in other comprehensive income. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. *MERALCO Group* does not have derivatives accounted for under hedge accounting.

An embedded derivative is separated from the hybrid or combined contract if all the following conditions are met: (a) the economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract; (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and (c) the hybrid instrument is not recognized as at *FVPL*.

Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed.

See *Note 28 – Financial Assets and Liabilities.*

Offsetting of Financial Instruments

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position if, and only if, there is currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Fair Value of Financial Instruments

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to quoted market prices at the close of business at the transaction or reporting date. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For financial instruments where there is no active market, fair value is determined using valuation techniques. Such techniques include use of recent arm's-length market transactions, reference to the current market value of another instrument, which are substantially the same, discounted cash flow analysis and other pricing models.

Amortized Cost of Financial Instruments

Amortized cost is computed using the effective interest method less any allowance for impairment and principal repayment, plus or minus the cumulative amortization of premium or discount. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of effective interest.

'Day 1' Profit or Loss

Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the *MERALCO Group* recognizes the difference between the transaction price and fair value (a 'Day 1' profit or loss) in the consolidated statement of income, unless it qualifies for recognition as some other type of asset or liability. In cases where data used are not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the *MERALCO Group* determines the appropriate method of recognizing the 'Day 1' profit or loss amount.

Impairment of Financial Assets

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

Financial Assets Carried at Amortized Cost

For financial assets carried at amortized cost, the *MERALCO Group* first assesses whether objective evidence of impairment exists individually. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment based on historical loss experience. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment. *MERALCO* and *CEDC* consider termination or disconnection of service and significant financial difficulties of debtors as objective evidence that a financial asset or group of financial assets is impaired. For both specific and collective assessments, any deposits, collateral and credit enhancement are considered in determining the amount of impairment loss.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). If a loan is subject to variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The carrying amount of the asset is reduced either directly or through the use of an allowance account and the amount of the loss is recognized in the consolidated statement of income. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. The financial asset together with associated allowance is written off when there is no realistic prospect of future recovery and all collateral or deposits has been realized or has been transferred to the *MERALCO Group*.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If an asset written off is recovered, the recovery is recognized in the consolidated statement of income. Any reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets

In the case of equity instruments classified as *AFS*, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. When a decline in the fair value of an *AFS* financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from equity to profit or loss even though the financial asset has not been derecognized. The amount of the cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on the financial asset previously recognized in profit or loss. Impairment losses recognized in profit or loss for investment in equity instruments are not reversed in the consolidated statement of income. Subsequent increases in fair value after impairment are recognized directly in other comprehensive income.

In the case of debt instruments classified as *AFS*, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of "Interest and other financial income" in the consolidated statement of income. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed in the consolidated statement of income.

Assets Carried at Cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

Derecognition of Financial Instruments

Financial Assets

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

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

Where the *MERALCO Group* has transferred its right to receive cash flows from an asset or has entered into a "pass-through" arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, a new asset is recognized to the extent of the *MERALCO Group*'s continuing involvement in the asset.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the *MERALCO Group* could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or has expired.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the carrying amount of a financial liability extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed is recognized in the consolidated statement of income.

Redeemable Preferred Stock

MERALCO's peso-denominated redeemable preferred stock has characteristics of a liability and is thus recognized as a liability in the consolidated statement of financial position. The corresponding dividends on those shares are recognized as part of "Interest and other financial charges" account in the consolidated statement of income. Dividends are no longer accrued when such shares have been called for redemption.

Provisions

Provisions are recognized when the *MERALCO Group* has a present obligation, legal or constructive, as a result of a past event, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the *MERALCO Group* expects a provision, or a portion, to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liabilities. Where discounting is used, the increase in the provision due to the passage of time is recognized as part of "Interest and other financial charges" account.

Retirement Benefits

MERALCO and substantially all of its subsidiaries have distinct, funded, noncontributory defined benefit retirement plans covering all permanent employees. *MERALCO's* retirement plan provides for post-retirement benefits in addition to a lump sum payment to employees hired up to December 31, 2003. Retirement benefits for employees hired commencing January 1, 2004 were amended to provide for a defined lump sum payment only. *MERALCO* also has a contributory Provident Plan introduced in January 2009 in which employees hired commencing January 1, 2004 may elect to participate.

The costs of providing benefits under the distinct defined benefit plans are determined using the projected unit credit actuarial valuation method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost, interest costs, return on plan assets plus amortizations of past service cost, experience adjustments and changes in actuarial assumptions. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately following the introduction of, or changes to a pension plan, past service cost is recognized immediately. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The defined benefit liability (or asset) is the aggregate of the present value of the defined benefit obligation and any actuarial gains not yet recognized reduced by past service cost and actuarial losses not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. Plan assets are assets that are held by a long-term employee benefit fund. Fair value is based on market price information, and the published bid price in the case of quoted securities. The amount of any defined benefit asset recognized is restricted to the sum of any past service cost and actuarial gains or losses not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

The retirement costs under the defined contribution plan are recorded based on *MERALCO*'s contribution to the defined contribution plan as services are rendered by the employee.

Employee Stock Purchase Plan or ESPP

Up to 2009, *MERALCO* had an employee stock purchase plan, which covered active and retired employees. Under the plan, the qualified participant may purchase fixed number of shares of stock at a pre-agreed price. The plan features include vesting requirements and payment terms.

The cost of equity-settled transactions with employees is measured by reference to the difference between the fair value of the shares on the grant date and the price at which the share may be purchased under the award or offer. In valuing equity-settled transactions, no account is taken of any performance conditions other than market conditions.

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

No expense is recognized for awards that do not ultimately vest.

When the terms of the equity-settled awards are modified and the modification increases the fair value of the equity instruments granted, as measured immediately before and after the modification, the entity shall include the incremental fair value granted in the measurement of the amount recognized for services received as consideration for the equity instrument granted. The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognized for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognized over the remainder of the original vesting period. If the modification occurs after vesting date, the incremental fair value granted is recognized immediately or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

Long-term Incentive Plan

Liability arising from the long-term incentive plan is determined using the projected unit credit actuarial valuation method.

The liability relating to the long-term incentive plan comprises the present value of the defined benefit obligation at the end of the reporting date.

Revenue Recognition

Revenues are stated at amounts invoiced to customers, inclusive of pass-through components, net of discounts, rebates, *VAT* and other taxes, where applicable. Revenue is recognized to the extent that it is probable that the economic benefits will flow to the *MERALCO Group* and the revenue can be reliably measured. In addition, collectibility is reasonably assured and the delivery of the goods or rendering of the service has occurred. The *MERALCO Group* assesses its revenue arrangements against specific criteria in order to determine if it is acting as principal or agent. The *MERALCO Group* concluded that it is acting as principal in all of its revenue arrangements. The following specific recognition criteria must also be met before revenue is recognized:

Sale of Electricity

Revenues are recognized upon supply of power to the customers. The Uniform Filing Requirements or *UFR,* on the rate unbundling released by the *ERC* on October 30, 2001 specified the following bill components: (a) generation charge, (b) transmission charge, (c) *SL* charge, (d) distribution charge, (e) supply charge, (f) metering charge, (g) Currency Exchange Rate Adjustment or *CERA* I and II, where applicable and (h) interclass and lifeline subsidies. *VAT* and *LFT*, the Power Act Reduction (for residential customers) adjustment and universal charges are also separately presented in the customer's billing statement. *VAT, LFT* and universal charges are billed and collected on behalf of the national and local governments and do not form part of *MERALCO* and *CEDC*'s revenues.

Sale of Services

Revenues from construction contracts are recognized and measured using the percentage-of-completion method of accounting for the physical portion of the contract work, determined based on the actual costs incurred in relation to the total estimated costs of the contract. Revenue from contracts to manage, supervise or coordinate construction activity for others and contracts where materials and services are supplied by project owners are recognized only to the extent of the contracted fees.

Contract costs principally include subcontracted costs related to contract performance. Expected losses on contracts are recognized immediately when it is probable that the total contract costs will exceed total contract revenues. The amount of such loss is determined irrespective of whether or not work has commenced on the contract; the stage of completion of contract activity; or the amount of profits expected to arise on other contracts, which are not treated as a single construction contract. Changes in contract performance, contract conditions and estimated profitability, including those arising after final contract settlements and after gross margins are recognized in the year in which the changes are determined.

Service and consulting fees are recognized when the services are rendered.

Interest Income

Revenue is recognized as interest accrues, using the effective interest method. The effective interest rate is the rate that discounts estimated future cash receipts through the expected life of the financial instrument.

Dividends

Revenue is recognized when the *MERALCO Group*'s right to receive the payment is established.

Lease Income

Income arising from lease of investment properties and poles is accounted for on a straight-line basis over the lease term.

Lease income is included under “Revenues – Sale of services and others” account in the consolidated statement of income.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at the inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or the arrangement conveys a right to use the asset.

Company as Lessee

Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term.

Company as Lessor

Leases where the *MERALCO Group* does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Foreign Currency-Denominated Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is also *MERALCO*'s functional and presentation currency. The Philippine peso is the currency of the primary economic environment in which *MERALCO Group* operates, except for *LOIL*. This is also the currency that mainly influences the revenue from and cost of rendering services. Each entity in *MERALCO Group* determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

The functional currency of *LOIL* is the United States or *U.S.* dollar.

Transactions in foreign currencies are initially recorded in the functional currency rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated using functional currency closing rate of exchange prevailing at the end of the reporting date. All differences are recognized in the consolidated statement of income except for foreign exchange differences that relate to capitalizable borrowing costs on qualifying assets. Nonmonetary items that are measured in terms of historical cost in foreign currency are translated using the exchange rate as at the date of the initial transactions.

As at the reporting date, the monetary assets and liabilities of an associate, and *LOIL* whose functional currency is other than Philippine peso, are translated into Philippine peso at the rate of exchange prevailing at the end of the reporting period, and income and expenses of an associate are translated monthly using the weighted average exchange rate for the month. The exchange differences arising on translation are recognized as a separate component of other comprehensive income as cumulative translation adjustments. On disposal of the associate, the amount of cumulative translation adjustments recognized in other comprehensive income is recognized in the consolidated statement of income.

Income Taxes

Current Income Tax

Current income tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authority. The tax rate and tax laws used to compute the amount are those that are enacted or substantively enacted as at the reporting date.

Deferred Income Tax

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

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

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

- in respect of taxable temporary differences associated with investments in associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized except:

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

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

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

Deferred income tax assets and liabilities are measured at the tax rate that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rate and tax laws that are enacted or substantively enacted as at the reporting date.

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

Deferred income tax items are recognized in correlation to the underlying transaction either in profit or loss or directly in equity.

Earnings per Share

Basic earnings per share is calculated by dividing the net income for the year attributable to equity holders of the parent by the weighted average number of common shares outstanding during the year.

Diluted earnings per share is calculated by dividing the net income for the year attributable to equity holders of the parent by the weighted average number of shares outstanding, adjusted for the effects of any dilutive potential common shares.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. These are disclosed in the notes to consolidated financial statements unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized unless the realization of the assets is virtually certain. These are disclosed in the notes to consolidated financial statements when an inflow of economic benefits is probable.

Events After the Reporting Date

Post reporting date events that provide additional information about the *MERALCO Group*'s financial position at the reporting date (adjusting events) are reflected in the consolidated financial statements. Post reporting date events that are not adjusting events are disclosed in the notes to consolidated financial statements, when material.

Equity

Common stock is measured at par value for all shares issued. Incremental costs incurred directly attributable to the issuance of new shares are shown as a deduction from equity, net of any related tax. The amount of proceeds and/or fair value of consideration, net of incremental costs incurred directly attributable to the issuance of new shares, received in excess of par value is recognized as additional paid-in capital.

Employee stock purchase plan cost represents the cumulative compensation expense recognized based on the amount determined using an option pricing model. The 14th and last *ESPP*, which was awarded in 2009 fully vested in October 2012. Since 2009, there have been no *ESPP*s awarded.

Change in the ownership interest of a subsidiary, without loss of control, is accounted for as an equity transaction and presented as "Excess of acquisition cost over carrying value of non-controlling interest acquired".

Other comprehensive income comprises items of income and expense, including reclassifications, which are not recognized in profit or loss as required or permitted by *PFRS*.

Retained earnings includes net income attributable to the equity holders of the Parent and reduced by dividends on common stock. Dividends are recognized as a liability and deducted from retained earnings when they are declared. Dividends approved after the financial reporting date are disclosed as events after the financial reporting date.

Non-controlling interests represent the equity interests in *CEDC* and *MIESCOR* and its subsidiaries, which are not held by *MERALCO*.

5. Management's Use of Judgments, Estimates and Assumptions

The preparation of the *MERALCO Group*'s consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent assets and liabilities, at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

Judgments

In the process of applying the *MERALCO Group*'s accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

Determination of Functional Currency

The functional currencies of the entities under the *MERALCO Group* are the currencies of the primary economic environment in which each entity operates. It is the currency that mainly influences the revenue and cost of rendering services.

Based on the economic substance of the underlying circumstances, the functional and presentation currency of *MERALCO* and its subsidiaries, except *LOIL*, is the Philippine peso. The functional and presentation currency of *LOIL* is the U.S. dollar.

Operating Lease Commitments

As Lessor

As a lessor, the *MERALCO Group* has several lease arrangements. Based on the terms and conditions of the arrangements, it has evaluated that the significant risks and rewards of ownership of such properties are retained by the *MERALCO Group*. The lease agreements do not transfer ownership of the assets to the lessees at the end of the lease term and do not give the lessees a bargain purchase option over the assets. Consequently, the lease agreements are accounted for as operating leases.

As Lessee

As a lessee, *MERALCO Group* has commercial lease arrangements covering certain office spaces, payment offices and substation sites and towers. The *MERALCO Group* has determined, based on the evaluation of the terms and conditions of the arrangements, that it has not acquired any significant risks and rewards of ownership of such properties because the lease arrangements do not transfer to the *MERALCO Group* the ownership over the assets at the end of the lease term and do not provide the *MERALCO Group* a bargain purchase option over the leased assets. Consequently, the lease agreements are accounted for as operating leases.

Arrangement that Contains a Lease

MERALCO's Purchased Power Agreements or *PPA*s with Independent Power Producers, or *IPP*s, qualify as leases on the basis that *MERALCO* and the *IPP*s have 'take or pay' or *TOP* arrangements where payments for purchased power are made on the basis of the availability of the power plant and not on actual consumption. In determining the lease classification, it is judged that substantially all the risks and rewards incident to the ownership of the *IPP*s' power plants are with the *IPPs*. Thus, the *PPAs* are classified as operating leases. Accordingly, capacity fees, fixed operating and transmission line fees that form part of purchased power expense are accounted for similar to a lease.

Components of purchased power expense, which have been accounted for similar to a lease, amounted to ₱18,946 million, ₱20,135 million and ₱19,960 million in 2012, 2011 and 2010, respectively. These are recognized as "Purchased power" in the consolidated statements of income.

See *Note 25 – Revenues and Purchased Power*.

Contingencies

The *MERALCO Group* has possible claims from or obligation to other parties from past events and whose existence may only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within its control. Management has determined that the present obligations with respect to contingent liabilities and claims with respect to contingent assets do not meet the recognition criteria, and therefore has not recorded any such amounts.

See *Note 30 – Contingencies and Legal Proceedings*.

Estimates and Assumptions

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

Estimating Useful Lives of Utility Plant and Others, Intangible Assets with Finite Lives and Investment Properties

The *MERALCO Group* estimates the useful lives of utility plant and others, intangible assets with finite lives and, investment properties based on the periods over which such assets are expected to be available for use. The estimate of the useful lives of the utility plant and others, intangible assets with finite lives and investment properties is based on management's collective assessment of industry practice, internal technical evaluation and experience with similar assets. The estimated useful lives are reviewed at least at each financial year-end and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limitations on the use of such assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in the factors mentioned in the foregoing. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of utility plant and others, intangible assets with finite lives and investment properties would increase recorded operating expenses and decrease noncurrent assets.

The total depreciation and amortization of utility plant and others amounted to ₱5,474 million, ₱5,466 million and ₱5,958 million for the years ended December 31, 2012, 2011 and 2010, respectively. Total carrying values of utility plant and others, net of accumulated depreciation and amortization, amounted to ₱109,312 million and ₱105,510 million as at December 31, 2012 and 2011, respectively.

Total depreciation of investment properties amounted to ₱8 million, ₱138 million and ₱219 million for the years ended December 31, 2012, 2011 and 2010, respectively. Total carrying value of investment properties, net of accumulated depreciation amounted to ₱1,634 million and ₱1,642 million as at December 31, 2012 and 2011, respectively.

Total amortization of intangible assets with finite lives amounted to ₱94 million, ₱33 million and ₱42 million for the years ended December 31, 2012, 2011 and 2010, respectively. Total carrying value of intangible assets with finite lives, net of accumulated amortization amounted to ₱1,021 million and ₱689 million as at December 31, 2012 and 2011, respectively.

See *Note 8 – Utility Plant and Others, Note 10 – Investment Properties* and *Note 11 – Other Noncurrent Assets*.

Impairment of Nonfinancial Assets

PFRS requires that an impairment review be performed when certain impairment indicators are present. These conditions include obsolescence, physical damage, significant changes in the manner by which an asset is used, worse than expected economic performance, drop in revenues or other external indicators, among others. In the case of goodwill, at a minimum, such asset is subject to an annual impairment test and more frequently whenever there is an indication that such asset may be impaired. This requires an estimation of the value in use of the cash generating unit to which the goodwill is allocated. Estimating the value in use requires preparation of an estimate of the expected future cash flows from the cash generating unit and choosing an appropriate discount rate in order to calculate the present value of those cash flows.

Determining the recoverable amount of utility plant and others, investment properties, investments in associates and joint ventures, goodwill and other noncurrent assets, requires (i) the determination of future cash flows expected to be generated from the continued use as well as ultimate disposition of such assets and (ii) making estimates and assumptions that can materially affect the consolidated financial statements. Future events may cause management to conclude that utility plant and others, construction in progress, investment properties, investments in associates and joint ventures, and other noncurrent assets are impaired. Any resulting impairment loss could have a material adverse impact on the *MERALCO Group*'s consolidated financial position and results of operations.

The preparation of estimated future cash flows involves significant estimations and assumptions. While management believes that the assumptions are appropriate and reasonable, significant changes in the assumptions may materially affect the assessment of recoverable values and may lead to future impairment charges under *PFRS*.

The carrying values of nonfinancial assets as at December 31, 2012 and 2011 subject to impairment review are as follows:

Account	**2012**	2011
	(Amounts in Millions)	
Utility plant and others - net	**₱109,312**	₱105,510
Investment properties - net	**1,634**	1,642
Investments in associates and joint ventures	**1,815**	844
Receivable from the *BIR*	**577**	577
Intangible assets	**1,021**	689
Goodwill	**36**	36

See Note 8 – Utility Plant and Others, Note 9 – Investments in Associates and Joint Ventures, Note 10 – Investment Properties and Note 11 – Other Noncurrent Assets

Goodwill

The *MERALCO Group*'s consolidated financial statements and results of operations reflect acquired businesses after the completion of the respective acquisition. *MERALCO Group* accounts for the acquisition of businesses using the acquisition method of accounting, which requires extensive use of accounting judgments and estimates to allocate the purchase price to the fair market values of the acquiree's identifiable assets and liabilities and contingent liabilities, if any, at the acquisition date. Any excess in the purchase price over the estimated fair market values of the net assets acquired is recorded as goodwill in the consolidated statement of financial position. Thus, the number of items, which involve judgments made in estimating the fair market value to be assigned to the acquiree's assets and liabilities can materially affect the *MERALCO Group*'s results of operations.

Realizability of Deferred Tax Assets

The *MERALCO Group* reviews the carrying amounts of deferred tax assets at the end of each reporting period and reduces these to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred income tax assets to be utilized. Assessment on the recognition of deferred tax assets on deductible temporary differences is based on the level and timing of forecasted taxable income for the subsequent reporting periods. This forecast is based on past results and future expectations on revenues and expenses as well as future tax planning strategies. Management believes that sufficient taxable profit will be generated to allow all or part of the deferred tax assets to be utilized. The amounts of the deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

Based on the foregoing assessment, following are the relevant consolidated information with respect to deferred tax assets:

	2012	2011
	(Amounts in Millions)	
Recognized deferred tax assets	**₱13,360**	₱10,073
Unrecognized deferred tax assets	**513**	115

See *Note 29 – Income Taxes and Local Franchise Taxes.*

Determination of Fair Values of Financial Assets and Liabilities

Where fair value of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using valuation techniques including the discounted cash flows model. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Total fair values of financial assets and liabilities as at December 31, 2012 amounted to ₱84,815 million and ₱95,337 million, respectively, while the total fair values of financial assets and liabilities as at December 31, 2011 amounted to ₱68,388 million and ₱89,866 million, respectively.

