

**NEGROS NAVIGATION CO., INC.  
AND SUBSIDIARIES**

**CONSOLIDATED FINANCIAL  
STATEMENTS  
December 31, 2008 and 2007**



## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of  
**Negros Navigation Co., Inc. and Subsidiaries**  
*(A Majority Subsidiary of Negros Holdings  
& Management Corporation)*  
Pier 2, North Harbor, Tondo, Manila.

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of **Negros Navigation Co., Inc. and Subsidiaries** *(A Majority Subsidiary of Negros Holdings & Management Corporation)* which comprise the consolidated balance sheets as of December 31, 2008 and 2007, and the consolidated statements of income, changes in capital deficiency and cash flows for each of the years then ended December 31, 2008, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

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

#### *Auditor's Responsibility*

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

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

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of **Negros Navigation Co., Inc. and Subsidiaries** (*A Majority Subsidiary of Negros Holdings & Management Corporation*) as of December 31, 2008 and 2007, and of its consolidated financial performance and its cash flows for the three years then ended December 31, 2008 in accordance with Philippine Financial Reporting Standards.



Makati City, Philippines  
February 6, 2009

**NEGROS NAVIGATION CO., INC. AND SUBSIDIARIES**  
(A Majority Subsidiary of Negros Holdings & Management Corporation)

**CONSOLIDATED BALANCE SHEETS**

December 31, 2008 and 2007

	Notes	2008	2007
		<i>(In Thousands)</i>	
<b><u>ASSETS</u></b>			
<b>Current assets</b>			
Cash and cash equivalents	5	P190,549	P137,962
Trade and other receivables - net	6	263,526	287,121
Inventories		41,419	112,178
Prepayments and other current assets		13,854	11,994
<b>Total current assets</b>		<b>509,348</b>	<b>549,255</b>
<b>Non-current assets</b>			
Property and equipment - net	7	1,506,084	997,269
Deferred tax assets	18	53,967	-
Other non-current assets - net		53,669	36,165
<b>Total non-current assets</b>		<b>1,613,720</b>	<b>1,033,434</b>
<b>TOTAL ASSETS</b>		<b>P2,123,068</b>	<b>P1,582,689</b>
<b><u>LIABILITIES AND CAPITAL DEFICIENCY</u></b>			
<b>Current liabilities</b>			
Trade and other current liabilities	8	P415,878	P518,029
Due to suppliers		3,781	4,724
Income tax payable		365	173
Cash bonds from agents		15,390	14,052
Current portion of:			
Obligations under finance lease	9	63,662	30,522
Restructured debt	10	132,934	-
Deferred credits	19	2,500	2,500
<b>Total current liabilities</b>		<b>634,510</b>	<b>570,000</b>
<b>Non-current liabilities</b>			
Notes payable		-	119,435
Obligations under finance lease - net of current portion	9	207,965	28,391
Restructured debt - net of current portion	10	845,634	888,801
Advances from a related party	19	329,455	193,342
Estimated retirement costs	15	17,655	24,678
Deferred credits - net of current portion	19	9,583	12,083
Deferred tax liabilities	18	127,001	159,100
<b>Total non-current liabilities</b>		<b>1,537,293</b>	<b>1,425,830</b>
<b>Capital deficiency</b>			
Share capital	11	2,960,810	2,960,810
Additional paid-in capital		890,932	890,932
Deposit for future stock subscription	19	280,310	100,000
Change in fair value on available-for-sale investments		292	656
Deficit		(4,181,079)	(4,365,539)
<b>Total capital deficiency</b>		<b>(48,735)</b>	<b>(413,141)</b>
<b>TOTAL LIABILITIES AND CAPITAL DEFICIENCY</b>		<b>P2,123,068</b>	<b>P1,582,689</b>

*See accompanying Notes to Financial Statements.*

**NEGROS NAVIGATION CO., INC. AND SUBSIDIARIES**  
*(A Majority Subsidiary of Negros Holdings & Management Corporation)*

**CONSOLIDATED STATEMENTS OF INCOME**

For the Years Ended December 31, 2008, 2007 and 2006

	Notes	2008	2007	2006
<i>(In Thousands)</i>				
<b>Revenues</b>				
Passage		<b>P687,393</b>	P753,949	P714,536
Freight		<b>1,066,188</b>	1,039,827	912,638
Others		<b>227,206</b>	222,459	177,278
		<b>1,980,787</b>	2,016,235	1,804,452
<b>Direct costs and expenses</b>	12	<b>(1,695,439)</b>	(1,753,530)	(2,043,408)
<b>General and administrative expenses</b>	13	<b>(157,116)</b>	(135,564)	(206,869)
<b>Interest and financing charges</b>	16	<b>(53,063)</b>	(56,929)	(10,498)
<b>Other income (expenses)</b>	17	<b>32,626</b>	150,704	(67,988)
<b>Income (loss) before tax</b>		<b>107,795</b>	220,916	(524,311)
<b>Provision for (benefit from) income tax</b>	18			
Current		<b>9,134</b>	12,366	5,148
Deferred		<b>(85,799)</b>	(89,162)	(42,410)
		<b>(76,665)</b>	(76,796)	(37,262)
<b>NET INCOME (LOSS)</b>		<b>P184,460</b>	P297,712	(P487,049)

*See accompanying Notes to Financial Statements.*

**NEGROS NAVIGATION CO., INC. AND SUBSIDIARIES**  
*(A Majority Subsidiary of Negros Holdings & Management Corporation)*

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the Years Ended December 31, 2008, 2007 and 2006

	Notes	2008	2007	2006
<i>(In Thousands)</i>				
<b>Cash flows from operating activities</b