See *Note 28 – Financial Assets and Liabilities.*

Estimating Allowance for Doubtful Accounts

If there is objective evidence that an impairment loss has been incurred in the trade and other receivables balance of the *MERALCO Group*, an estimate of the allowance for doubtful accounts related to trade and other receivables that are specifically identified as doubtful of collection is made. The amount of allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. In such case, use of judgment based on the best available facts and circumstances, including but not limited to, the length of the *MERALCO Group*'s relationship with the customer and the customer's credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due in order to reduce the *MERALCO Group*'s receivables to amounts that management expects to collect is applied. These specific reserves are reevaluated and adjusted as additional information received affect the amounts estimated.

In addition to specific allowance against individually significant receivables, an assessment for collective impairment allowance against credit exposures of the customers, which were grouped based on common credit characteristics, although not specifically identified as requiring a specific allowance, have a greater risk of default than when the receivables were originally granted to customers is done. This collective allowance is based on historical loss experience using various factors, such as historical performance of the customers within the collective group, deterioration in the markets in which the customers operate, and identified structural weaknesses or deterioration in the cash flows of customers.

Total asset impairment provision for trade and other receivables and other current assets recognized in the consolidated statements of income amounted to ₱832 million, ₱2,243 million and ₱961 million for the years ended December 31, 2012, 2011 and 2010, respectively. Trade and other receivables, net of asset impairment, amounted to ₱28,077 million and ₱29,108 million as at December 31, 2012 and 2011, respectively.

See *Note 13 – Trade and Other Receivables* and *Note 15 – Other Current Assets*.

Estimating Net Realizable Value of Inventories

Inventories consist of materials and supplies used in the power distribution and services segments. The excess of cost over net realizable value relating to inventories consists of collective and specific provisions. The cost of inventories is written down whenever the net realizable value of inventories becomes lower than the cost due to damage, physical deterioration, obsolescence, change in price levels or other causes. The lower of cost or net realizable value of inventories is reviewed on a periodic basis. Inventory items identified to be obsolete and unusable are written-off and charged as expense in the consolidated statement of income.

The carrying values of inventories amounted to ₱1,371 million and ₱1,675 million as at December 31, 2012 and 2011, respectively.

See *Note 14 – Inventories.*

Estimation of Retirement Benefit Costs

The cost of defined benefit plans and present value of the pension obligation are actuarially determined. Actuarial valuation requires formulating various assumptions, which include discount rates, expected rates of return on plan assets, rates of compensation increases and mortality rates. Actual results that differ from the *MERALCO Group's* assumptions are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. Due to complexity of valuation, the underlying assumptions and its long-term nature, a defined benefit obligation is highly sensitive to changes in assumptions. While management believes that the assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect cost for pension and other retirement obligations. All assumptions are reviewed at each reporting date.

Total consolidated defined pension benefit costs and other long-term post-employment benefits costs amounted to ₱1,364 million, ₱1,461 million and ₱1,750 million for the years ended December 31, 2012, 2011 and 2010, respectively. Unrecognized net actuarial gains amounted to ₱836 million as at December 31, 2012, and unrecognized net actuarial losses as at December 31, 2011 amounted to ₱1,900 million. Consolidated net pension liability as at December 31, 2012 and 2011 amounted to ₱6,838 million and ₱6,585 million, respectively.

See *Note 26 – Expenses and Income* and *Note 27 – Long-term Employee Benefits*.

Insurance Liabilities Arising from Insurance Contracts

RSIC estimates the expected ultimate costs of claims reported and claims incurred but not yet reported at reporting date. It takes a significant period of time to establish with certainty the ultimate cost of claims.

The primary technique adopted by *RSIC*'s management in estimating the cost of claims incurred but not yet reported is using the past claims settlement trend to predict the future claims settlement trend. At each reporting date, prior year claims estimates are reassessed for adequacy and any changes are charged to provisions. Insurance contract liabilities are not discounted for the time value of money.

As at December 31, 2012 and 2011, gross carrying values of insurance liabilities arising from insurance contracts (included in "Other noncurrent liabilities" account) amounted to ₱625 million and ₱622 million, respectively.

Provision for Asset Retirement Obligations

Provision for asset retirement obligations is recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. This requires an estimation of the cost to restore or dismantle, on a per area basis, depending on the location, and is based on the best estimate of the expenditure required to settle the obligation at the future restoration/dismantlement date, discounted using a pre-tax rate that reflects the current market assessment of the time value of money and, where appropriate, the risk specific to the liability.

No asset retirement obligation was recognized since the amount is immaterial.

Provisions

MERALCO is involved in various legal proceedings as discussed in Note 30 – *Contingencies and Legal Proceedings. MERALCO*'s estimate for probable costs for the resolution of these claims, assessments and cases has been developed in consultation with external counsels handling the defense in these claims, assessments and cases and is based upon thorough analysis of potential outcome.

MERALCO, in consultation with its external legal counsels, does not believe that these proceedings will have a material adverse effect on the consolidated financial statements. It is possible, however, that future financial performance could be materially affected by changes in the estimates or the effectiveness of management's strategies relating to these proceedings.

MERALCO recognized provisions amounting to ₱19,411 million and ₱16,919 million as at December 31, 2012 and 2011, respectively.

Revenue Recognition

The *MERALCO Group*'s revenue recognition policies require the use of estimates and assumptions that may affect the reported amounts of its revenues and receivables.

Revenues from sale of electricity by *MERALCO* and *CEDC* are billed based on customer-specific billing cycle cut-off date for each customer, while recording of related power purchase cost in the accounts is based on calendar month as provided in the terms of the Power Supply Agreement or *PSAs*. The recognition of unbilled revenues for billing cycles with earlier than month-end cut-off dates requires the use of estimates.

The difference between the amount initially recognized based on provisional invoices and the settlement of the actual billings by the generators is taken up in the subsequent period. Management believes that such use of estimates will not result in material adjustments in future periods.

Revenues and costs from construction contracts of *MIESCOR* are recognized based on the percentage of completion method. This is measured principally on the basis of the estimated completion of a physical proportion of the contract work as determined from the reports of the contractors and project consultants. There is no assurance that such use of estimates may not result in material adjustments in future periods.

6. Discontinued Operations

In 2011, upon approval by the *BOD* of *MERALCO* of the divestment plan of *MERALCO*'s investment in common shares of *Rockwell Land* through the declaration of property dividends, *MERALCO* reclassified the related assets, liabilities and cumulative other comprehensive income of *Rockwell Land* as "Assets of discontinued operations", "Liabilities of discontinued operations" and "Unrealized fair value gains on *AFS* investments of discontinued operations", respectively, in the 2011 consolidated statement of financial position.

On February 27, 2012, the *BOD* of *MERALCO* approved the declaration of its investment in common shares of *Rockwell Land* as property dividends in favor of common stockholders as of March 23, 2012, except for foreign common stockholders who were paid the cash equivalent of the property dividends. Such property dividends were paid on May 14, 2012, within five (5) trading days after approval of the property dividend by the *SEC* and registration of the *Rockwell Land* shares under the Securities Regulation Code and the listing thereof with the *PSE* on May 11, 2012. As of the date of declaration, *MERALCO* owned 3,176,474,995 common shares at ₱1.46 per share with a total cost of ₱4,638 million. On April 25, 2012, the *SEC* approved the property dividend declaration. *MERALCO* recognized gain from the divestment of *Rockwell Land* amounting to ₱780 million, included in "Income from discontinued operations, net of income tax" in the 2012 consolidated statement of income.

The assets and liabilities of *Rockwell Land* classified as "Assets of discontinued operations" and "Liabilities of discontinued operations", respectively, in the consolidated statement of financial position as at December 31, 2011 are as follows:

	Amount *(In Millions)*
Noncurrent Assets:	
Property and equipment	₱465
Investment properties	6,297
Other noncurrent assets	362
Current Assets:	
Cash and cash equivalents	769
Trade and other receivables	2,782
Land and development costs	5,950
Other current assets	1,724
	₱18,349
Noncurrent Liabilities:	
Interest-bearing long-term financial liabilities	₱2,867
Deposits from pre-selling condominium units	284
Deferred tax liabilities - net	146
Other noncurrent liabilities	470
Current Liabilities:	
Trade and other payables	5,258
Income tax payable	88
	₱9,113

Investment Properties

Investment properties of *Rockwell Land* in 2011 are stated at cost. These consist of real properties held for (i) capital appreciation, and (ii) lease mainly the Rockwell Power Plant Mall in Makati City.

The aggregate fair value of the Rockwell Power Plant Mall in 2011 amounted to ₱6,267 million.

Rockwell Land's interest-bearing long-term financial liabilities are partly collateralized by the Rockwell Power Plant Mall.

Receivables

Installment Contracts Receivable

Installment contracts receivable represent receivables from sale of condominium units with credit terms ranging from one to five years. As at December 31, 2011, the gross undiscounted trade receivables (both recognized and future receivables) from the sale of condominium units at the "Number One Rockwell" or *One Rockwell*, "The Grove by Rockwell" or *The Grove*, and "Edades Tower and Garden Villas" or *Edades* projects amounting to ₱0.3 billion, ₱1.6 billion and ₱1.1 billion, respectively, have been assigned as security for interest-bearing long-term financial liabilities. Under the terms of the assignment, *Rockwell Land* will deliver all Contracts to Sell and customers' copies of the Condominium Certificates of Title covered by these receivables to be held in custody by the counterparty until the receivables are paid and/or repurchased by *Rockwell Land*. Installment contracts receivable amounting to ₱2,368 million as of December 31, 2011 is included in "Assets of discontinued operations" account in the 2011 consolidated statement of financial position.

Inventories

Condominium units for sale amounting to ₱63 million is included in "Assets of discontinued operations" account in the 2011 consolidated statement of financial position. As at December 31, 2011, the condominium units for sale are stated at cost.

Land and Development Costs

Land and development costs of *Rockwell Land* are stated at net realizable value of ₱5,950 million, which is lower than its cost as at December 31, 2011. These are presented as part of "Assets of discontinued operations" account in the 2011 consolidated statement of financial position. The development costs pertain to the Greater Rockwell, *Edades*, and *The Grove* located in Pasig City.

Specific borrowings capitalized as part of development costs amounted to ₱175 million in 2011. Capitalization rate used was 7.9% in 2011.

Interest-bearing long-term financial liabilities

₱4.0 Billion Note Facility Agreement

Rockwell Land signed a ₱4.0 billion Fixed Rate Note Facility Agreement with a consortium of local banks to finance the acquisition of properties for development and to refinance certain obligations. The fixed rate notes consist of Tranche 1 and Tranche 2 amounting to ₱2,500 million and ₱1,500 million, respectively. Tranche 1 was drawn in April 2011 and is payable in 22 quarterly payments starting January 2013 until April 2018. The balance of the Tranche 1 notes of ₱2,500 million is included under "Liabilities of discontinued operations" in the 2011 consolidated statement of financial position.

Loans from Various Local Banks and Financial Institutions

Peso denominated loans from various local banks and financial institutions of *Rockwell Land* consist of bridge facilities, mostly payable by the end of 2011, and a term loan payable in December 2014.

All interest-bearing loans and borrowings outstanding as of December 31, 2011 are secured by assignment of *One Rockwell* and *The Grove* receivables, a parcel of land and Mortgage Participation Certificates in a Mortgage Trust Indenture and its amendments and supplements over the Rockwell Power Plant Mall. The balance of the various denominated loans from various local banks amounting to ₱1,060 million is included under "Liabilities of discontinued operations" account in the 2011 consolidated statement of financial position.

Installment Payable

In November 2011, *Rockwell Land* entered into a Deed of Sale with a third party for the purchase of land for development adjacent to the Rockwell Center. This is the site of its latest residential condominium projects of *Rockwell Land* called the *"Proscensium"*.

Under the Deed of Sale, *Rockwell Land* will pay for the cost of the property in installment until 2015 and a one-time payment in 2020. The installment payable and the corresponding land held for development were recorded at present value using the discount rate of 8%.

Installment payable is partially secured by standby letters of credit from various financial institutions.

As at December 31, 2011, the carrying value of installment payable amounted to ₱3 billion and is included under "Liabilities of discontinued operations" account in the 2011 consolidated statement of financial position.

The interest-bearing financial obligations of *Rockwell Land* are secured by the assignment of receivables from the sale of *One Rockwell* and *The Grove* units and Mortgage Participation Certificates in a Mortgage Trust Indenture and its amendments and supplements over the Rockwell Power Plant Mall.

Included in accumulated other comprehensive income as at December 31, 2011 are unrealized fair value gains on *AFS* investments amounting to ₱14 million.

The results of operations of *Rockwell Land* for the four months ended April 30, 2012 and for the years ended December 31, 2011 and 2010 are presented as "Income from discontinued operations, net of income tax" in the consolidated statements of income. The details are presented as follows:

	2012	2011	2010
	(Amounts in Millions, Except Per Share Data)		
Revenues	**₱1,501**	₱5,834	₱4,378
Cost and expenses	**1,288**	4,887	3,687
Gross profit	**213**	947	691
Interest and other financial income	**114**	520	571
Interest and other financial expenses	**(71)**	(183)	(153)
Others	**805**	4	10
Income before income tax	**1,061**	1,288	1,119
Provision for income tax	**(83)**	(322)	(297)
Net income from discontinued operations	**₱978**	₱966	₱822
Earnings Per Share of Discontinued Operations			
Basic	**₱0.87**	₱0.86	₱0.73
Diluted	**0.87**	0.86	0.73

The net cash flows for the four months ended April 30, 2012 and the years ended December 31, 2011 and 2010 are as follows:

	2012	2011	2010
	(Amounts in Millions)		
Operating activities	**₱104**	₱398	(₱39)
Investing activities	**(5)**	(214)	157
Financing activities	**1,085**	(58)	(187)
Net cash flows	**₱1,184**	₱126	(₱69)

Significant Contracts and Commitments

Operating Lease Commitments

Rockwell Land is a lessor of commercial spaces included in its investment properties portfolio. These non-cancellable leases have remaining terms up to six years from 2011. All leases include an annual escalation to enable upward revision of the rental charge on an annual basis according to prevailing market conditions.

Construction Contracts of Rockwell Land

One Rockwell

In April 2008, *Rockwell Land* entered into a contract with DATEM Incorporated for the construction of the superstructure of *One Rockwell*, amounting to ₱2,500 million, inclusive of all taxes and related costs. As at December 31, 2011, the accumulated amount incurred was ₱2,120 million.

The Grove

The superstructure works related to *The Grove* project was contracted by Hilmarc's Construction Corporation or *Hilmarc*. The contract sum for the work amounted to ₱1,600 million, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the work. Superstructure works commenced in February 2010. As at December 31, 2011, total amount incurred and paid related to this contract amounted to ₱669 million.

Edades

In October 2010, *Rockwell Land* contracted *Hilmarc* to do substructure works related to the *Edades* project. The contract amounted to a fixed fee of ₱2,500 million, inclusive of all pertinent local and national taxes, overhead and cost of labor and materials and all cost necessary for the proper execution of the works. Substructure works commenced in November 2010 and are currently ongoing. As at December 31, 2011, ₱168 million has been incurred and was already paid.

7. **Segment Information**

Each operating segment of the *MERALCO Group* engages in business activities from which revenues are earned and expenses are incurred (including revenue and expenses relating to transactions with other business segments within the *MERALCO Group*). The operating results of each of the operating segments are regularly reviewed by *MERALCO*'s chief operating decision-maker (Management Committee) to determine how resources are to be allocated to the operating segments and to assess their performances for which discrete financial information is available.

For management purposes, the *MERALCO Group*'s operating businesses are organized and managed separately according to the nature of services provided, with each segment representing a strategic business unit that offers different products and/or services, as follows:

- Power

  The Power segment consists of (a) electricity distribution, (b) power generation and (c) *RES*. In 2010, the *MERALCO Group* declared its strategic decision to re-enter into the power generation business. In 2011, *MERALCO* obtained a local *RES* license to participate in the forthcoming Retail Competition and Open Access or *RCOA*.

  Electricity distribution – This is principally electricity distribution and supply of electricity covering the *MERALCO* franchise area and the *CEDC* franchise area in the Luzon Grid. Electricity distribution within the *MERALCO* franchise area accounts for approximately 55% of the power requirements of the country. *CEDC*'s service area covers the *CSEZ*.

  Power generation – The *MERALCO Group's* strategic decision to re-enter into power generation through *MGen* is through its investment in Redondo Peninsula Energy, Inc. or *RP Energy*. *RP Energy* is undertaking the ongoing development of a 2 x 300*MW* Circulating Fluidized Bed or *CFB*, coal-fired power generation plant in the Subic Freeport Zone. Simultaneously, *MGen* is in various stages of pre-development of other power generation projects.

  RES – This covers the sourcing and supply of electricity to qualified contestable customers upon the start of *RCOA*. The *MERALCO Group* will serve as a local *RES* only within its franchise area under the brand *MPower*. *MPower* has been assisting customers in preparing for the commencement of *RCOA*.

- Services and Others

  The services segment is involved principally in electricity-related services such as electro-mechanical engineering, construction, consulting and related manpower as well as light rail- related maintenance services, e-transaction and bills collection, insurance and e-business development and energy systems management. These services are provided by *MIESCOR*, *MBI*, *MLI* and *Miescorrail* (collectively known as "*MIESCOR Group*"), *CIS*, *Bayad Center and CFSI* (collectively referred to as "*CIS Group*"), *RSIC*, *LOIL*, *Finserve*, *e-MVI* and *MEI*.

MERALCO's Real Estate segment, which was provided by *Rockwell Land*, is involved in luxury residential and commercial real estate development and leasing. In 2012, the accounts of *Rockwell Land* were deconsolidated from those of *MERALCO* as discussed in Note 6 – *Discontinued Operations*.

The Management Committee monitors the operating results of each business unit separately for the purpose of determining resource allocation and assessing performance. Performance is evaluated based on net income for the year, earnings before interest, taxes, and depreciation and amortization or *EBITDA*; and consolidated core net income. Net income for the year is measured consistent with reported consolidated net income in the consolidated financial statements.

EBITDA is measured as net income excluding depreciation and amortization, impairment of noncurrent assets, interest and other financial charges, interest and other financial income, equity in net earnings of associates and joint ventures, foreign exchange gain or loss, mark-to-market gain or loss, provision for income tax and other non-recurring gain or loss, if any.

Consolidated core net income for the year is measured as net income attributable to equity holders of *MERALCO* adjusted for foreign exchange gain or loss, mark-to-market gain or loss, impairment of noncurrent assets and other non-recurring gain or loss, net of tax effect of the foregoing adjustments.

Transfer prices between operating segments are set on an arm's-length basis in a manner similar to transactions with third parties. Segment revenues, segment expenses and segment results include transfers among business segments. Those transfers are eliminated in the consolidation.

The *MERALCO Group* mainly operates and generates substantially all its revenues in the Philippines (i.e., one geographical location). Thus, geographical segment information is not presented. The *MERALCO Group* has no revenues from transactions with a single external customer accounting for 10% or more of its revenues from external customers.

	Note	Power			Services and Others			Inter-segment Transactions			Total		
		2012	2011	2010	**2012**	2011	2010	**2012**	2011	2010	**2012**	2011	2010
								(Amounts in Millions)					
Revenues		**₱282,991**	₱253,989	₱239,077	**₱3,829**	₱3,923	₱3,444	**(₱1,550)**	(₱1,104)	(₱1,588)	**₱285,270**	₱256,808	₱240,933
Segment results		**₱25,260**	₱22,038	₱16,899	**₱1,127**	₱1,330	₱1,045	**₱–**	(₱35)	(₱35)	**₱26,387**	₱23,333	₱17,909
Depreciation and amortization		**(5,400)**	(5,360)	(5,795)	**(176)**	(144)	(116)	**–**	–	–	**(5,576)**	(5,504)	(5,911)
Interest and other financial income	*26*	**2,519**	2,186	1,596	**50**	78	9	**–**	–	–	**2,569**	2,264	1,605
Equity in net earnings (losses) of associates and joint ventures	*9*	**247**	914	1,012	**–**	–	–	**(262)**	(847)	(729)	**(15)**	67	283
Interest and other financial charges	*26*	**(1,518)**	(1,435)	(534)	**(10)**	(10)	(27)	**–**	–	–	**(1,528)**	(1,445)	(561)
Derivative mark-to-market gain (loss)		**40**	(16)	(7)	**–**	–	–	**–**	–	–	**40**	(16)	(7)
Provision for income tax - net		**(5,410)**	(5,575)	(3,729)	**(287)**	(364)	(294)	**–**	–	–	**(5,697)**	(5,939)	(4,023)
Net income attributable on non-controlling interests		**–**	–	–	**–**	–	–	**(142)**	(499)	(432)	**(142)**	(499)	(432)
Income from discontinued operations, net of income tax		**–**	–	–	**978**	1,016	786	**–**	(50)	36	**978**	966	822
Net income attributable to equity holders of the Parent		**₱15,738**	₱12,752	₱9,442	**₱1,682**	₱1,906	₱1,403	**(₱404)**	(₱1,431)	(₱1,160)	**₱17,016**	₱13,227	₱9,685

The inter-segment revenues mainly represent revenues of services and others segment to the power segment.

The following table shows the reconciliation of the consolidated *EBITDA* to reported consolidated net income:

	2012	2011	2010
		(Amounts in Millions)	
Consolidated *EBITDA*	**₱27,545**	₱24,602	₱18,841
EBITDA from discontinued operations	**(1,154)**	(1,262)	(900)
EBITDA from continuing operations	**26,391**	23,340	17,941
Depreciation and amortization	**(5,576)**	(5,504)	(5,911)
Interest and other financial income	**2,569**	2,264	1,605
Interest and other financial charges	**(1,528)**	(1,445)	(561)
Equity in net earnings (losses) of associates and joint ventures	**(15)**	67	283
Derivative mark-to-market gain (loss)	**40**	(16)	(7)
Foreign exchange loss	**(4)**	(7)	(32)
Consolidated income before income tax	**21,877**	18,699	13,318
Provision for income tax	**(5,697)**	(5,939)	(4,023)
Income from continuing operations	**16,180**	12,760	9,295
Income from discontinued operations, net of income tax	**978**	966	822
Reported consolidated net income	**₱17,158**	₱13,726	₱10,117

The following table shows the reconciliation of the consolidated core net income to the consolidated net income:

	2012	2011	2010
		(Amounts in Millions)	
Consolidated core net income for the year	**₱16,265**	₱14,887	₱12,155
Add (deduct) non-core items, net of tax:			
Gain on divestment from *Rockwell Land*	**780**	–	–
Non-core expense	**(56)**	(1,568)	(3,903)
Mark-to-market gain (loss)	**28**	(12)	2
Foreign exchange loss	**(1)**	(2)	(36)
Day “1” loss of advance payments to a supplier	**–**	(95)	–
Gain on return of an investment	**–**	17	248
Reversal of interest on bill deposits	**–**	–	1,219
Net income for the year attributable to equity holders of the Parent	**17,016**	13,227	9,685
Net income for the year attributable to non-controlling interest	**142**	499	432
Reported consolidated net income	**₱17,158**	₱13,726	₱10,117

8. **Utility Plant and Others**

The movements in utility plant and others are as follows:

	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
2012										
						(Amounts in Millions)				
Cost:										
Balance at beginning of year		**₱126,338**	**₱14,849**	**₱4,866**	**₱6,248**	**₱3,658**	**₱2,442**	**₱2,730**	**₱2,471**	**₱163,602**
Transfers from construction in progress		**5,621**	**–**	**222**	**240**	**–**	**–**	**–**	**(6,083)**	**–**
Additions		**1,563**	**410**	**2**	**61**	**383**	**242**	**292**	**6,577**	**9,530**
Disposals/retirements		**(1,170)**	**–**	**–**	**(11)**	**(14)**	**(23)**	**(3)**	**–**	**(1,221)**
Reclassification and others	*11*	**74**	**–**	**42**	**52**	**(535)**	**28**	**(17)**	**(120)**	**(476)**
Balance at end of year		**132,426**	**15,259**	**5,132**	**6,590**	**3,492**	**2,689**	**3,002**	**2,845**	**171,435**
Less accumulated depreciation and amortization:										
Balance at beginning of year		**45,968**	**–**	**1,887**	**4,379**	**2,928**	**1,509**	**1,421**	**–**	**58,092**
Depreciation and amortization		**4,225**	**–**	**122**	**414**	**282**	**187**	**244**	**–**	**5,474**
Disposals/retirements		**(1,033)**	**–**	**–**	**(8)**	**(13)**	**(22)**	**(2)**	**–**	**(1,078)**
Reclassification and others	*11*	**32**	**–**	**21**	**23**	**(446)**	**20**	**(15)**	**–**	**(365)**
Balance at end of year		**49,192**	**–**	**2,030**	**4,808**	**2,751**	**1,694**	**1,648**	**–**	**62,123**
		₱83,234	**₱15,259**	**₱3,102**	**₱1,782**	**₱741**	**₱995**	**₱1,354**	**₱2,845**	**₱109,312**

	Note	Subtransmission and Distribution	Land	Buildings and Improvements	Communication Equipment	Office Furniture, Fixtures and Other Equipment	Transportation Equipment	Others	Construction in Progress	Total
2011										
						(Amounts in Millions)				
Cost:										
Balance at beginning of year		₱121,212	₱14,870	₱4,961	₱5,893	₱4,311	₱2,325	₱2,668	₱2,241	₱158,481
Transfers from construction in progress		5,896	–	202	324	–	–	6	(6,428)	–
Additions		995	–	22	124	34	286	224	6,658	8,343
Disposals/retirements		(1,796)	–	–	(88)	(44)	(51)	–	–	(1,979)
Discontinued operations	*6*	–	(21)	(307)	–	(629)	(118)	(168)	–	(1,243)
Reclassification and others		31	–	(12)	(5)	(14)	–	–	–	–
Balance at end of year		126,338	14,849	4,866	6,248	3,658	2,442	2,730	2,471	163,602
Less accumulated depreciation and amortization:										
Balance at beginning of year		43,353	–	1,914	4,095	3,075	1,426	1,368	–	55,231
Depreciation and amortization		4,284	–	142	362	412	213	53	–	5,466
Disposals/retirements		(1,672)	–	–	(75)	(38)	(42)	–	–	(1,827)
Discontinued operations	*6*	–	–	(169)	–	(521)	(88)	–	–	(778)
Reclassification and others		3	–	–	(3)	–	–	–	–	–
Balance at end of year		45,968	–	1,887	4,379	2,928	1,509	1,421	–	58,092
		₱80,370	₱14,849	₱2,979	₱1,869	₱730	₱933	₱1,309	₱2,471	₱105,510

A significant portion of *MERALCO*'s and *CEDC*'s utility plant and others are purchased from foreign suppliers. Such transactions are concluded in currencies other than the Philippine peso, principally the *U.S.* dollar. *MERALCO* and *CEDC* record the assets and liabilities in Philippine peso using the exchange rate at the date of the transaction. The outstanding amount of foreign currency-denominated liabilities is restated at each reporting date.

See *Note 23 – Trade Payables and Other Current Liabilities* and *Note 28 – Financial Assets and Liabilities*.

Construction in progress pertains to on-going electric capital projects or *ECP*s and non-electric capital projects or *NEP*s. *ECP*s are capital projects involving construction of new electric distribution-related facilities and the upgrade and major rehabilitation of existing electrical facilities. In 2012, major *ECP*s under construction in progress include the development of a 230kV-115kV delivery point and construction of a 115kV line, among others. *NEP*s relate to construction of non-network structures and/or major renovation of existing non-network facilities.

Total interest capitalized amounted to ₱127 million, ₱82 million and ₱119 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The average annual interest rates used for capitalization in 2012, 2011 and 2010 ranged from 5.5% to 6.2%, 5.3% to 6.2% and 7.6% to 8.6%, respectively.

9. **Investments in Associates and Joint Ventures**

This account consists of the following as at December 31, 2012 and 2011:

	Country of Incorporation	Principal Activities	**2012**	2011
			Percentage of Ownership	
Associates				
RP Energy	Philippines	Power generation	**47**	47
Bauang Private Power Corporation or *BPPC*	Philippines	Power generation	**38**	38
General Electric Philippines Meter and Instrument Company, Inc. or *GEPMICI*	Philippines	Sale of metering products and services	**35**	35
Joint Ventures				
Indra Philippines	Philippines	Management and information technology, or *IT*, consultancy	**50**	50
Rockwell Business Center	Philippines	Real estate	**30**	–

The movements in investments in associates and joint ventures account are as follows:

	2012	2011
	(Amounts in Millions)	
Acquisition costs:		
Balance at beginning of year	**₱538**	₱62
Additions	**1,025**	517
Return of capital	**–**	(41)
Balance at end of year	**1,563**	538
Accumulated equity in net earnings:		
Balance at beginning of year	**294**	247
Equity in net earnings (losses)	**(15)**	67
Dividends received	**(33)**	(20)
Adjustment	**3**	**–**
Balance at end of year	**249**	294
Share in cumulative translation adjustments of an associate	**3**	12
	₱1,815	₱844

The additions of ₱1,025 million in 2012 include the ₱827 million investment in *Rockwell Business Center*.

Investment in RP Energy

On July 22, 2011, *MGen* signed a Shareholders' Agreement with Therma Power Inc. or *TPI*, and Taiwan Cogeneration International Corporation – Philippine Branch or *TCIC* for the construction and operation of a 2 x 300 *MW CFB* coal-fired power plant to be located in the Subic Bay Freeport Zone. *RP Energy* is a partnership among *TPI*, *MGen* and *TCIC* for the development of the coal-fired power plant project.

As at February 25, 2013, site preparation work is almost complete and *RP Energy* has commenced negotiations with the lowest bidder for the engineering, procurement and construction of the power plant. The Department of Environment and Natural Resources or *DENR* has issued the Environmental Compliance Certificate or *ECC* for the 2 x 300 *MW* coal-fired power plant following a rigorous review and public consultation process. The Board of Investments or *BOI* has approved the registration of *RP Energy*, qualifying it for various *BOI* incentives. The Subic Bay Metropolitan Authority or *SBMA* has approved the lease agreement for the 2 x 300 *MW* coal-fired power plant, which approval remains to be ratified. Development activities are continuing with the aim of bringing the first 300*MW* plant into commercial operations by first half of 2016 and the next 300*MW* six months after.

A Writ of Kalikasan was filed with the *SC* by certain parties in opposition to the *RP Energy* project. The case was remanded by the *SC* to the *CA* for hearing on the merits thereof. A decision has been issued by the *CA* denying the Writ of Kalikasan, but noting certain deficiencies in the process of the *DENR* in its issuance of the original *ECC* for a 300 *MW* coal-fired power plant and in the process of the *SBMA* in the conclusion of the original Lease and Development Agreement or *LDA* with *RP Energy*, thereby declaring these invalid. *DENR*, *SBMA* and *RP Energy* have filed their respective Motions for Reconsideration with the *CA*, strongly asserting the legality and validity of the original *ECC* and the original *LDA*.

Total capital commitment of *MGen* in *RP Energy* is ₱1.4 billion in 2013.

Investment in BPPC

BPPC was organized in October 1992 to engage in the power generation business.

In accordance with the Build-Operate-Transfer or *BOT* Agreement signed in 1993, First Private Power Corporation or *FPPC,* then parent company, constructed the 215*MW* Bauang Power Plant or *Bauang Plant*, and operated the same under a 15-year Cooperation Period up to July 25, 2010.

On July 26, 2010, *FPPC* turned-over the *Bauang Plant* to the National Power Corporation or *NPC,* without any compensation and free of any liens. Thereafter, *FPPC* and *BPPC* were legally merged, with *BPPC* as the surviving entity. Subsequent thereto, *BPPC* began winding down operations.

Investment in GEPMICI

GEPMICI was established in 1979 together with General Electric Company of U.S.A., to serve the Philippine market for ANSI-type Watt-hour meters.

Investment in Indra Philippines

Indra Philippines is an *IT* service provider in the country and in the Asia Pacific region, with a wide range of services across various industries. *Indra Philippines* supports *MERALCO*'s information technology requirements in the area of system development, outsourcing of *IS* and *IT* operations and management consulting.

Investment in Rockwell Business Center

Investment in *Rockwell Business Center* represents the 30% interest of *MERALCO,* accounted for using equity method upon *MERALCO*'s divestment of its investment in common shares of *Rockwell Land* in April 2012. *Rockwell Land* owns the remaining 70% interest in *Rockwell Business Center*. Prior to *MERALCO*'s divestment from *Rockwell Land*, the assets, liabilities, revenues and expenses of *Rockwell Business Center* were consolidated line by line in *MERALCO*'s consolidated financial statements.

The carrying values of investments in associates and joint ventures follow:

	2012	2011
	(Amounts in Millions)	
Rockwell Business Center	**₱847**	₱–
RP Energy	**648**	516
Indra Philippines	**253**	216
GEPMICI	**58**	64
BPPC	**9**	48
	₱1,815	₱844

The condensed financial information of *RP Energy*, *BPPC, GEPMICI*, *Indra Philippines* and *Rockwell Business Center* follow:

			2012		
	RP Energy	***BPPC***	***GEPMICI***	***Indra Philippines***	***Rockwell Business Center***
			(Amounts in Millions)		
Current assets	**₱611**	**₱24**	**₱230**	**₱984**	**₱465**
Noncurrent assets	**723**	**–**	**14**	**161**	**2,586**
Current liabilities	**(63)**	**–**	**(47)**	**(635)**	**(139)**
Noncurrent liabilities	**–**	**–**	**(32)**	**(4)**	**(8)**
Net assets	**₱1,271**	**₱24**	**₱165**	**₱506**	**₱2,904**

2011	RP Energy	BPPC	GEPMICI	Indra Philippines
	(Amounts in Millions)			
Current assets	₱628	₱56	₱235	₱507
Noncurrent assets	419	1	14	142
Current liabilities	(4)	(1)	(66)	(206)
Noncurrent liabilities	–	–	–	(10)
Net assets	₱1,043	₱56	₱183	₱433

2012	**RP Energy**	**BPPC**	**GEPMICI**	**Indra Philippines**	**Rockwell Business Center**
	(Amounts in Millions)				
Revenues	**₱8**	**₱2**	**₱514**	**₱1,526**	**₱302**
Costs and expenses	**(149)**	**(43)**	**(476)**	**(1,453)**	**(198)**
Net income (loss)	**(₱141)**	**(₱41)**	**₱38**	**₱73**	**₱104**

2011	RP Energy	BPPC	GEPMICI	Indra Philippines
	(Amounts in Millions)			
Revenues	₱–	₱–	₱172	₱964
Costs and expenses	(39)	–	(116)	(880)
Net income (loss)	(₱39)	₱–	₱56	₱84

2010	BPPC	GEPMICI	Indra Philippines
	(Amounts in Millions)		
Revenues	₱442	₱115	₱948
Costs and expenses	(451)	(100)	(888)
Net income (loss)	(₱9)	₱15	₱60

10. Investment Properties

The movements in investment properties are as follows:

2012	**Land**	**Buildings and Improvements**	**Total**
		(Amounts in Millions)	
Cost	**₱1,535**	**₱206**	**₱1,741**
Less accumulated depreciation:			
Balance at beginning of year	**–**	**99**	**99**
Depreciation	**–**	**8**	**8**
Balance at end of year	**–**	**107**	**107**
	₱1,535	**₱99**	**₱1,634**

There were no additions or disposals of investment properties in 2012.

2011	*Note*	Land	Buildings and Improvements	Total
			(Amounts in Millions)	
Cost:				
Balance at beginning of year		₱3,280	₱6,128	₱9,408
Additions during the year		–	42	42
Disposals		(2)	–	(2)
Discontinued operations	*6*	(1,743)	(5,964)	(7,707)
Balance at end of year		1,535	206	1,741
Less accumulated depreciation:				
Balance at beginning of year		–	1,371	1,371
Depreciation		–	138	138
Discontinued operations	*6*	–	(1,410)	(1,410)
Balance at end of year		–	99	99
		₱1,535	₱107	₱1,642

Investment properties are stated at cost. These consist of real properties held for capital appreciation, previous substation sites and other non-regulatory asset base real properties, some of which are being leased out.

The aggregate fair values of the investment properties are as follows:

	2012	2011
	(Amounts in Millions)	
Land	**₱1,853**	₱1,853
Other investment properties held for lease/capital appreciation	**173**	173

Land pertains to non-regulatory asset base properties currently unutilized and the properties where the *BPO* building and "Strip" mall are located.

The fair values of investment properties were determined by independent, professionally qualified appraisers. The fair value represents the amount at which the asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable willing seller in an arm's-length transaction at the date of valuation.

11. Other Noncurrent Assets

This account consists of:

	Note	2012	2011
		(Amounts in Millions)	
Unbilled receivables - net	*2 and 13*	**₱4,954**	₱3,321
Deferred input *VAT*		**1,148**	1,054
Intangible assets - net		**1,021**	689
Receivable from the *BIR*	*30*	**577**	577
Advance payments to a supplier	*31*	**325**	239
Deferred reinsurance premium		**209**	193
AFS investments		**331**	140
HTM investments		**123**	106
Goodwill		**36**	36
Others		**113**	239
		₱8,837	₱6,594

Unbilled Receivables

This account represents generation and other pass-through costs incurred by *MERALCO* and *CEDC* and still to be billed, which are covered by the approved recovery mechanism of the *ERC*. This also includes certain other unbilled generation and pass-through charges of current and prior years, which are the subject of various applications for recovery with and approval by the *ERC*.

Deferred Input VAT

The amount includes the portion of input *VAT* incurred and paid in connection with purchase of capital assets in excess of ₱1 million per month. As provided for in *RA* No. 9337 or "*EVAT Law*", said portion of input *VAT* shall be deferred and credited evenly over the estimated useful life of the related capital assets or 60 months, whichever is shorter, against the output *VAT* due.

Intangible Assets

The movements of intangible assets are as follows:

		2012		
	Note	Software	Franchise	Total
			(Amounts in Millions)	
Cost:				
Balance at beginning of year		**₱734**	**₱49**	**₱783**
Additions		**315**	**–**	**315**
Reclassification	*8*	**476**	**–**	**476**
Balance at end of year		**1,525**	**49**	**1,574**
Less accumulated amortization:				
Balance at beginning of year		**94**	**–**	**94**
Amortization		**94**	**–**	**94**
Reclassification	*8*	**365**	**–**	**365**
Balance at end of year		**553**	**–**	**553**
		₱972	**₱49**	**₱1,021**

	2011		
	Software	Franchise	Total
	(Amounts in Millions)		
Cost:			
Balance at beginning of year	₱525	₱49	₱574
Additions	209	–	209
Balance at end of year	734	49	783
Less accumulated amortization:			
Balance at beginning of year	61	–	61
Amortization	33	–	33
Balance at end of year	94	–	94
	₱640	₱49	₱689

12. **Cash and Cash Equivalents**

This account consists of:

	2012	2011
	(Amounts in Millions)	
Cash on hand and in banks	**₱3,256**	₱2,704
Cash equivalents	**57,244**	41,437
	₱60,500	₱44,141

Cash in banks earns interest at prevailing bank deposit rates. Cash equivalents are temporary cash investments, which are made for varying periods up to three months depending on the *MERALCO Group*'s immediate cash requirements, and earn interest at the prevailing short-term investment rates.

13. **Trade and Other Receivables**

This account consists of:

	Note	**2012**	2011
		(Amounts in Millions)	
Trade:			
Electricity:			
Billed		**₱23,338**	₱23,299
Unbilled	*2 and 11*	**4,630**	5,440
Service contracts		**816**	821
Insurance receivable		**383**	319
Cost and estimated earnings in excess of billings on uncompleted contracts		**258**	168
Nontrade		**1,358**	1,193
		30,783	31,240
Less allowance for doubtful accounts		**2,706**	2,132
		₱28,077	₱29,108

Billed receivables from sale of electricity of *MERALCO* and *CEDC* consist of the following:

	2012	2011
	(Amounts in Millions)	
Residential	**₱6,181**	₱7,009
Commercial	**4,916**	6,043
Industrial	**11,870**	9,415
Flat streetlights	**371**	832
	23,338	23,299
Less allowance for doubtful accounts	**2,559**	1,952
	₱20,779	₱21,347

Movements in allowance for doubtful accounts for trade and other receivables are as follows:

	2012			
	Balance at beginning of year	**Provisions (Reversals)**	**Write-offs/ Others**	**Balance at end of year**
		(Amounts in Millions)		
Billed trade receivables:				
Residential	**₱528**	**₱272**	**(₱244)**	**₱556**
Commercial	**911**	**159**	**(42)**	**1,028**
Industrial	**74**	**702**	**(4)**	**772**
Flat streetlights	**439**	**(139)**	**(97)**	**203**
	1,952	**994**	**(387)**	**2,559**
Other receivables	**180**	**12**	**(45)**	**147**
	₱2,132	**₱1,006**	**(₱432)**	**₱2,706**

	2012					
	Residential	**Commercial**	**Industrial**	**Flat Streetlights**	**Others**	**Total**
			(Amounts in Millions)			
Individually impaired	**₱345**	**₱142**	**₱207**	**₱64**	**₱147**	**₱905**
Collectively impaired	**211**	**886**	**565**	**139**	**–**	**1,801**
	₱556	**₱1,028**	**₱772**	**₱203**	**₱147**	**₱2,706**

	2011			
	Balance at beginning of year	Provisions	Write-offs/ Others	Balance at end of year
		(Amounts in Millions)		
Billed trade receivables:				
Residential	₱361	₱142	₱25	₱528
Commercial	858	91	(38)	911
Industrial	57	31	(14)	74
Flat streetlights	242	199	(2)	439
	1,518	463	(29)	1,952
Other receivables	183	–	(3)	180
	₱1,701	₱463	(₱32)	₱2,132

	2011					
	Residential	Commercial	Industrial	Flat Streetlights	Others	Total
			(Amounts in Millions)			
Individually impaired	₱371	₱128	₱5	₱302	₱180	₱986
Collectively impaired	157	783	69	137	–	1,146
	₱528	₱911	₱74	₱439	₱180	₱2,132

Trade Receivables – Electricity

Trade receivables of *MERALCO* and *CEDC* include charges for pass-through costs. Pass-through costs consist largely of generation and transmission charges, which represent 65% and 11%, respectively, of the total billed amount in 2012 and 62% and 13%, respectively, of the total billed amount in 2011. Billed receivables are due 10 days after bill date.

Unbilled receivables represent electricity consumed after the meter reading cut-off dates, which will be billed to customers in the immediately following billing period. This also includes the current portion of pass-through cost under-recoveries, net of over-recoveries, which are billed to the customers over the period approved by the *ERC*. *MERALCO*'s and *CEDC*'s trade receivables are noninterest-bearing and are substantially secured by bill deposits. See *Note 19 – Customers' Deposits* and *Note 28 – Financial Assets and Liabilities*.

Service Contracts

Service contracts receivable arise from contracts entered into by *MIESCOR* and subsidiaries, *e-MVI*, *CIS*, *Bayad Center* and *MEI* for construction, engineering, related manpower, consulting, light rail maintenance, data transport, bills collection, tellering and e-business development and energy management services to third parties.

Receivables from service contracts and others are noninterest-bearing and are generally on 30 to 60-day terms.

14. **Inventories**

	2012	2011
	(Amounts in Millions)	
Materials and supplies:		
At net realizable value	**₱1,371**	₱1,675
At cost	**1,578**	1,927
Total inventories at the lower of cost or net realizable value	**₱1,371**	₱1,675

15. **Other Current Assets**

	Note	2012	2011
		(Amounts in Millions)	
Pass-through *VAT* - net		**₱1,389**	₱1,644
Prepaid tax		**475**	211
Creditable withholding tax		**127**	101
Prepayments to suppliers		**93**	123
Prepaid expenses		**60**	249
Input *VAT*		**47**	24
Derivative assets	*28*	**24**	4
Others		**80**	144
		₱2,295	₱2,500

Pass-through *VAT* pertains to *VAT* on generation and transmission costs. Remittance of such deferred *VAT* is based on collection of billed receivables from the customers.

16. **Equity**

Common Stock

The movement in the number of shares of *MERALCO*'s common stock is as follows:

	2012	2011
	(In Millions)	
Authorized - ₱10 par value a share	**1,250**	1,250
Issued and outstanding:		
Balance at beginning of year	**1,127**	1,127
Treasury shares acquired during the year	**–**	–
Balance at end of year	**1,127**	1,127

On January 8, 1992, *MERALCO* listed its common shares in the *PSE*. There are 47,892 and 49,150 shareholders of *MERALCO*'s common share as at December 31, 2012 and 2011, respectively.

Unappropriated Retained Earnings

The unappropriated retained earnings include undeclared accumulated earnings of subsidiaries, associates and joint ventures, and the balance of *MERALCO*'s revaluation increment in utility plant and others and investment properties carried at deemed cost, deferred tax assets and derivative assets amounting to ₱33,076 million and ₱33,242 million as at December 31, 2012 and 2011, respectively. Such amounts are restricted for dividend declaration purposes.

The following are cash dividends declared on common shares in 2012, 2011 and 2010:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In Millions)
July 30, 2012	August 29, 2012	September 24, 2012	₱4.00	₱4,508
February 27, 2012	March 23, 2012	April 23, 2012	4.10	4,621
November 2, 2011	December 2, 2011	December 27, 2011	1.70	1,916
July 25, 2011	August 17, 2011	September 13, 2011	3.45	3,888
February 28, 2011	March 28, 2011	April 20, 2011	2.65	2,987
December 13, 2010	December 29, 2010	January 17, 2011	1.30	1,465
July 26, 2010	August 23, 2010	September 16, 2010	2.50	2,818
March 22, 2010	April 21, 2010	May 11, 2010	3.15	3,550

MERALCO pays regular cash dividends equivalent to 50% of consolidated core net income for the year, which may be supplemented by a special dividend determined on a "look-back" basis. Any declaration and payment of special dividend is dependent on the availability of unrestricted retained earnings and availability of free cash. The declaration, record and payment dates shall be consistent with the guidelines and regulations of the *SEC*.

Appropriated Retained Earnings

Retained earnings of ₱6,000 million have been appropriated for planned business expansion of *MERALCO,* mainly power generation projects, the development of one of the planned projects *(RP Energy)* is ongoing. The expected commercial operations date of such development is mid-2016. Such business expansion plan was approved by the *BOD* on February 22, 2010.

See *Note 9 – Investments in Associates and Joint Ventures.*

Treasury Shares

Treasury shares represent subscribed shares and the related rights of employees who have opted to withdraw from the *ESPP* in accordance with the provisions of the *ESPP* and which *MERALCO* purchased. For the years ended December 31, 2012 and 2011, a total of 25,830 shares and 146,023 shares, respectively, were acquired from the cancellation of employee participation in the *ESPP*.

17. Employee Stock Purchase Plan

MERALCO has an *ESPP*, which entitles participants to purchase its common shares subject to certain terms and conditions, during a nominated offer period. There were no other *ESPP* awards since October 2009. Movements in the number of common shares subscribed by employees under the *ESPP* are as follows:

	2012			
	13th	**13th A**	**14th**	**Total**
Balances at beginning of year	**1,189,306**	**389,355**	**12,284,290**	**13,862,951**
Fully paid	**(1,185,997)**	**(251,747)**	**(4,507,093)**	**(5,944,837)**
Cancelled	**–**	**(1,905)**	**(23,925)**	**(25,830)**
Balances at end of year	**3,309**	**135,703**	**7,753,272**	**7,892,284**

	2011			
	13th	13th A	14th	Total
Balances at beginning of year	1,548,404	407,137	12,410,516	14,366,057
Fully paid	(357,083)	–	–	(357,083)
Cancelled	(2,015)	(17,782)	(126,226)	(146,023)
Balances at end of year	1,189,306	389,355	12,284,290	13,862,951

MERALCO allotted a total of 55 million common shares for *ESPP* awards. As at December 31, 2012, 13 million common shares are available for any future offerings.

The fair value of the offerings was estimated at the dates of the grant using the Black-Scholes Option Pricing Model.

Total expense arising from the employee stock purchase plan amounted to ₱134 million in 2012, ₱172 million in 2011 and ₱174 million in 2010.

See *Note 26 – Expenses and Income*.

18. Interest-bearing Long-term Financial Liabilities

This account consists of the following:

	2012	2011
	(Amounts in Millions)	
Long-term portion of interest-bearing financial liabilities:		
Long-term debt	**₱20,466**	₱19,816
Current portion of interest-bearing financial liabilities:		
Long-term debt	**766**	2,909
Redeemable preferred stock	**1,594**	1,651
	2,360	4,560
	₱22,826	₱24,376

All of the redeemable preferred shares have been called for redemption as at June 30, 2011, consistent with the terms of the Preferred Shares Subscription Agreement. The unpaid dividends amounted to ₱256 million and ₱261 million as at December 31, 2012 and December 31, 2011, respectively. Interest is no longer accrued on the preferred shares, which have been called for redemption.

See *Note 23 – Trade Payables and Other Current Liabilities.*

The details of interest-bearing long-term financial liabilities are as follows:

Description	2012	2011
	(Amounts in Millions)	
Floating Rate Loan		
MERALCO		
₱2.5 Billion Term Loan Facility	**₱2,488**	₱2,500
₱3.0 Billion Term Loan Facility	**1,200**	1,800
Fixed Rate Loan		
MERALCO		
₱5.0 Billion Note Facility Agreement	**4,950**	5,000
₱5.0 Billion Note Facility Agreement	**4,900**	4,950
₱4.8 Billion Note Facility Agreement	**4,776**	4,800
₱3.0 Billion Note Facility Agreement	**3,000**	–
₱5.0 Billion Note Facility Agreement	**–**	2,172
₱5.5 Billion Note Facility Agreement	**–**	1,600
Total long-term debt	**21,314**	22,822
Less unamortized debt issuance costs	**82**	97
	21,232	22,725
Redeemable Preferred Stock	**1,594**	1,651
	22,826	24,376
Less portion maturing within one year	**2,360**	4,560
Long-term portion of interest-bearing financial liabilities	**₱20,466**	₱19,816

All of *MERALCO*'s interest-bearing long-term financial liabilities as at December 31, 2012 and 2011 are denominated in Philippine pesos. The scheduled maturities of *MERALCO*'s outstanding long-term debt at nominal values as at December 31, 2012 are as follows:

Year	Amount
	(In Millions)
2013	₱766
2014	766
2015	189
2016	4,845
2017	2,054
After 2017	12,694
	₱21,314

Floating Rate Loans

₱2.5 Billion Term Loan Facility

The ₱2,500 million, 7-year Floating Rate Term Loan Facility, was drawn in January 2011 from a local bank. Interest rate is repriced every six months based on 6-month *PDST-F* plus a spread. The principal is payable in nominal annual amortizations with a balloon payment on maturity date.

₱3.0 Billion Term Loan Facility

The ₱3,000 million, 5-year bilateral Floating Rate Term Loan Facility, was drawn in October 2009. The principal is payable over five years with final maturity in October 2014.

Fixed Rate Loans

₱5.0 Billion Note Facility Agreement

In June 2011, *MERALCO* entered into a Fixed Rate Note Facility Agreement for its ₱500 million, 7-year notes and ₱4,500 million, 10-year notes due in 2018 and 2021, respectively. The principal is payable in nominal annual amortizations with a balloon payment on each of the two final maturity dates.

₱5.0 Billion Note Facility Agreement

In December 2010, *MERALCO* entered into a Fixed Rate Note Facility Agreement for the issuance of ₱23 million, 5-year fixed rate notes maturing in December 2015 and ₱4,977 million, 5.5-year fixed rate notes due in June 2016. The 5-year fixed rate notes are payable in full at maturity date while the 5.5-year fixed rate notes are payable in nominal annual amortizations with a balloon payment on maturity date.

₱4.8 Billion Note Facility Agreement

In November 2010, *MERALCO* signed a Fixed Rate Note Facility Agreement for its ₱1,997 million, 7-year fixed rate notes and ₱2,803 million, 10-year fixed rate notes. The notes were issued on December 2, 2010 and are payable in nominal annual amortizations with a balloon payment on each of the two maturity dates.

₱3.0 Billion Note Facility Agreement

On January 5, 2012, *MERALCO* signed a ₱3,000 million Fixed Rate Note Facility Agreement for its ₱1,000 million, 7-year notes and ₱2,000 million, 10-year notes due in 2019 and 2022, respectively. The notes were priced off the relevant 7-year and 10-year benchmarks plus a spread and issued on January 9, 2012. Principal repayments are through annual nominal amortizations and a balloon payment on maturity date.

₱5.0 Billion Note Facility Agreement

In January 2009, *MERALCO* entered into a Note Facility Agreement for its ₱2,712 million fixed rate notes with final maturity in January 2014 and ₱2,285 million floating rate notes due in January 2010. The floating rate notes were prepaid in October 2009 without penalty while the fixed rate notes are payable in annual installments of 10% of the original principal amount from 2010 to 2013 with the remaining balance payable in 2014. The fixed rate notes were prepaid in January 2012 without penalty.

₱5.5 Billion Note Facility Agreement

On December 9, 2009, *MERALCO* signed a ₱5,500 million Note Facility Agreement covering its fixed and floating rate notes. The ₱1,600 million fixed rate notes are payable in full on maturity date in 2014. The ₱3,900 million floating rate notes were prepaid in December 2010 without penalty. The ₱1,600 million fixed rate notes were prepaid in December 2012 without penalty.

The average annual interest rates for the interest-bearing financial liabilities are as follows:

Fixed Rate Notes	
2012	**5.23% to 7.47%**
2011	4.00% to 8.79%
Floating Rate Notes	
2012	**2.63% to 2.99%**
2011	4.60% to 5.88%

Debt Covenants

MERALCO's loan agreements require compliance with debt service coverage of 1.2 times calculated at specific measurement dates. The agreements also contain restrictions with respect to the creation of liens or encumbrances on assets, issuance of guarantees, mergers or consolidations, disposition of a significant portion of its assets and related party transactions.

As at December 31, 2012 and 2011, *MERALCO* is in compliance with all covenants of the loan agreements.

Unamortized Debt Issuance Costs

Unamortized debt issuance costs amounted to ₱82 million and ₱97 million as at December 31, 2012 and 2011, respectively.

The following presents the changes to the unamortized debt issuance costs:

	Note	**2012**	2011
		(Amounts in Millions)	
Balance at beginning of year		**₱97**	₱114
Additions		**22**	27
Accretions charged to interest and other financial charges	*26*	**(37)**	(23)
Unamortized debt issuance costs of discontinued operations		**–**	(21)
Balance at end of year		**₱82**	₱97

Redeemable Preferred Stock

The movements in the number of shares of the redeemable preferred stock, which have all been called, are as follows:

	2012	2011
Balance at beginning of year	**165,129,647**	191,964,025
Redemptions	**(5,772,708)**	(26,834,378)
Balance at end of year	**159,356,939**	165,129,647

The original "Terms and Conditions" of *MERALCO*'s Special Stock Subscription Agreement, which required an applicant to subscribe to preferred stock with 10% dividend to cover the cost of extension of, or new distribution facilities, has been amended by the *Magna Carta* and the Distribution Services and Open Access Rule, or *DSOAR,* effective June 17, 2004 and January 18, 2006, respectively. The amendment sets forth the guidelines for the issuance of preferred stock, only if such instrument is available.

19. Customers' Deposits

This account consists of:

	2012			2011		
	Current Portion (*see Note 23*)	**Long-term Portion**	**Total**	Current Portion (*see Note 23*)	Long-term Portion	Total
			(*Amounts in Millions*)			
Meter deposits	**₱2,188**	**₱–**	**₱2,188**	₱2,266	₱–	₱2,266
Bill deposits	**4,064**	**23,313**	**27,377**	2,349	24,080	26,429
	₱6,252	**₱23,313**	**₱29,565**	₱4,615	₱24,080	₱28,695

Meter Deposits

Meter deposit was intended to guarantee the cost of meters installed.

The *Magna Carta* for residential customers (effective June 17, 2004) and *DSOAR* (effective January 18, 2006) for non-residential customers exempt all customer groups from payment of meter deposits beginning July 2004 for residential customers and April 2006 for non-residential customers.

The *ERC* released Resolution No. 8, Series of 2008, otherwise known as "Rules to Govern the Refund of Meter Deposits to Residential and Non-Residential Customers," or *Rules,* which required the refund of meter deposits from the effectivity of the said *Rules* on July 5, 2008. Under the *Rules*, a customer has the option of receiving his refund in cash, credit to future monthly billings, or as an offset to other due and demandable claims of the *DU* against him.

The total amount of refund shall be equivalent to the meter deposit paid by the customer plus the total accrued interest earned from the time the customer paid the meter deposit until the day prior to the start of refund.

On August 8, 2008, in compliance with the *Rules*, *MERALCO* submitted to the *ERC* an accounting of the total meter deposit principal amount for refund. The actual refund of meter deposits commenced on November 3, 2008.

As at December 31, 2012 and 2011, total meter deposits refunded by *MERALCO* amounted to ₱908 million (inclusive of ₱466 million interest) and ₱828 million (inclusive of ₱425 million interest), respectively.

Bill Deposits

Bill deposits serve to guarantee payment of bills by a customer in accordance with existing regulation.

As provided for under the *Magna Carta* and *DSOAR*, residential and non-residential customers, respectively, are required to deposit with the *DU* an amount equivalent to the estimated monthly bill calculated based on applied load, which shall be recognized as bill deposit of the customer.

On February 22, 2010, the amended *DSOAR,* which became effective on April 1, 2010, was promulgated by the *ERC.* Under the amended *DSOAR,* interest on bill deposits for both residential and non-residential customers shall be computed using the equivalent peso savings account interest rate of the Land Bank of the Philippines or *Land Bank,* or other government banks, on the first working day of the year, subject to the confirmation of the *ERC.* Based on the foregoing, the interest rate effective April 1, 2010 through December 31, 2010 was 0.75% per annum. Effective January 1, 2011 until December 31, 2012, the interest rate for bill deposits is 0.5% per annum.

The following are the movements of bill deposits account:

	2012	2011
	(*Amounts in Millions*)	
Balance at beginning of year	**₱26,429**	₱24,439
Additions	**3,211**	2,506
Refunds	**(2,263)**	(516)
Balance at end of year	**27,377**	26,429
Less portion maturing within one year	**4,064**	2,349
Long-term portion of bill deposits and interest	**₱23,313**	₱24,080

20. Provisions

Provisions consist of amounts provided for probable charges and expenses from claims, among others. The movements follow:

	2012	2011
	(Amounts in Millions)	
Balance at beginning of year	**₱16,919**	₱12,875
Provisions	**2,770**	7,571
Settlements	**(278)**	(126)
Reclassification	**–**	(3,401)
Balance at end of year	**₱19,411**	₱16,919

21. Customers' Refund

This account represents the balance of the refund related to the *SC* decision promulgated on April 30, 2003, which has not yet been claimed by the customers.

In June 2003, the *ERC*, in the implementation of the *SC* decision, ordered *MERALCO* to refund to its customers an equivalent ₱0.167 per *kWh* for billings made from February 1994 to April 2003.

On February 7, 2011, the *ERC* approved *MERALCO*'s proposal for the extension of the *SC* refund process for five years up to December 31, 2015, in view of difficulties encountered by (i) the customers in meeting the necessary documentation requirements to claim a refund and (ii) *MERALCO* in contacting or locating customers entitled to the refund.

22. Notes Payable

Notes payable represent unsecured, peso-denominated, interest-bearing working capital loans obtained from various local banks. Annual interest rates ranged from 3.9% to 6.5% in 2012 and 6.5% to 6.7% in 2011.

Interest expense on notes payable amounted to ₱5 million, ₱6 million and ₱26 million in 2012, 2011 and 2010, respectively. See *Note 26 – Expenses and Income*.

23. Trade Payables and Other Current Liabilities

This account consists of the following:

	Note	2012	2011
		(Amounts in Millions)	
Trade accounts payable	*24*	**₱23,991**	₱22,475
Output *VAT* - net		**4,580**	2,470
Accrued expenses:			
Employee benefits		**2,629**	1,940
Taxes		**2,590**	1,440
Liability for *GSL* payout		**741**	580
Interest	*18*	**308**	192
Current portions of:			
Bill deposits and related interest	*19*	**4,064**	2,349
Meter deposits and related interest	*19*	**2,188**	2,266
Deferred lease income		**761**	–
Derivative liability	*28*	**–**	6
Refundable service extension costs		**1,512**	1,145
Dividends payable on:			
Common stock	*16*	**1,023**	598
Redeemable preferred stock	*18*	**256**	261
Universal charges payable		**320**	573
Reinsurance liability		**213**	198
Regulatory fees payable		**204**	208
Refundable transmission charges		**180**	130
Other current liabilities		**2,016**	3,180
		₱47,576	₱40,011

Trade Accounts Payable

Trade accounts payable mainly represent obligations to power suppliers, namely, *NPC/*Power Sector Assets and Liabilities Management Corporation or *PSALM*, (including *NPC* successor generating companies or *SGCs/*Independent Power Plant Administrators or *IPPA*s), *NGCP,* Philippine Electricity Market Corporation or *PEMC*, *FGPC* and *FGP*, *QPPL*, Philippine Power Development Corporation, Montalban Methane Power Corporation or *MMPC*, Bacavalley Energy, Inc. or *BEI,* for costs of power purchased and for cost of transmission. In addition, this account includes liabilities due to local and foreign suppliers for purchases of goods and services, which consist of transformers, poles, materials and supplies and, contracted services.

Trade payables are noninterest-bearing and are generally settled within the 15 to 60-day trade term. Other payables are noninterest-bearing and are due in no more than six months from incurrence.

See *Note 24 – Related Party Transactions* and *Note 31 - Significant Contracts and Commitments.*

Refundable Service Extension Costs

Article 14 of the *Magna Carta*, specifically, "Right to Extension of Lines and Facilities," requires a customer requesting for an extension of lines and facilities beyond 30-meter service distance from the nearest voltage facilities of the *DU* to advance the cost of the project. The amended *DSOAR*, which became effective April 1, 2010 requires such advances from customers to be refunded at the rate of 75% of the distribution revenue generated from the extension lines and facilities until such amounts are fully refunded. The related asset forms part of the rate base only at the time a refund has been paid out. Customer advances are noninterest-bearing.

As at December 31, 2012 and 2011, the noncurrent portion of refundable service extension costs of ₱4,357 million and ₱3,794 million, respectively, is presented as "Refundable Service Extension Costs - net of current portion" account in the consolidated statement of financial position.

24. **Related Party Transactions**

The following provides the total amount of transactions, which have been provided and/or contracted by the *MERALCO Group* with related parties for the relevant financial year. The outstanding balances are unsecured, non-interest bearing and settled in cash.

PSAs with San Miguel Energy Corporation or SMEC and South Premier Power Corporation or SPPC.

MERALCO has *PSA*s with *SMEC* and *SPPC* beginning December 26, 2012. See *Note 31 – Significant Contracts and Commitments* for the related discussions. There is no purchase transaction under these *PSA*s in 2012, hence there is no outstanding liability to *SMEC* and *SPPC* as at December 31, 2012.

SMEC and *SPPC* are subsidiaries of *SMC.*

Pole Attachment Contracts with Philippine Long Distance Telephone Company or *PLDT*

MERALCO has a Pole Attachment Contract with *PLDT* similar to third party pole attachment contracts of *MERALCO* with other telecommunication companies. Under the Pole Attachment Contract, *PLDT* shall use the contacted cable position exclusively for its telecommunication cable network facilities.

Sale of Electricity under Various Service Contracts

MERALCO sells electricity to related party shareholder groups such as *PLDT*, *Metro Pacific* and *SMC* and their respective subsidiaries, and affiliates for the latters' facilities within *MERALCO*'s franchise area. The rates charged to related parties are the same *ERC*-mandated rates applicable to customers within the franchise area.

Purchase of Telecommunication Services from PLDT and Subsidiaries

The *MERALCO Group*'s primary telecommunications carriers are *PLDT* for its wireline and *SMART* for its wireless services. *MERALCO Group* also purchases its wireline services from Digitel Mobile Philippines, Inc., which became a subsidiary of *PLDT* in 2011. Such services are covered by standard service contracts between the telecommunications carriers and each legal entity within the *MERALCO Group*.

Purchase of Goods and Services

In the ordinary course of business, the *MERALCO Group* purchases goods and services from its affiliates and sells power to such affiliates.

Following is the summary of related party transactions for the years ended December 31, 2012, 2011 and 2010 and the outstanding balances as at December 31, 2012 and 2011:

Category	Amount of Transactions 2012	2011	2010	Outstanding Receivable (Liability) as at December 31 2012	2011	Terms	Conditions
	(Amounts in Millions)						
Sale of Electricity							
PLDT Group	**₱2,936**	₱2,669	₱2,106	**₱268**	₱160	10-day; noninterest-bearing	Unsecured, no impairment
SMC Group	**1,040**	945	1,026	**83**	81	10-day; noninterest-bearing	Unsecured, no impairment
Metro Pacific Group	**1,172**	594	518	**54**	45	10-day; noninterest-bearing	Unsecured, no impairment
Purchases of IT services - *Indra Philippines*	**423**	451	510	**–**	–	30-day; noninterest-bearing	Unsecured
Purchases of meters and devices - *GEPMICI*	**248**	314	52	**–**	(7)	30-day; noninterest-bearing	Unsecured
Revenue from pole attachment - *PLDT*	**206**	197	199	**–**	–	Advance payment	Unsecured, no impairment
Purchases of wireline and wireless services - *PLDT Group*	**47**	43	61	**–**	–	30-day; noninterest-bearing	Unsecured

Transaction with MERALCO Pension Fund

MERALCO Pension Fund holds 6,000 common shares of *RP Energy* at ₱100 par value per share, with total carrying amount of ₱600,000 or an equivalent 3% equity interest in *RP Energy*. The fair value of *RP Energy*'s common shares cannot be reliably measured as these are not traded in the financial market. As at December 31, 2012, the fair value of the total assets being managed by *MERALCO* Pension Fund amounted to ₱30.5 billion.

See Note 27 – Long-Term Employee Benefits.

Compensation of Key Management Personnel

The compensation of key management personnel of the *MERALCO Group* by benefit type is as follows:

	2012	2011	2010
		(Amounts in Millions)	
Short-term employee benefits	**₱432**	₱413	₱376
Long-term employee and retirement benefits	**69**	112	133
Share-based payments	**31**	16	14
Total compensation to key management personnel	**₱532**	₱541	₱523

Each of the directors is entitled to a per diem of ₱120,000 for every *BOD* meeting attended. Each member of the Audit and Risk Management, Remuneration and Leadership Development (formerly Compensation and Benefits), Finance, Governance and Nomination Committees is entitled to a fee of ₱20,000 for every committee meeting attended.

There are no agreements between the *MERALCO Group* and any of its key management personnel providing for benefits upon termination of employment or retirement, except with respect to benefits provided under the retirement and pension plans. The Pension Plan covers employees hired up to December 31, 2003 only. The Provident Plan, which is implemented on a voluntary basis, covers employees hired after January 1, 2004.

25. Revenues and Purchased Power

Electricity Revenue

Electricity revenues account for 99% of the total revenues in 2012, 2011 and 2010. Following is a breakdown of electricity revenues:

	2012	2011	2010
		(Amounts in Millions)	
Pass-through charges:			
Generation charge	**₱183,708**	₱157,850	₱158,850
Transmission charge	**31,971**	32,340	25,456
System loss charge	**16,411**	15,500	11,567
Power Act Reduction adjustment	**(25)**	(106)	(219)
Interclass, lifeline subsidies and others	**34**	(201)	(233)
Distribution service charges	**50,892**	48,606	43,656
	₱282,991	₱253,989	₱239,077

Distribution revenue accounted for 18%, 19% and 18% of total revenues in 2012, 2011 and 2010 respectively.

See *Note 7 – Segment Information.*

Purchased Power

Actual purchased power costs are pass-through costs and are revenue-neutral to *MERALCO* and *CEDC*. The details are as follows:

	2012	2011	2010
		(Amounts in Millions)	
Generation charge	**₱198,648**	₱170,445	₱172,946
Transmission charge	**34,420**	35,229	27,970
	₱233,068	₱205,674	₱200,916

Generation charge is inclusive of line rentals and must-run unit charges billed by *PEMC*.

Purchased power includes capacity fees, fixed operating fees and transmission line fees that are accounted for similar to a lease under Philippine Interpretation *IFRIC 4, "Determining whether an arrangement contains a lease"*. The total amounts billed by the suppliers presented as part of "Purchased power" account in the consolidated statements of income are ₱18,946 million, ₱20,135 million and ₱19,960 million in 2012, 2011 and 2010, respectively. This also includes the actual *SL* incurred but no more than 8.5%. *MERALCO*'s actual *SL* rates were 7.04%, 7.3% and 7.9%, in 2012, 2011 and 2010, respectively.

Purchased power cost in 2011 and 2010 is inclusive of the volume of banked gas consumed effectively reducing the cost of purchased power as these were sourced at lower prices then. In 2011, the balance of banked gas was fully utilized.

The details of purchased power follow:

	2012	2011	2010
		(Amounts in Millions)	
FGPC and *FGP*	**₱58,592**	₱58,537	₱53,322
NPC/PSALM (including NPC SGCs/IPPAs)	**96,375**	75,775	65,170
TransCo/NGCP	**33,420**	35,229	27,970
PEMC/ WESM	**28,401**	20,265	39,140
QPPL	**15,147**	15,687	15,238
Others	**133**	181	76
	₱232,068	₱205,674	₱200,916

Generation and transmission cost over/under-recoveries occur as a result of the lag in the billing and recovery of generation and transmission costs from consumers. As at December 31, 2012 and 2011, the total generation and transmission cost over-recoveries included in "Other noncurrent liabilities" account in the consolidated statements of financial position amounted to ₱6,414 million and ₱4,004 million, respectively.

26. **Expenses and Income**

Salaries, Wages and Employee Benefits

	Note	2012	2011	2010
			(Amounts in Millions)	
Salaries and wages		**₱8,219**	₱6,648	₱6,412
Pension expense	*27*	**1,367**	1,465	1,752
Health, medical and related benefits		**1,619**	2,287	529
Other long-term post-employment benefits	*27*	**411**	339	285
Employee stock payment plan expense	*17*	**134**	172	174
		₱11,750	₱10,911	₱9,152

Other Expenses

	Note	2012	2011	2010
			(Amounts in Millions)	
Materials and supplies	*14*	**₱527**	₱735	₱846
Rent and utilities		**574**	412	179
Transportation and travel		**386**	475	349
Corporate expenses		**249**	258	297
Insurance		**208**	259	222
Advertising expenses		**179**	197	188
Communication expenses	*24*	**68**	62	61
Others		**1,559**	489	1,718
		₱3,750	₱2,887	₱3,860

Interest and Other Financial Charges

	Note	**2012**	2011	2010
			(Amounts in Millions)	
Interest expense on interest-bearing long-term financial liabilities, net of interest capitalized	*8 and 18*	**₱1,202**	₱1,163	₱1,182
Interest expense on bill deposits	*19*	**91**	83	(1,326)
Amortization of:				
Debt issuance costs	*18*	**37**	23	73
Loan premium		**–**	–	(24)
Carrying charge on *ERC*-approved over-recoveries	*2*	**79**	20	108
Interest expense on notes payable	*22*	**5**	6	26
Interest expense on meter deposits	*19*	**1**	3	76
Others		**113**	147	446
		₱1,528	₱1,445	₱561

Interest and Other Financial Income

	Note	**2012**	2011	2010
			(Amounts in Millions)	
Interest income on cash and cash equivalents		**₱1,762**	₱1,379	₱535
Carrying costs on *ERC*-approved under-recoveries	*2*	**755**	791	723
Gain on return of investment		**–**	24	355
Others		**52**	70	(8)
		₱2,569	₱2,264	₱1,605

27. Long-term Employee Benefits

Liabilities for long-term employee benefits consist of the following:

	2012	2011
	(Amounts in Millions)	
Pension liability	**₱5,313**	₱5,398
Long-term incentives	**2,600**	1,641
Other long-term post-employment benefits	**1,525**	1,187
	₱9,438	₱8,226

Retirement Plan

The features of the *MERALCO Group*'s defined benefit plans are discussed in *Note 4 – Significant Accounting Policies.*

Actuarial valuations are prepared annually by independent actuaries.

Net Pension Costs (included in "Salaries, wages and employee benefits" account)

	2012	2011	2010
		(Amounts in Millions)	
Interest costs	**₱1,948**	₱1,956	₱2,011
Current service costs	**1,045**	1,097	869
Expected return on plan assets	**(1,633)**	(1,595)	(1,133)
Past service costs	**1**	1	1
Actuarial loss	**3**	2	2
Net pension costs	**₱1,364**	₱1,461	₱1,750
Actual return on plan assets	**₱3,376**	₱1,863	₱4,178

Pension Liability

	2012	2011
	(Amounts in Millions)	
Defined benefit obligation	**₱33,811**	₱33,234
Fair value of plan assets	**(30,532)**	(27,283)
Unrecognized net actuarial gains (losses)	**2,036**	(550)
Unrecognized past service costs	**(2)**	(3)
Pension liability	**₱5,313**	₱5,398

Changes in the present value of the defined benefit obligation are as follows:

	2012	2011
	(Amounts in Millions)	
Defined benefit obligation at beginning of year	**₱33,234**	₱32,729
Interest costs	**1,948**	1,956
Current service costs	**1,045**	1,097
Benefits paid	**(1,573)**	(1,695)
Actuarial losses (gains) due to:		
Changes in assumptions	**(846)**	455
Experience adjustments	**3**	(1,140)
Defined benefit obligation of discontinued operations	**–**	(168)
Defined benefit obligation at end of year	**₱33,811**	₱33,234

Changes in the fair value of plan assets are as follows:

	2012	2011
	(Amounts in Millions)	
Fair value of plan assets at beginning of year	**₱27,283**	₱22,986
Contributions by employer	**1,446**	4,323
Benefits paid	**(1,573)**	(1,695)
Expected return on plan assets	**1,633**	1,594
Actuarial gains	**1,743**	269
Defined benefit obligation of discontinued operations	**–**	(194)
Fair value of plan assets at end of year	**₱30,532**	₱27,283

The Board of Trustees or *BOT*, which manages the retirement benefit fund, is chaired by the chairman of *MERALCO*, who is neither an executive nor a beneficiary. The other members of the *BOT* are (i) an executive member of the *BOD*; (ii) two (2) senior executives; (iii) an independent member of the *BOD*; (iv) a member of the *BOD* who represents the largest shareholder group and (v) a non-executive, non-*BOD* member who represents another shareholder group, all of whom are non-beneficiaries of the Plan.

The Fund follows a generally conservative investment approach where investments are diversified to minimize risks but ensures an increase in value of the Fund assets. Substantially all of the funds of the Plan are managed by four (4) trustee banks whose common objective is to maximize the long-term expected return of plan assets. As approved by the *BOT*, the funds are invested in a guided proportion of fixed income instruments, cash investments and equities.

MERALCO expects to contribute approximately ₱2,929 million to its defined benefit pension plan in 2013.

Net carrying amount and fair value of the assets of the fund as at December 31, 2012 and 2011 amounted to ₱30,532 million and ₱27,283 million, respectively.

The major categories of plan assets of *MERALCO* Pension Fund as a percentage of the fair value of total plan assets are as follows:

	2012	2011
	(In Percentage)	
Government securities	**33**	26
Marketable equity securities	**24**	38
Bonds and commercial notes	**22**	14
Cash and cash equivalents	**11**	16
Receivables	**7**	3
Real properties	**3**	3
	100	100

Marketable equity securities, government securities, bonds and commercial notes are investments held by the trustee banks. The Pension Fund does not have any direct equity interests in *MERALCO*.

The overall expected rate of return on assets is determined based on the prevailing rates of return on equity and fixed income securities applicable for the period over which the obligation is to be settled.

The key information of the retirement plan is as follows:

	2012	2011	2010	2009	2008
		(Amounts in Millions)			
Present value of defined benefit obligation	**₱33,811**	₱33,234	₱32,728	₱25,255	₱22,694
Fair value of plan assets	**(30,532)**	(27,283)	(23,004)	(16,348)	(10,408)
Excess of present value of defined benefit obligation over fair value of plan assets	**3,279**	5,951	9,724	8,907	12,286
Experience adjustments on plan liabilities	**3**	(685)	(451)	(467)	165
Experience adjustments on plan assets	**1,743**	269	3,072	3,423	(2,531)

Other Long-term Post-employment Benefits (included as part of "Salaries, wages and employee benefits" account)

	2012	2011	2010
		(Amounts in Millions)	
Interest costs	**₱176**	₱156	₱151
Current service costs	**85**	54	34
Actuarial loss	**150**	129	100
	₱411	₱339	₱285

Other Long-term Post-employment Benefits Liability

	2012	2011
	(Amounts in Millions)	
Other long-term post-employment benefits obligation	**₱2,725**	₱2,537
Unrecognized net actuarial losses	**(1,200)**	(1,350)
	₱1,525	₱1,187

Changes in the present value of other long-term post-employment benefits liability are as follows:

	2012	2011
	(Amounts in Millions)	
Balance at beginning of year	**₱2,537**	₱2,471
Interest costs	**176**	156
Current service costs	**85**	54
Benefits paid	**(73)**	(73)
Actuarial gains	**–**	(71)
Balance at end of year	**₱2,725**	₱2,537

The principal assumptions used as at January 1, 2012, 2011 and 2010 in determining pension and other long-term post-employment benefits obligations are shown below:

	2012	2011	2010
Annual discount rate	**6%**	6%	6%–8%
Expected annual rate of return on assets	**6%**	6%	7%–10%
Future range of annual salary increases	**6%–8%**	6%–8%	5%–9.6%

MERALCO Defined Contribution Provident Plan

MERALCO has a contributory Provident Plan effective January 1, 2009, intended to be a Supplemental Retirement Benefit for employees hired after 2004, on a voluntary basis. Each qualified employee-member who opts to participate in the plan shall have the option to contribute up to a maximum of 25% of his base salary. *MERALCO* shall match the member's contribution up to the first 10% of the member's base salary. Upon resignation, the member shall be entitled to the total amount credited to his personal retirement account immediately preceding his actual retirement date, subject to provisions of the Provident Plan. Total amount contributed by *MERALCO* are ₱3 million, ₱4 million and ₱2 million in 2012, 2011 and 2010, respectively.

Consolidated Pension Benefit Cost (included in "Salaries, wages and employee benefits" account)

	2012	2011	2010
		(Amounts in Millions)	
Expense recognized for defined benefit plans	**₱1,364**	₱1,461	₱1,750
Expense recognized for defined contribution plan	**3**	4	2
Consolidated pension benefit costs	**₱1,367**	₱1,465	₱1,752

Long-term Incentive Plan or LTIP

MERALCO's *LTIP* covers qualified executives with at least the rank of superintendent. The *LTIP* hinges on *MERALCO Group*'s achievement of a certain level of consolidated core net income determined on an aggregate basis for the three year period ended December 31, 2012 and the executives' attainment of a certain level of performance rating. Executives invited to the plan must serve a minimum uninterrupted period to be entitled to any pay-out under the plan.

28. Financial Assets and Liabilities

Financial assets consist of cash and cash equivalents and trade and non-trade receivables, which are generated directly from operations. The principal financial liabilities, other than derivatives, consist of bank loans, redeemable preferred shares, trade and non-trade payables, which are incurred to finance operations in the normal course of business. Accounting policies related to financial assets and liabilities are set out in *Note 4 – Significant Accounting Policies*.

The following table sets forth the financial assets and liabilities as at December 31, 2012 and 2011:

	Loans and Receivables	Held-to-maturity Investments	Fair Value through Profit or Loss	Held-for-trading	Available-for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
			(Amounts in Millions)				
Assets as at December 31, 2012							
Noncurrent							
Other noncurrent assets	**₱325**	**₱123**	**₱–**	**₱–**	**₱331**	**₱–**	**₱779**
Current							
Cash and cash equivalents	**60,500**	**–**	**–**	**–**	**–**	**–**	**60,500**
Trade and other receivables - net	**23,447**	**–**	**–**	**–**	**–**	**–**	**23,447**
Other current assets – derivative assets	**–**	**–**	**24**	**–**	**–**	**–**	**24**
Total assets	**84,272**	**123**	**24**	**–**	**331**	**–**	**84,750**
Liabilities as at December 31, 2012							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	**–**	**–**	**–**	**–**	**–**	**20,466**	**20,466**
Customers' deposits - net of current portion	**–**	**–**	**–**	**–**	**–**	**23,313**	**23,313**
Refundable service extension costs - net of current portion	**–**	**–**	**–**	**–**	**–**	**4,357**	**4,357**
Current							
Notes payable	**–**	**–**	**–**	**–**	**–**	**1,787**	**1,787**
Trade payables and other current liabilities	**–**	**–**	**–**	**–**	**–**	**34,966**	**34,966**
Customers' refund	**–**	**–**	**–**	**–**	**–**	**6,127**	**6,127**
Current portion of interest-bearing long-term financial liabilities	**–**	**–**	**–**	**–**	**–**	**2,360**	**2,360**
Total liabilities	**–**	**–**	**–**	**–**	**–**	**93,376**	**93,376**
Net Assets (Liabilities)	**₱84,272**	**₱123**	**₱24**	**₱–**	**₱331**	**(₱93,376)**	**(₱8,626)**

	Loans and Receivables	Held-to-maturity Investments	Fair Value through Profit or Loss	Held-for-trading	Available-for-sale Financial Assets	Liabilities Carried at Amortized Cost	Total Financial Assets and Liabilities
			(Amounts in Millions)				
Assets as at December 31, 2011							
Noncurrent							
Other noncurrent assets	₱266	₱106	₱–	₱–	₱140	₱–	₱512
Current							
Cash and cash equivalents	44,141	–	–	–	–	–	44,141
Trade and other receivables - net	23,668	–	–	–	–	–	23,668
Other current assets – derivative assets	–	–	4	–	–	–	4
Total assets	68,075	106	4	–	140	–	68,325
Liabilities as at December 31, 2011							
Noncurrent							
Interest-bearing long-term financial liabilities - net of current portion	–	–	–	–	–	19,816	19,816
Customers' deposits - net of current portion	–	–	–	–	–	24,080	24,080
Refundable service extension costs - net of current portion	–	–	–	–	–	3,794	3,794
Current							
Notes payable	–	–	–	–	–	67	67
Trade payables and other current liabilities	–	–	6	–	–	30,975	30,981
Customers' refund	–	–	–	–	–	6,250	6,250
Current portion of interest-bearing long-term financial liabilities	–	–	–	–	–	4,560	4,560
Total liabilities	–	–	6	–	–	89,542	89,548
Net Assets (Liabilities)	₱68,075	₱106	(₱2)	₱–	₱140	(₱89,542)	(₱21,223)

The following table sets forth the consolidated carrying values and estimated fair values of the financial assets and liabilities recognized as at December 31, 2012 and 2011:

	Carrying Value		Fair Value	
	2012	2011	**2012**	2011
	(Amounts in Millions)			
Noncurrent Financial Assets				
AFS financial assets:				
Quoted equity securities	**₱128**	₱121	**₱128**	₱121
Unquoted equity securities	**203**	19	**203**	19
Other noncurrent assets:				
Advance payments to a supplier	**325**	239	**390**	302
HTM	**123**	106	**123**	106
Notes receivable	**–**	27	**–**	27
Total noncurrent financial assets	**779**	512	**844**	575
Current Financial Assets				
Cash and cash equivalents:				
Cash on hand and in banks	**3,256**	2,704	**3,256**	2,704
Cash equivalents	**57,244**	41,437	**57,244**	41,437
Trade and other receivables - net:				
Billed electricity	**20,779**	21,347	**20,779**	21,347
Service contracts	**671**	761	**671**	761
Insurance receivable	**383**	319	**383**	319
Cost and estimated earnings in excess of billings on uncompleted contracts	**258**	167	**258**	167
Nontrade receivables	**1,356**	1,074	**1,356**	1,074
Other current assets – derivative assets	**24**	4	**24**	4
Total current financial assets	**83,971**	67,813	**83,971**	67,813
Total Financial Assets	**₱84,750**	₱68,325	**₱84,815**	₱68,388

	Carrying Value		Fair Value	
	2012	2011	**2012**	2011
	(Amounts in Millions)			
Noncurrent Financial Liabilities				
Interest-bearing long-term financial liabilities	**₱20,466**	₱19,816	**₱22,427**	₱20,134
Customers' deposits - net of current portion	**23,313**	24,080	**23,313**	24,080
Refundable service extension costs	**4,357**	3,794	**4,357**	3,794
Total noncurrent financial liabilities	**48,136**	47,690	**50,097**	48,008
Current Financial Liabilities				
Trade payables and other current liabilities				
Trade accounts payable	**23,991**	22,475	**23,991**	22,475
Accrued expenses	**1,015**	772	**1,015**	772
Current portion of:				
Meter deposits and related interests	**2,188**	2,266	**2,188**	2,266
Bill deposits and related interests	**4,064**	2,349	**4,064**	2,349
Derivative liability	**–**	6	**–**	6
Dividends payable	**1,279**	859	**1,279**	859
Refundable service extension costs	**1,512**	1,145	**1,512**	1,145
Regulatory fees	**204**	208	**204**	208
Reinsurance liabilities	**213**	198	**213**	198
Universal charges payable	**320**	573	**320**	573
Refundable transmission charges	**180**	130	**180**	130
Customers' refund	**6,127**	6,250	**6,127**	6,250
Interest-bearing financial liabilities:				
Notes payable	**1,787**	67	**1,787**	67
Current portion of interest-bearing long-term financial liabilities	**2,360**	4,560	**2,360**	4,560
	45,240	41,858	**45,240**	41,858
Total Financial Liabilities	**₱93,376**	₱89,548	**₱95,337**	₱89,866

The fair values of the financial assets and liabilities are stated at the amounts at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables, Trade Payables and Other Current Liabilities and Notes Payable

Due to the short-term nature of transactions, the fair values of these instruments approximate their carrying amounts as at reporting date

Bifurcated Foreign Currency Forward and Foreign Currency Forward

The fair values of embedded currency forwards and freestanding currency forwards were calculated by reference to forward exchange market rates.

AFS Investments

The fair values were determined by reference to market bid quotes as at reporting date. The unquoted equity securities were carried at cost.

Meter Deposits and Customers' Refund

Meter deposits and customers' refund are due and demandable. Thus, the fair values of these instruments approximate their carrying amounts.

Bill Deposits

The carrying amount of bill deposits approximates their fair values as bill deposits are interest-bearing.

Interest-bearing Long-term Financial Liabilities

The fair values of interest-bearing long-term debt (except for redeemable preferred stock) were computed by discounting the instruments' expected future cash flows using the rates ranging from 1.65% to 4.49% in 2012 and 2.73% to 5.68% in 2011.

Redeemable Preferred Stock

The carrying amount of the preferred stock represents the fair value. Such preferred shares have been called and are payable anytime upon presentation by the shareholder of their certification. This is included under "Interest-bearing long-term financial liabilities" account.

Refundable Service Extension Costs

The fair values of refundable service extension costs cannot be reliably measured since the timing of related cash flows cannot be reasonably estimated and are accordingly measured at cost.

Fair Value Hierarchy

MERALCO uses the following hierarchy in determining and disclosing the fair value of financial instruments by valuation technique:

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

Below is the list of financial assets and liabilities carried at fair value that are classified using a fair value hierarchy:

	December 31, 2012			December 31, 2011		
	Level 1	**Level 2**	**Total**	Level 1	Level 2	Total
			(Amounts in Millions)			
Noncurrent financial assets -						
AFS investments	**₱128**	**₱–**	**₱128**	₱121	₱–	₱121
Current financial assets -						
Derivative assets	**–**	**24**	**24**	–	4	4
	₱128	**₱24**	**₱152**	₱121	₱4	₱125
Current financial liability -						
Derivative liability	**₱–**	**₱–**	**₱–**	₱–	₱6	₱6

As at December 31, 2012 and 2011, the *MERALCO Group* does not have financial instruments with fair values determined using inputs that are not based on observable market data (Level 3).

For the years ended December 31, 2012 and 2011, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Derivative Financial Instruments

Embedded Currency Forward

MERALCO has bifurcated embedded currency forwards noted in various purchases and service agreements denominated in currencies other than Philippine peso, which includes *U.S.* dollar, Euro, among others. As at December 31, 2012 and 2011, these agreements represent 12% and 16% of *MERALCO*'s trade payables, respectively. As at December 31, 2012, the *U.S.* dollar and Euro-denominated agreements amounted to $15 million (equivalent to ₱620 million) and €1 million (equivalent to ₱44 million), respectively. As at December 31, 2011, the *U.S.* dollar- and Euro-denominated agreements amounted to $14 million (equivalent to ₱630 million) and €1 million (equivalent to ₱48 million), respectively. These are part of "Trade payables and other current liabilities" account in the consolidated statements of financial position. The net fair value of the embedded currency forward amounted to ₱24 million and ₱2 million as at December 31, 2012 and 2011, respectively.

The net movements in fair value changes of the derivative financial instruments for the years ended December 31, 2012, 2011 and 2010 are as follows:

	2012	2011	2010
	(Amounts in Millions)		
Balance at beginning of year	**(₱2)**	₱23	₱155
Net changes in fair value of derivatives not designated as accounting hedges	**40**	(16)	7
Fair value of settled instruments	**(14)**	(5)	(139)
Balance at end of year	**₱24**	(₱2)	₱23

The fair value changes of the derivative instruments in 2012 and 2011 are presented as follows:

	Note	**2012**	2011
		(Amounts in Millions)	
Derivative assets	*15*	**₱24**	₱4
Derivative liabilities	*23*	**–**	(6)
		₱24	(₱2)

Financial Risk Management Objectives and Policies

The main risks arising from the financial instruments are interest rate risk, foreign currency risk, commodity price risk, credit risk and liquidity risk. The importance of managing these risks has significantly increased in light of the considerable change and volatility in the Philippine and international financial markets. The *BOD* reviews and approves policies for managing each of these risks. Management monitors the market price risk arising from all financial instruments. The policies for managing these risks are as follows:

Interest Rate Risk

The *MERALCO Group*'s exposure to the changes in market interest rates relates primarily to the debt obligations with floating interest rates since the *MERALCO Group*'s interest-bearing short-term investments mature within 90 days.

The *MERALCO Group*'s policy is to manage its interest rate risk exposure using a mix of fixed and variable rate debts. The strategy, which yields a reasonably lower effective cost based on market conditions, is adopted. Refinancing of fixed rate loans may also be undertaken to manage interest cost. As at December 31, 2012 and 2011, approximately 83% and 81% of the borrowings bear fixed rate of interest, respectively.

The following table sets out the maturity profile of the financial instruments that are exposed to interest rate risk (exclusive of debt issuance costs):

	Within 1 Year	**1–2 Years**	**2–3 Years**	**3–4 Years**	**4–5 Years**	**More than 5 Years**	**Total**
				(Amounts in Millions)			
2012 Floating Rate	**₱612**	**₱612**	**₱13**	**₱13**	**₱13**	**₱2,425**	**₱3,688**
2011 Floating Rate	612	612	612	13	13	2,438	4,300

Floating interest rate on bank loans is repriced at intervals of less than one year. The other financial liabilities of the *MERALCO Group* that are not included in the foregoing have fixed interest rate, or are noninterest-bearing, or have no fixed or determinable maturity and are therefore not subject to interest rate risk. The short-term investments are not exposed to significant changes in market rates because they mature within 90 days to coincide with *MERALCO Group*'s monthly payment obligations.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of *MERALCO*'s profit before tax as at December 31, 2012 and 2011 through the impact on floating rate borrowings. There is no other impact on *MERALCO*'s equity other than those already affecting the consolidated statement of income.

	2012		2011	
	Increase (Decrease) in Basis Points	**Effect on Profit before Tax**	Increase (Decrease) in Basis Points	Effect on Profit before Tax
		(Amounts in Millions)		
Floating rate loans from various banks	**+100**	**(₱37 million)**	+100	(₱43 million)
	(100)	**37 million**	(100)	43 million

Interest expense on floating rate loans is computed for the year, taking into account actual principal movements during the year, based on management's best estimate of a +/-100 basis points change in interest rates. There has been no change in the methods and assumptions used by the management in the above analysis.

Foreign Currency Risk

The revaluation of any of foreign currency-denominated financial assets and liabilities as a result of the appreciation or depreciation of the Philippine peso is recognized as foreign exchange gains or losses as at the end of each reporting period. The extent of foreign exchange gains or losses is largely dependent on the amount of foreign currency-denominated financial instruments. While an insignificant percentage of the *MERALCO Group*'s revenues and liabilities is denominated in *U.S.* dollars, a substantial portion of the *MERALCO Group*'s capital expenditures for electricity capital projects and a portion of the operating expenses are denominated in foreign currencies, mostly in *U.S.* dollars. As such, a strengthening or weakening of the Philippine peso against the *U.S.* dollar will decrease or increase in Philippine peso terms, the principal amount of the *MERALCO Group*'s foreign currency-denominated liabilities and the related interest expense, foreign currency-denominated capital expenditures and operating expenses as well as *U.S.* dollar-denominated revenues.

The following table shows the consolidated foreign currency-denominated financial assets and liabilities as at December 31, 2012 and 2011, translated to Philippine peso at the following exchange rates:

	2012	2011
U.S. Dollar ($)	**₱41.05**	₱43.84
Yen (¥)	**0.4787**	0.5638

	December 31, 2012		
	Foreign Currency		**Peso**
	U.S. Dollar	**Yen**	**Equivalent**
	(Amount in Millions)		
Financial assets:			
Cash and cash equivalents	**$47**	**¥–**	**₱1,913**
Trade and other receivables	**1**	**–**	**53**
Advance payments to a supplier	**8**	**–**	**325**
	56	**–**	**2,291**
Financial liabilities -			
Trade payables and other current liabilities	**(139)**	**–**	**(5,724)**
	($83)	**¥–**	**(₱3,433)**

	December 31, 2011		
	Foreign Currency		Peso
	U.S. Dollar	Yen	Equivalent
	(Amount in Millions)		
Financial assets:			
Cash and cash equivalents	$51	¥–	₱2,219
Trade and other receivables	2	–	89
Advance payments to a supplier	5	–	240
	58	–	2,548
Financial liabilities -			
Trade payables and other current liabilities	(169)	(200)	(7,456)
	($111)	(¥200)	(₱4,908)

All of *MERALCO*'s long-term financial liabilities are denominated in Philippine Peso. However, an insignificant portion of its trade payables are denominated in *U.S.* dollars. Thus, the impact of ₱1 movement of the Philippine Peso against the *U.S.* dollar will not have a significant impact on *MERALCO*'s principal and interest payments. Further, *PBR* assumes a forecast level of foreign currency movements in its calculation of the regulatory asset base and expenditures. *PBR* also allows for adjustment of the rates *MERALCO* charges should there be significant deviations in the foreign exchange forecast from what is actually realized.

The following table demonstrates the sensitivity to a reasonably possible change in the *U.S.* dollar exchange rate vis-a-vis the peso, with all other variables held constant, of the *MERALCO Group*'s profit before tax as at December 31, 2012 and 2011 (due to changes in the fair value of financial assets and liabilities). There is no other impact on *MERALCO*'s equity other than those already affecting the profit and loss.

	2012		2011	
	Appreciation (Depreciation) of U.S. Dollar/Yen	**Effect on Profit before Tax**	Appreciation (Depreciation) of U.S. Dollar	Effect on Profit before Tax
	(In %)	*(In Millions)*	*(In %)*	*(In Millions)*
U.S. dollar-denominated financial assets and liabilities	**+5**	**(₱170)**	+5	(₱243)
	–5	**170**	–5	243
Yen-denominated financial liabilities	**–**	**–**	+5	(6)
	–	**–**	–5	6

Foreign exchange gain or loss is computed for the year based on management's best estimate of a +/–5 percent change in the closing Philippine peso to *U.S.* dollar conversion rate using the year-end balances of *U.S.* dollar-denominated cash and cash equivalents, accounts receivable, liabilities and forward contracts. There has been no change in the methods and assumptions used by management in the foregoing analysis.

Commodity Price Risk

Commodity price risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in commodity prices. The exposure of *MERALCO* and *CEDC* to price risk is minimal. The cost of fuel is part of *MERALCO*'s and *CEDC*'s generation costs that are recoverable through the generation charge in the billings to customers.

Credit Risk

Credit risk is the risk that the *MERALCO Group* will incur a loss arising from customers, clients or counterparties who fail to discharge their contracted obligations. The *MERALCO Group* manages and controls credit risk by setting limits on the amount of risk that it is willing to accept for individual counterparties and by monitoring exposures in relation to such limits.

The *MERALCO Group* trades only with recognized, creditworthy third parties. It is the *MERALCO Group*'s policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivables are monitored on an ongoing basis to reduce exposure to bad debt. Power distribution receivables are, to a certain extent, backed by bill deposits. Also, as a policy, disconnection notices are sent three days after the due date and disconnections are carried out beginning on the third day after receipt of disconnection notice.

With respect to placements of cash with financial institutions, these institutions are subject to the *MERALCO Group*'s accreditation evaluation based on liquidity and solvency ratios and on the bank's credit rating. The *MERALCO Group* transacts derivatives only with similarly accredited financial institutions. In addition, the *MERALCO Group*'s deposit accounts in banks are insured by the Philippine Deposit Insurance Corporation up to ₱500,000 per bank account.

Credit risk on other financial assets, which include cash and cash equivalents, trade and other receivables and certain derivative instruments, arises from the potential default of the counterparty.

Finally, credit quality review procedures are in place to provide regular identification of changes in the creditworthiness of counterparties. Counterparty limits are established and reviewed periodically based on latest available financial information of counterparties, credit ratings and liquidity. The *MERALCO Group*'s credit quality review process allows it to assess any potential loss as a result of the risks to which it may be exposed and to take corrective actions.

There are no significant concentrations of credit risk within the *MERALCO Group*.

The table below shows the maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives as at December 31, 2012 and 2011. The maximum exposure is equivalent to the nominal amount of the accounts.

	Gross Maximum Exposure	
	2012	2011
	(Amounts in Millions)	
Cash and cash equivalents:		
Cash in banks	**₱1,348**	₱792
Cash equivalents	**57,244**	41,437
Trade and other receivables:		
Billed electricity	**20,779**	21,347
Service contracts	**671**	761
Insurance receivable	**383**	319
Cost of estimated earnings in excess of billings on uncompleted contracts	**258**	167
Nontrade receivables	**1,356**	1,074
Other current assets - derivative assets	**24**	4
Other noncurrent assets:		
Advance payments to a supplier	**325**	239
HTM investments	**123**	106
Notes receivable	**–**	27
	₱82,511	₱66,273

The credit quality of financial assets is managed by *MERALCO* (excluding subsidiaries) using "High Grade," "Standard Grade" and "Sub-standard Grade" for accounts, which are neither impaired nor past due as internal credit ratings. The following tables show the credit quality by asset class:

	2012					
	Neither Past Due nor Impaired					
	High Grade	**Standard Grade**	**Sub-standard Grade**	**Past Due but not Impaired**	**Impaired Financial Assets**	**Total**
			(Amounts in Millions)			
Cash in banks and cash equivalents	**₱58,592**	**₱–**	**₱–**	**₱–**	**₱–**	**₱58,592**
Trade and other receivables:						
Billed electricity	**5,747**	**3,313**	**8,513**	**2,995**	**2,556**	**23,124**
Nontrade receivables	**573**	**31**	**3**	**241**	**–**	**848**
Derivative assets	**24**	**–**	**–**	**–**	**–**	**24**
Other noncurrent assets	**–**	**–**	**448**	**–**	**–**	**448**
	₱64,936	**₱3,344**	**₱8,964**	**₱3,236**	**₱2,556**	**₱83,036**

	2011					
	Neither Past Due nor Impaired					
	High Grade	Standard Grade	Sub-standard Grade	Past Due but not Impaired	Impaired Financial Assets	Total
			(Amounts in Millions)			
Cash in banks and cash equivalents	₱42,229	₱–	₱–	₱–	₱–	₱42,229
Trade and other receivables:						
Billed electricity	6,703	3,866	6,173	4,607	1,950	23,299
Nontrade receivables	21	357	48	472	–	898
Derivative assets	4	–	–	–	–	4
Other noncurrent assets	–	–	372	–	–	372
	₱48,957	₱4,223	₱6,593	₱5,079	₱1,950	₱66,802

Credit ratings are determined as follows:

- "High Grade"

  'High' grade financial assets include "cash in banks and cash equivalents and derivative assets to counterparties with good credit rating or bank standing. Consequently, credit risk is minimal. These counterparties include large prime financial institutions, large industrial companies and commercial establishments, and government agencies. For trade receivables, these consist of current month's billings (less than 30 days) that are expected to be collected within 10 days from the time bills are delivered.

- "Standard Grade"

  'Standard' grade financial assets include trade receivables that consist of current month's billings (less than 30 days) that are expected to be collected before due date (10 to 14 days after bill date).

- "Sub-standard Grade"

  'Sub-standard' grade financial assets include trade receivables that consist of current month's billings, which are not expected to be collected within 60 days.

The following table shows the aging analysis of financial assets as at December 31, 2012 and 2011:

	2012					
	Neither Past Due nor Impaired	**Past Due But Not Impaired**			**Impaired Financial Assets**	**Total**
		31–60 Days	**61–90 Days**	**Over 90 Days**		
			(Amounts in Millions)			
Cash and cash equivalents:						
Cash in banks	**₱1,348**	**₱–**	**₱–**	**₱–**	**₱–**	**₱1,348**
Cash equivalents	**57,244**	**–**	**–**	**–**	**–**	**57,244**
Trade and other receivables:						
Trade:						
Billed electricity	**17,772**	**1,896**	**628**	**483**	**2,559**	**23,338**
Service contracts	**671**	**–**	**–**	**–**	**145**	**816**
Insurance receivable	**313**	**11**	**12**	**47**	**–**	**383**
Cost and estimated earnings in excess of billings on uncompleted contracts	**258**	**–**	**–**	**–**	**–**	**258**
Nontrade receivables	**1,106**	**9**	**6**	**235**	**2**	**1,358**
Other current assets - derivative assets	**24**	**–**	**–**	**–**	**–**	**24**
Other noncurrent assets:						
Advance payments to a supplier	**325**	**–**	**–**	**–**	**–**	**325**
HTM investments	**123**	**–**	**–**	**–**	**–**	**123**
	₱79,184	**₱1,916**	**₱646**	**₱765**	**₱2,706**	**₱85,217**

	2011					
	Neither Past Due nor Impaired	Past Due But Not Impaired 31–60 Days	61–90 Days	Over 90 Days	Impaired Financial Assets	Total
	(Amounts in Millions)					
Cash and cash equivalents:						
Cash in banks	₱792	₱–	₱–	₱–	₱–	₱792
Cash equivalents	41,437	–	–	–	–	41,437
Trade and other receivables:						
Trade:						
Billed electricity	16,700	2,149	564	1,934	1,952	23,299
Service contracts	561	37	65	98	60	821
Insurance receivable	301	4	2	12	–	319
Cost and estimated earnings in excess of billings on uncompleted contracts	87	80	–	–	1	168
Nontrade receivables	210	203	130	531	119	1,193
Other current assets -						
Derivative assets	4	–	–	–	–	4
Other noncurrent assets:						
Advance payments to a supplier	239	–	–	–	–	239
HTM investments	106	–	–	–	–	106
Notes receivable	27	–	–	–	–	27
	₱60,464	₱2,473	₱761	₱2,575	₱2,132	₱68,405

Liquidity Risk

Liquidity risk is the risk that the *MERALCO Group* will be unable to meet its payment obligations when these fall due. The *MERALCO Group* manages this risk through monitoring of cash flows in consideration of future payment of obligations and the collection of its trade receivables. The *MERALCO Group* also ensures that there are sufficient, available and approved working capital lines that it can draw from at any time.

The *MERALCO Group* maintains an adequate amount of cash and cash placements and government securities, which may be readily converted to cash in any unforeseen interruption of its cash collections. The *MERALCO Group* also maintains accounts with several relationship banks to avoid significant concentration of cash with one institution.

The following table sets out the maturity profile of the financial liabilities based on contractual undiscounted payments plus future interest:

	2012				
	Less than 3 Months	**3–12 Months**	**1–5 Years**	**More than 5 Years**	**Total**
	(Amounts in Millions)				
Notes payable	**₱283**	**₱2,224**	**₱–**	**₱–**	**₱2,507**
Trade payables and other current liabilities	**26,076**	**1,126**	**–**	**–**	**27,202**
Customers' refund	**6,127**	**–**	**–**	**–**	**6,127**
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	**35**	**684**	**847**	**2,447**	**4,013**
Fixed rate borrowings	**388**	**847**	**11,206**	**12,361**	**24,802**
Redeemable preferred stock	**1,594**	**–**	**–**	**–**	**1,594**
Customers' deposits	**640**	**5,612**	**169**	**23,144**	**29,565**
Refundable service extension costs	**1,512**	**–**	**4,357**	**–**	**5,869**
Total undiscounted financial liabilities	**₱36,655**	**₱10,493**	**₱16,579**	**₱37,952**	**₱101,679**

	2011				
	Less than 3 Months	3–12 Months	1–5 Years	More than 5 Years	Total
	(Amounts in Millions)				
Notes payable	₱67	₱–	₱–	₱–	₱67
Trade payables and other current liabilities	27,695	743	–	–	28,438
Customers' refund	1,562	4,688	–	–	6,250
Interest-bearing long-term financial liabilities:					
Floating rate borrowings	36	684	1,509	2,504	4,733
Fixed rate borrowings	2,678	726	10,423	11,622	25,449
Redeemable preferred stock	478	1,434	–	–	1,912
Customers' deposits	600	559	4,636	19,444	25,239
Refundable service extension costs	1,229	–	3,688	–	4,917
Total undiscounted financial liabilities	₱34,345	₱8,834	₱20,256	₱33,570	₱97,005

The maturity profile of bill deposits is not determinable since the timing of each refund is linked to the cessation of service, which is not reasonably predictable. However, *MERALCO* estimates that a portion of bill deposits (including related interest), amounting to ₱4,064 million, will be refunded in 2013. This is shown as part of "Trade payables and other current liabilities" account in the 2012 consolidated statement of financial position.

Capital Management

The primary objective of the *MERALCO Group*'s capital management is to enhance shareholder value. The capital structure is reviewed with the end view of achieving a competitive cost of capital and at the same time ensuring that returns on, and of, capital are consistent with the levels approved by its regulators for its core distribution business.

The capital structure optimization plan is complemented by efforts to improve capital efficiency to increase yields on invested capital. This entails efforts to improve the efficiency of capital assets, working capital and non-core assets.

The *MERALCO Group* monitors capital using debt to *EBITDA* ratio, which is gross debt divided by *EBITDA*. The *MERALCO Group* considers long-term debt, redeemable preferred stock and notes payable as debt.

	2012	2011
	(Amounts in Millions, except Debt to EBITDA)	
Long-term debt	**₱21,232**	₱22,725
Redeemable preferred stock	**1,594**	1,651
Notes payable	**1,787**	67
Debt (a)	**24,613**	24,443
EBITDA (b)	**27,545**	24,602
Debt to *EBITDA* ratio (a)/(b)	**0.89**	0.99

29. **Income Taxes and Local Franchise Taxes**

Income Taxes

The components of net deferred tax assets (liabilities) as at December 31, 2012 and 2011 are as follows:

	Note	**2012**	2011
		(Amounts in Millions)	
Deferred tax assets:			
Provisions for various claims	*20*	**₱9,503**	₱7,126
Unfunded pension cost and unamortized past service cost		**1,759**	1,873
Allowance for doubtful accounts	*13*	**777**	593
Allowance for excess of cost over net realizable value	*14*	**62**	148
Excess of effective interest rate amortization over straight-line amortization of debt issuance costs		**–**	1
Others		**1,419**	332
		13,520	10,073
Deferred tax liabilities:			
Revaluation increment in utility plant and others	*16*	**7,645**	7,831
Depreciation method differential		**1,124**	1,242
Capitalized interest		**751**	755
Capitalized duties and taxes deducted in advance		**655**	676
Net book value of capitalized/realized foreign exchange losses		**37**	61
Others		**76**	78
		10,288	10,643
		₱3,232	(₱570)

The deferred tax assets and liabilities are presented in the consolidated statements of financial position as follows:

	2012	2011
	(Amounts in Millions)	
Deferred tax assets - net	**₱3,232**	₱25
Deferred tax liabilities - net	**–**	(595)
	₱3,232	(₱570)

Provision for income tax consists of:

	2012	2011	2010
		(Amounts in Millions)	
Current	**₱9,490**	₱8,454	₱4,960
Deferred	**(3,793)**	(2,515)	(937)
	₱5,697	₱5,939	₱4,023

A reconciliation between the provision for (benefit from) income tax computed at statutory income tax rate of 30% in 2012, 2011 and 2010, and provision for (benefit from) income tax as shown in the consolidated statements of income is as follows:

	2012	2011	2010
		(Amounts in Millions)	
Income tax computed at statutory tax rate of:			
Continuing operations	**₱6,563**	₱5,600	₱3,995
Discontinued operations	**317**	386	336
	6,880	5,986	4,331
Income tax effects of:			
Interest income subjected to lower final tax rate	**(521)**	(590)	(183)
Nondeductible expenses	**40**	593	79
Nondeductible interest expense	**213**	236	61
Equity in net losses (earnings) of associates and joint ventures	**4**	(20)	(85)
Nontaxable income	**(28)**	(10)	(63)
Others	**(574)**	66	180
	6,014	6,261	4,320
Less provision for income tax of discontinued operations	**317**	322	297
	₱5,697	₱5,939	₱4,023

On December 18, 2009, the *BIR* issued Revenue Regulation, or *RR* No. 16–2008, which implemented the provisions of *RA* No. 9504 on Optional Standard Deductions or *OSD*. Such regulation allows both individual and corporate taxpayers to use *OSD* in computing their taxable income. For corporations, they may elect to adopt standard deduction in an amount not exceeding 40% of gross income in lieu of the itemized deductions. For the years ended December 31, 2012, 2011 and 2010, none of the entities in the *MERALCO Group* availed of the *OSD* in computing taxable income, except for *RSIC* and *CFS*.

The temporary difference for which deferred tax assets have not been recognized pertains to the tax effect of net operating loss carryover amounting ₱513 million and ₱115 million as at December 31, 2012 and 2011, respectively.

LFT

Consistent with the decisions of the *ERC, LFT* is a recoverable charge of the *DU* in the particular province or city imposing and collecting the *LFT*. It is presented as a separate line item in the customer's bill and computed as a percentage of the sum of generation, transmission, distribution services and related system loss charges.

Furthermore, the Implementing Rules and Regulations issued by the *ERC* provide that local franchise taxes shall be paid only on its distribution wheeling and captive market supply revenues. At present, pending the promulgation of guidelines from the relevant government agencies, *MERALCO* is paying *LFT* based on the sum of the foregoing charges in the customers' bill.

30. Contingencies and Legal Proceedings

Overpayment of Income Tax related to SC Refund

With the decision of the *SC* for *MERALCO* to refund ₱0.167 per *kWh* to covered customers during the billing period February 1994 to May 2003, *MERALCO* overpaid income tax in the amount of ₱7,107 million for taxable years 1994 to 1998 and 2000 to 2001. Accordingly, *MERALCO* filed a claim on November 27, 2003 for the recovery of such excess income taxes paid. After examination of the books of *MERALCO* for the covered periods, the *BIR* determined that *MERALCO* had in fact overpaid income taxes in the amount of ₱6,690 million. However, the *BIR* also maintained that *MERALCO* is entitled to a refund amount of only ₱894 million, which pertains to taxable year 2001, claiming that the period for filing a claim had prescribed in respect of the difference between *MERALCO*'s overpayment and the refund amount *MERALCO* is entitled to.

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

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

See *Note 11 – Other Noncurrent Assets*.

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

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

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

Overpayment of Income Tax Related to Change in Tax Basis

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

LFT Assessments of Municipalities

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

Real Property Tax or RPT Assessments

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

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

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

Mediation with NPC

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

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

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

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

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

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

Subsequently, the Office of the Solicitor General or *OSG* filed a "Motion for Leave to Intervene with Motion to Admit Attached Opposition to the Joint Application and Settlement Agreement between *NPC* and *MERALCO*." As a result, *MERALCO* sought judicial clarification with the *RTC-Pasig*. Pre-trials were set which *MERALCO* complied with and attended. However, the *OSG* refused to participate in the pre-trial and opted to seek a Temporary Restraining Order or *TRO* from the *CA*.

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

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

Sucat-Araneta-Balintawak Transmission Line

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

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

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

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

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

Petition for Dispute Resolution

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

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

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

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

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

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

PSALM versus PEMC and MERALCO

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

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

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

Petition for Dispute Resolution with NPC on Premium Charges

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

Others

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

31. Significant Contracts and Commitments

NPC

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

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

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

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

Assignment of TSC Volume to Successor Generating Companies

From 2008 to 2009, *NPC* privatized a number of its generating assets and *IPP* contracts in favor of the successful bidders. As a result, the contracted energy volume under the original *TSC* between *MERALCO* and *NPC* was assigned by *NPC* to the respective new owners and *IPPAs*. Following are the privatized plants and *IPP* contracts:

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

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

PSAs with Successor Generating Companies

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

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

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

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

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

Motions for Reconsideration were filed regarding the *ERC* decisions on the *PSA*s with *SPPC*, *Sem-Calaca* and *SMEC*. The motions are set for decision by the ERC upon the submission of the *FOE*s and other documents requested by the *ERC*.

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

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

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

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

FGPC and FGP

In compliance with the *DOE's* program to create a market for Camago-Malampaya gas field and enable its development, *MERALCO* was committed to contract 1,500-*MW* of the 2,700 *MW* output of the Malampaya gas field.

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

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

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

QPPL

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

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

See Note 11 – Other Noncurrent Assets.

Committed Energy Volume to be Purchased

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

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

MMPC

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

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

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

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

BEI

MERALCO signed a *CSE* with *BEI* on November 12, 2010. *BEI* owns and operates a 4*MW* renewable energy generation facility powered by landfill gas in San Pedro, Laguna.

The terms of the *CSE* with *BEI* are similar to that signed with *MMPC*. Purchases from *BEI*, an embedded renewable energy generator, are *VAT* zero-rated and exempt from power delivery service charge. *MERALCO* filed an application for the approval of the *CSE* with the *ERC*, for the provisional implementation of the contract on December 15, 2010. In an order dated January 31, 2011, the *ERC* provisionally approved the said application which extended the implementation indefinitely. The said case is pending decision by the *ERC*.

Interconnection Agreement with Alternergy Philippine Holdings Corporation or Alternergy

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

32. Earnings Per Share Attributable to Equity Holders of the Parent

Basic and diluted earnings per share are calculated as follows:

	2012	2011	2010
	(In Millions, Except per Share Data)		
Net income attributable to equity holders of the Parent (a)	**₱17,016**	₱13,227	₱9,685
Weighted average common shares (b)	**1,127**	1,127	1,127
Per Share Amounts:			
Basic and diluted earnings per share (a/b)	**₱15.10**	₱11.73	₱8.59

Basic and diluted earnings per share amounts are calculated by dividing net income for the year attributable to common shareholders of the parent by the weighted average number of common shares outstanding during the year. There are no potential dilutive common shares in 2012, 2011 and 2010.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2012	2011	2010
Net income attributable to common shareholders of the parent from continuing operations	**₱16,916**	₱12,714	₱9,255
Net income attributable to common shareholders of the parent from discontinued operations	**100**	513	430
Net income attributable to common shareholders of the parent for basic and diluted earnings	**₱17,016**	₱13,227	₱9,685

Following is the weighted average number of common shares used for both basic and diluted earnings per share:

	2012	2011	2010
Common shares at beginning of year	**1,127**	1,127	1,127
Weighted average common shares - issuances/repurchases*	**–**	–	–
Weighted average common shares	**1,127**	1,127	1,127

**The effect of cancellation of ESPP shares is not significant.*

There are no other transactions involving common shares or potential common shares between the reporting date and the date of completion of these financial statements.

To calculate earnings per share amounts for the discontinued operations, the weighted average number of common shares for both basic and diluted amounts is as per the table above.

33. **Other Matters**

Revised SL Caps

On December 8, 2008, the *ERC* promulgated a resolution providing for a lower maximum rate of *SL* (technical and non-technical) that a utility can pass on to its customers. The revised *SL* cap is 8.5% for private utilities, effective January 2010 billing. This is one percentage point lower than the *SL* cap of 9.5% provided under *RA* No. 7832. The actual volume of electricity used by *MERALCO* (administrative loss) is treated as part of the operation and maintenance expense beginning July 2011. The manner by which the utility is rewarded for their efforts in *SL* reduction is addressed by the *ERC* in the *PIS* under *PBR*.

On December 8, 2009, *MERALCO* filed a Petition to amend the said Resolution with an urgent prayer for the immediate suspension of the implementation of the new *SL* cap of 8.5% starting January 2010. The proposed amendment is aimed at making the Resolution consistent with the provisions of *RA No. 9136* and *RA No. 7832*, by increasing the *SL* cap to not less than 9%. The hearing on the Petition was conducted on November 18, 2010. Thereafter, *MERALCO* was directed to submit its *FOE*.

The Petition is awaiting the resolution by the *ERC* as at February 25, 2013.

Retail Competition

On February 18, 2011, the *ERC* issued an Order setting public hearings for the purpose of determining whether or not *RCOA* may already be declared.

Subsequent to the conduct of hearings, in a decision dated June 6, 2011, the *ERC* decided December 26, 2011 as the Open Access Date for the commencement of the operation of the competitive retail electricity market in Luzon and the Visayas. Effective such date, electricity end-users with an average monthly peak demand of one (1) *MW* for the 12 months preceeding December 26, 2011, as certified by the *ERC*, shall have the right to choose their own electricity suppliers.

MERALCO has formally advised the *ERC* of its firm intent to participate as a local *RES* under a *RCOA* regime.

However, on October 24, 2011, *ERC* resolved to defer *RCOA* commencement and to consider the study and recommendations of the *DOE* Steering Committee in setting up the new Open Access Date.

On February 24, 2012, the *DOE* issued a circular designating *PEMC* as the Central Registration Body and Settlement Agent to manage transactions in the competitive retail market.

In a joint statement with the *DOE*, the *ERC* set the updated implementation of *RCOA* on December 26, 2012 with the following timeline:

a. December 26, 2012 to June 2013 - Transition period for all concerned parties to undertake all assigned tasks to ensure a smooth transition to full *RCOA* implementation

b. March 26, 2013 to May 25, 2013 - Trial operation program

c. June 26, 2013 - Commercial transactions based on an interim development system

d. Last quarter of 2013 - Establishment of information technology infrastructure

On December 17, 2012, the ERC promulgated ERC Resolution No. 16, Series of 2012, which embodied the *RCOA* Transitory Rules. Relative thereto, the *DOE* also released a *DOE* circular which embodied the Retail Rules for the Integration of *RCOA* in the *WESM*.

Philippine Export Zone Authority or PEZA – ERC Jurisdiction

On September 13, 2007, *PEZA* issued "Guidelines in the Registration of Electric Power Generation Facilities/Utilities/Entities Operating Inside the Ecozones" and "Guidelines for the Supply of Electric Power in Ecozones." Under these Guidelines, *PEZA* effectively bestowed upon itself franchising and regulatory powers in Ecozones operating within the legislative franchise areas of *DU*s which are under the legislatively-authorized regulatory jurisdiction of the *ERC*. The Guidelines are the subject of an injunction case filed by the *DU*s at the *RTC*-Pasig.

In support of the government's objective of providing lower cost to Ecozone locators, *MERALCO* entered into a *MOA* with *NPC* on September 17, 2007 for the provision of special Ecozone rates to high load factor *PEZA*-accredited industries. The *ERC* authorized the immediate implementation of the Ecozone Rate Program or *ERP*.

The *ERP* was initially scheduled to expire by December 25, 2011 but has been extended twice and was terminated as at December 25, 2012.

In January 2013, *MERALCO* entered into a tripartite agreement with *PEZA* and Trans-Asia Oil and Energy Development Corporation for the sale of power to *CEZ* and its locators beginning February 27, 2013.

Purchase of Subtransmission Assets or STAs

On November 25, 2009, *MERALCO* signed a Contract to Sell with *TransCo* for the sale and purchase of certain subtransmission assets for ₱86 million. On February 25, 2010, the *ERC* approved this Contract to Sell. On June 1, 2012, the *ERC* rendered a decision dated March 6, 2012, approving the sale of the said *STA*s in favor of *MERALCO* for ₱85 million.

On April 17, 2012, *MERALCO* and *TransCo* filed a joint application for the approval of the Batch 4 contract to sell with the *ERC*. The case is awaiting the resolution of the *ERC*.

On December 12, 2011, *MERALCO* signed various agreements for the acquisition of certain sub-transmission assets of *TransCo* within the *MERALCO* franchise area for its sole account, as well as with a consortium with Batangas II Electric Cooperative, Inc., or *BATELEC* II and First Bay Power Corporation. On September 18, 2012, an amended consortium agreement was executed between *MERALCO* and *FBPC*. On October 17, 2012, *MERALCO* signed two separate amended consortium agreements with *BATELEC* II, and with *FBPC* and *BATELEC* II. These amended consortium agreements superseded the ones signed on December 12, 2011. On December 27 and 28, 2012, the Contract to Sell and Consortium Agreements, respectively, covering these sub-transmission assets were filed with the *ERC* for approval.

Lifeline Subsidy

On June 21, 2011, *Republic Act No.* 10150, "An Act Extending the Implementation of the Lifeline Rate, Amending for the Purpose Section 73 of the Republic Act 9136, Otherwise known as the *EPIRA* of 2001," was promulgated. The Act extended the implementation of the lifeline rate for another 10 years.

Expanded Senior Citizens Act of 2010 or ESCA

RA No. 9994, otherwise known as the Expanded Senior Citizens Act of 2010 or *ESCA*, was signed into law last February 16, 2010 mandating the grant of benefits to senior citizens.

The *ESCA* grants senior citizens whose monthly consumption does not exceed 100 *kWh* a minimum 5% discount on the monthly electric bill, for services that are registered in their name. The law also gives a discount of at least 50% on the consumption of electricity by senior citizens centers and residential care/group homes.

On January 5, 2011, the *ERC* issued a Resolution which took effect on January 22, 2011 adopting the "Rules Implementing the Discounts to Qualified Senior Citizen End-Users and Subsidy from the Subsidizing End-Users on Electricity Consumption under Sections 4 and 5 of *RA* No. 9994". *MERALCO* implemented the discount starting with its February 2011 billing.

MERALCO's Peak/Off-Peak or POP Program

On November 15, 2012, *MERALCO* filed an application with the *ERC* for the approval of its revised Time of Use or *TOU* rates program, also known as the *POP* Program. The *POP* is a rate program being offered by *MERALCO* to customers whose load characteristics can benefit from *TOU* rates as well as to those that can shift their loads from peak to off-peak hours. The proposed revised *POP* Rate aims to provide better savings to availees by providing them with a *TOU* program that has a wider pricing difference between peak and off-peak rates.

In an Order dated December 17, 2012, the *ERC* provisionally approved the *POP* Program.

34. **Event after the Reporting Date**

On February 25, 2013, the *BOD* declared final cash dividends of ₱6.10 a share to all shareholders of record as at March 26, 2013, payable on April 24, 2013.

Glossary of Terms

MERALCO'S UNBUNDLED TARIFF COMPONENTS

DISTRIBUTION CHARGE refers to the cost of developing, constructing, operating and maintaining the distribution system of Meralco, which delivers power from high-voltage transmission grids to commercial and industrial establishments and residential end-users.

ENVIRONMENTAL CHARGE is a universal charge that accrues to an environmental fund to be used solely for watershed rehabilitation and management. Such fund is managed by the National Power Corporation (NPC) under existing arrangements and, under Section 34(d) of the Republic Act No. 9136, or the Electric Power Industry Reform Act (EPIRA), is pegged at PhP0.0025 per kWh.

GENERATION CHARGE is the cost associated with Meralco's purchase of power, from its suppliers – the NPC, Independent Power Producers (IPPs) and the Wholesale Electricity Spot Market (WESM).

LIFELINE DISCOUNT/LIFELINE SUBSIDY is a socialized pricing mechanism under Section 73 of the EPIRA to benefit marginalized/low-income captive market customers. In Meralco's case, as approved by the ERC, residential customers using up to 100 kWh in a given month enjoy a Lifeline Discount to be applied to the total of the generation, transmission, system loss, distribution, supply and metering charges. The discount varies according to consumption and is funded by a Lifeline Subsidy Charge to be paid by all other customers.

LOCAL FRANCHISE TAX is levied by provinces and cities for businesses enjoying a franchise, and paid to such local government units, in accordance with the provisions of Sections 15 and 137 of the Local Government Code. This is a pass-through charge for Meralco paid and collected in accordance with BIR and ERC Regulations.

METERING CHARGE refers to the cost of reading, operating and maintaining power metering facilities and associated equipment, as well as other costs attributed to the provision of metering service.

MISSIONARY ELECTRIFICATION CHARGE is a universal charge to fund the electrification of remote and unviable areas, as well as areas not connected to the transmission system, as mandated under Section 70 of the EPIRA.

SENIOR CITIZEN DISCOUNT/SENIOR CITIZEN SUBSIDY is a socialized pricing mechanism for senior citizens provided under Republic Act No. 8884 or the Expanded Senior Citizens Act of 2010. There are two Senior Citizen Discounts provided to end-users. The first provides a maximum of 5% discount on the electricity bills of residential accounts registered under the name of a senior citizen which consume not more than 100 kWh a month. The second grants a 50% discount on the electricity bills of senior citizen institutions accredited by the Department of Social Welfare and Development (DSWD). The discounts are applied on the qualified customers' total generation, transmission, system loss, distribution, supply and metering charges amount, net of lifeline discount, and are funded through a subsidy to be paid by customers that are not availing of the Senior Citizen Discount or the Lifeline Discount.

STRANDED CONTRACT COSTS OF NPC refer to the excess of the contracted cost of electricity under eligible contracts of NPC over the actual selling price of the contracted energy output of such contracts in the market.

SUPPLY CHARGE refers to the cost of rendering service to customers such as billing, collection, customer assistance and other associated services.

SYSTEM LOSS CHARGE refers to the cost-recovery of power lost due to technical and non-technical system

losses. The maximum level of losses that may be recovered by private distribution utilities was set at 9.5% by Republic Act No. 7832 which was reduced to 8.5% starting 2010, as provided under ERC Resolution No.17, Series of 2008.

TRANSMISSION CHARGE refers to the cost of delivery of electricity from generators, usually located in other provinces or in remote areas outside the distribution utility's franchise area, to the distribution system of Meralco. This is paid to the National Grid Corporation of the Philippines (NGCP), the transmission service provider.

UNIVERSAL CHARGE is a charge imposed on all electricity end-users as determined, fixed and approved by the ERC, pursuant to Section 34 of the EPIRA. It is remitted to the Power Sector Assets and Liabilities Management Corporation (PSALM), a government-owned and controlled corporation created by Republic Act No. 9136. At present, this includes the stranded contract costs of NPC, missionary electrification, and environmental charges. Other possible components of the Universal Charge which are yet to be resolved by the ERC are: a) Stranded Debts of the NPC, b) Stranded Contract Costs of Distribution Utilities, and c) Equalization of the taxes and royalties applied to indigenous or renewable sources of energy *vis-à-vis* imported fuels.

VALUE ADDED TAX (VAT) is the percentage tax imposed on the value of the sale of electricity and related services through all the stages of generation, transmission, distribution and sale of electricity to the final consumer. It is a form of indirect sales tax because the total of the VAT collected on each sale transaction in all the stages mentioned is charged to the final consumer as part of the purchased price with sellers and utilities acting merely as tax collectors.

MERALCO'S TARIFF CATEGORIES

RESIDENTIAL AND GENERAL SERVICE A (RGSA) is the rate class applicable to residential customers for all domestic purposes such as lighting, heating, etc., in a single dwelling unit. This is also applicable to non-industrial and industrial customers with a connected load of less than five kilowatts.

GENERAL SERVICE B is the rate class applicable to non-residential customers with a connected load of five to less than 40 kilowatts.

GENERAL POWER (GP) is the rate class applicable to non-industrial and industrial customers with a minimum demand of 40 kilowatts for general power, heating and/or lighting.

GOVERNMENT HOSPITALS, METERED STREETLIGHTING SERVICE AND CHARITABLE INSTITUTIONS (GHMSCI) is the rate class applicable to government hospitals duly registered and certified by the Department of Health, metered streetlights, traffic lights, certain public parks under the National Park Development Committee and duly registered facilities of charitable nstitutions.

FLAT STREETLIGHTING SERVICE (FS) is the rate class applicable to customers who wish to avail of public streetlighting at a fixed monthly rate. Street lamps for this service are installed by Meralco on existing distribution poles in accordance with company specifications for equipment, installation, maintenance and operation.

EMBEDDED GENERATORS WHEELING POWER TO NON-MERALCO CUSTOMERS AND/OR WESM is the rate class applicable to embedded generators connected to the distribution utility system with a minimum capacity of 40 kilowatts for wheeling of power to non-Meralco customers and/or selling to the WESM.

OTHER ELECTRICITY RATE TERMS

AUTOMATIC ADJUSTMENT OF GENERATION, TRANSMISSION AND SYSTEM LOSS CHARGES is an automatic recovery mechanism promulgated by the ERC that allows the monthly adjustment of Generation, Transmission and System Loss Charges to reflect the actual movement in generation and transmission costs and the losses per voltage level. This mechanism allows DUs to more timely recover the true cost of electricity, since changes in the generation and transmission costs are immediately reflected on customers' bills. The computation of generation, transmission and system loss charges is in accordance with the formulas prescribed in ERC Resolution No. 16, Series of 2009.

PERFORMANCE-BASED REGULATION (PBR) is an internationally accepted rate-setting methodology adopted by the ERC, pursuant to Section 43 (f) of the EPIRA to replace the Return-on-Rate Base (RORB) or Cost-Plus regulation. PBR is a forward-looking framework that aims to ensure that capital and operating expenditures are efficiently undertaken to provide timely, reliable, adequate and affordable power by the distribution utility to consumers in its franchise area. PBR entails the use of incentive mechanisms that reward or penalize the utility for exceeding or falling short of the prescribed performance standards.

REGULATORY ASSET BASE (RAB) consists of the assets employed by a regulated entity to provide efficient regulated distribution services, and upon which a utility is allowed to earn a rate of return based on a Weighted Average Cost of Capital (WACC). The RAB represents the appraised or roll-forward asset value of the utility's investment in facilities, equipment and other properties used and useful in the provision of electric service.

RETURN ON RATE BASE (RORB) is the ratio of operating income to the utility's rate base which is expressed as a percentage. Prior to the ERC's adoption of PBR, Meralco's unbundled tariffs were based on a RORB equivalent to its WACC for the year 2000, as determined by the ERC.

RULES FOR SETTING DISTRIBUTION WHEELING RATES (RDWR) is a price-cap variation of the Performance-Based Regulation as adopted by the ERC for private distribution utilities. This is an update of the Distribution Wheeling Rates Guidelines (DWRG) considering specific entry points among private distribution utilities. RDWR includes a reward and penalty mechanism called the Performance Incentive Scheme (PIS), which includes the following: a) a Price linked Incentive (S-factor) scheme which determines the rewards or penalties of DUs using a weighted performance measure, based on the performance levels achieved against a number of indices in the calendar year preceding each Regulatory Year. b) a Guaranteed Service Level (GSL) scheme which provides customers guarantees regarding responsiveness and effectiveness of DUs. If GSLs are not met, predetermined penalties will be paid by distribution utilities directly to customers.

TIME-OF-USE RATES (TOU) are electricity prices that vary depending on the time periods in which energy is consumed. With time-of-use pricing, higher rates are charged during hours when the demand for electricity is at its highest, and lower rates during off-peak hours. Such rates provide an incentive for consumers to curb power use during peak times, thus reducing the peak system demand of the utility. These can defer the construction of new power plants, substations, transmission and distribution facilities,freeing much needed resources that can be redirected to other productive activities.

ELECTRIC INDUSTRY PARTICIPANTS refers to any person or entity engaged in the generation, transmission, distribution or supply of electricity.

DISTRIBUTION UTILITY (DU) refers to any electric cooperative, private corporation, government-owned utility or existing local government unit which has an exclusive franchise to operate a Distribution System in accordance with its franchise and the EPIRA.

ENERGY REGULATORY COMMISSION (ERC) is the independent, quasi-judicial regulatory body that was created pursuant to Section 38 of the EPIRA.

INDEPENDENT POWER PRODUCER (IPP) is an existing power-generating entity not owned by the NPC.

NATIONAL GRID CORPORATION OF THE PHILIPPINES (NGCP) is a privately-owned corporation which was awarded the concession to operate and maintain the Philippines' electricity transmission network. NGCP was granted a 50-year franchise under Republic Act No. 9511. As the system operator of the power grid, NGCP balances the demand and supply of electricity to efficiently serve all of its customers which are generators, private distribution utilities, electric cooperatives, government-owned utilities, ecozones, industries and directly connected companies.

NATIONAL POWER CORPORATION (NPC) is the government-owned and controlled corporation created under Republic Act No. 6395, as amended.

NATIONAL TRANSMISSION CORPORATION (TransCo) is a government-owned and controlled corporation created under Section 8 of the EPIRA to which NPC transferred its transmission and sub-transmission facilities and assumed the authority and responsibility of NPC for the planning, construction and centralized operation and maintenance of its high voltage transmission facilities. Following the competitive public bidding in 2007, TransCo awarded the concession contract for the operation, maintenance, improvement and expansion of its transmission assets and the operation of any related business to the NGCP. Ownership of all transmission assets, however, remains with TransCo. As owner of the transmission assets, TransCo monitors NGCP's compliance with the terms and conditions of the Concession Agreement, divests remaining sub-transmission assets to qualified distribution utilities, and undertakes contractual consultancy and other technical services for the Philippine Economic Zone Authority.

PEAK/OFF-PEAK (POP) PROGRAM - Provides customers an incentive to take advantage of significantly lower power rates by shifting at least 46% of their operations to off peak-hours when cost of electricity is lower than the blended rates.

PHILIPPINE ECONOMIC ZONE AUTHORITY (PEZA) is the Philippine government agency created under Republic Act No. 7916 tasked to promote investments, extend assistance, register, grant incentives and facilitate the business operations of investors in export-oriented manufacturing and service facilities inside selected areas throughout the country proclaimed as PEZA Special Economic Zones (ecozones).

PHILIPPINE ELECTRICITY MARKET CORPORATION (PEMC) is a non-stock and non-profit corporation constituted in November 2003 upon the initiative of the Department of Energy (DOE) with representatives from the various sectors of the electric power industry to be the governance arm of the WESM. The PEMC was likewise constituted as the autonomous group market operator (AGMO) to undertake the preparations for the establishment of the WESM and its initial operations during the interim period prior to the selection of the independent market operator (IMO). As AGMO, it acts as both the governance arm and market operator of the WESM. After the transition to the IMO, the PEMC will remain to be the governance arm of the WESM while its market operations functions will be transferred to the IMO.

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION (PSALM) is a government-owned and controlled corporation created under Section 49 of the EPIRA, which took ownership of all existing NPC generation assets, liabilities, IPP contracts, real estate and all other disposable assets.

PRIVATE ELECTRIC POWER OPERATORS ASSOCIATION, INC. (PEPOA) is an association of privately-owned electricity utilities franchised to operate an electric light and power distribution service in the urban areas outside of Metro Manila.

RETAIL ELECTRICITY SUPPLIER (RES) is a person or entity authorized by ERC to sell, broker, market or aggregate electricity to end-users in the Contestable Market.

WHOLESALE ELECTRICITY SPOT MARKET (WESM) is the market where trading of electricity is made and was established by the DOE pursuant to Section 30 of the EPIRA.

OTHER ELECTRIC INDUSTRY TERMS

MAGNA CARTA FOR RESIDENTIAL ELECTRICITY CONSUMERS refers to the set of rules promulgated by the ERC which governs the rights and obligations of residential consumers.

OPEN ACCESS refers to the system of allowing any qualified person the use of transmission and/or distribution system and associated facilities subject to the payment of transmission and/or distribution retail wheeling rates duly approved by the ERC.

RESTRUCTURING refers to the process of reorganizing the electric power industry to introduce higher efficiency, greater innovation and end-user choice. It will be understood as covering a range of alternatives enhancing exposure of the industry to competitive market forces.

TRANSITION SUPPLY CONTRACT (TSC) is a document, that contains the agreement between a generator and a distribution utility on the terms and conditions of the supply and purchase of energy including a corresponding schedule of applicable rates and consistent with Section 67 of the EPIRA.

TECHNICAL TERMS

AUTOMATIC LOAD DROPPING (ALD) is the process of automatically and deliberately removing pre-selected loads from a power system in response to an abnormal condition in order to maintain the integrity of the power system.

CUMULATIVE INTERRUPTION TIME (CIT) is the average cumulative length of power interruption, in hours, that a customer connected to the Meralco distribution system experiences within a certain time period.

DISTRIBUTION SYSTEM refers to the system of wires and associated facilities of a franchised DU extending between: (a) the delivery points on the transmission or sub transmission system or generating plant connection and (b) the points of connection to the premises of end-users.

ELECTRIC POWER GENERATION is the process of converting primary energy sources, e.g. flowing water, fossil fuels (oil, natural gas and coal), radioactive (uranium) materials, solar radiation, wind and geothermal energy into electricity.

ELECTRIC POWER PLANT refers to facilities for producing electricity through electric power generation.

ENERGY is the integral of the active power with respect to time, measured in watt-hour or multiples thereof.

GIGAWATTHOUR (GWh) is the unit of electric energy equal to 1,000,000,000 watt-hours.

GIGAWATT (GW) is the unit of electric power equal to 1,000,000,000 watts.

GRID is the high voltage backbone system of interconnected transmission lines, substations and related facilities, located in each of Luzon, Visayas and Mindanao, or as may be determined by the ERC in accordance with Section 45 of the EPIRA.

INTERRUPTION FREQUENCY RATE (IFR) is the average number of times each customer connected to the Meralco distribution system experiences power interruption within a certain time period. IFR includes pre-arranged, forced and generation/transmission-related interruptions. Forced interruptions result from emergency conditions directly associated with a power system component, requiring that it be taken out of service immediately, either automatically or through a switching operation. Examples of interruptions of this nature include those that are initiated by typhoons, fires, earthquakes, equipment failures, trees and other foreign objects touching the lines, and transient faults.

KILOVOLT-AMPERE (kVA) is the practical unit of apparent power, equivalent to 1,000 volt-amperes.

KILOWATT (kW) is the unit of electric power equal to 1,000 watts.

KILOWATTHOUR (kWh) is the unit of energy equal to 1,000 watthours.

LOAD is the entity or electrical equipment that consumes or draws electrical energy.

LOAD FACTOR is the ratio of the total energy delivered during a given period to the product of the maximum demand and the number of hours during the same period.

LUZON GRID is the high voltage backbone system of interconnected transmission lines, substations and related facilities located in the island of Luzon.

MAINTENANCE is any activity intended to keep equipment in satisfactory working condition including tests, measurements, replacements, adjustments and repairs that are either corrective or preventive in nature.

MANUAL LOAD DROPPING (MLD) is the process of manually and deliberately removing pre-selected loads from a power system, in response to an abnormal condition, and in order to maintain the integrity of the power system.

POWER is the average of the instantaneous power over one period of the electrical wave, measured in watts or multiples thereof.

SUBTRANSMISSION LINES carry power from a bulk power source to distribution substations.

SYSTEM LOSS, in a distribution system, is the difference between the electric energy purchased and/or generated and the electric energy sold by the distributor. More specifically, it refers to technical and non-technical losses occurring in a distribution system during the conveyance of electricity to end-users.

SYSTEM TROUBLES are interruptions resulting from equipment failure, operating problems, construction troubles and design deficiencies.

TRANSIENT FAULT is a fault that is self-clearing or one that can be cleared by momentary interruptions of the circuit.

WATT is the amount of usable (effective) power delivered or consumed.

OTHERS

CUSTOMER SATISFACTION INDEX (CSI) is the weighted index that measures general and specific areas of customer satisfaction and priorities. Both satisfaction and level of importance by attribute are dictated by customers through an annual survey (quarterly reading starting 2009). This survey is conducted among residential, core and non-core customers.

Our Awards

Corporate Governance Asia

- Asia's Best CFO (Investor Relations) - Rafael Andrada
- Best Investor Relations Company in the Philippines
- Best Corporate Social Responsibility
- Best in Asia on Corporate Governance

Institute of Corporate Directors

SILVER

- 2011 Corporate Governance Scorecard for Publicly-Listed Companies (PLCs)

Personnel Management Association of the Philippines (PMAP)

- 2012 Employer of the Year

Asia CEO Awards

FINALIST

- 2012 Top Employer Organization
- Executive Leadership Team of the Year
- Technology Leadership Team of the Year

Anvil Awards

EXCELLENCE

- The Meralco Twitter Typhoon Response
- Meralco Liwanag Park: A Memorable and Delightful Christmas Experience

MERIT

- Enabling Growth, Enabling Hope: Meralco and One Meralco Foundation Unified 2011 Annual Report
- Energizing Public Schools in Isla Verde
- Isla Verde School Electrification Community Launch
- The Meralco Community Electrification Program Community Launches
- Meralco Offers Time-Of-Use Rates to Boost SME Businesses
- Conquering New Heights: Achieving Leadership Commitment and Collaboration

Philippine Quill Awards

EXCELLENCE

- 5773 Powering Up to Success: One Vision, Shared Goals
- Learning Summit: Promoting a Culture of Learning and Empowerment
- Meralco Power Up Forum
- Strengthening Partnerships with Meralco's Customer Choice Program
- The Meralco Channel Partnership Program– Efficient Management of Customer Relationships in a Manpower-Challenged Structure
- Communicating One Meralco Foundation Initiatives via the News Media
- Energizing Public Schools in Isla Verde
- Meralco Basketboys Program
- One Meralco Makabayan Volunteerism Program
- Transforming Communities through the Meralco Community Electrification Program
- Meralco and One Meralco Foundation Unified 2011 Annual Report
- Business Book Summaries: Learning in a Nutshell
- Meralco Managed Services

MERIT

- The Meralco Website: An Information Hub for the Customers
- Enhancing and Sustaining Meralco's Employee Engagement –
- The Pulse Survey
- The 2nd Philippine Electric Vehicle Summit 2012
- Meralco Liwanag Park

FINALIST

- Adapting to Change (A2C): Empowering Employees to Cope with Work Transitions
- Conquering New Heights: Achieving Leadership Commitment and Collaboration
- Meralco Offers Time-of-Use Rates to Boost SME Businesses
- Meralco's Customer Conversion Program for Companies Producing their Own Electricity
- Pasiklaban ng Finance sa Review ng Standards (PFRS): Enhancing the Learning of PFRS Through Games
- Revving Up to Achieve a Culture of Excellence
- Isla Verde School Electrification Community Launch
- Maliwanag ang Pasko Employees Treat for Children
- One Meralco Makabayan Volunteerism Program Launch
- The Meralco Community Electrification Program Community Launches
- The Meralco Customer Segments AVP: Partners for Progress
- Meralco and One Meralco Foundation Unified 2011 Annual Reports (Communication Creative)

SPECIAL AWARD:
COMPANY OF THE YEAR

1st runner-up

- Meralco

Nominee

- One Meralco Foundation

2012 Employer of the Year

2012 Philippine Quill Awards

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COMMON STOCK
The Company's common stock is listed in the Philippine Stock Exchange (Ticker symbol: MER). The declassification of the Company's common stock removed the Class "A" and Class "B" classification effective September 3, 2007. The declassification does not entail a recall, a cancellation or a replacement of certificates previously issued. All existing stock certificates, whether Class "A" or Class "B", will remain valid. Shares are available to foreign investors up to a maximum of 40 percent of the outstanding capital stock.

2012 MERALCO ANNUAL REPORT

Corporate Communications - Meralco
Concept and design: Studio 5 Designs, Inc.
Portraits and operations photography: Wig Tysmans, Albert Labrador

Galleria Regency Condominium Corporation
Rockwell Business Center
Wack Wack 8 Condominium

Certifications of Maine Gloss Green and Satimat Green

FSC ñ Forest Stewardship Council
The forest Stewardship Council is an international, non-profit organization, which encourages the practice of responsible forestry worldwide through an independent forest certification and product labeling system. Certification is awarded by several third-party certifiers and endorsed by Forest Ethics.

Post-consumer recovered fibre is reclaimed fibre from materials that have met their end use and have been collected to reclaim the fibre.

ISO 14001
International Environmental Management Standard.

ISO 9001

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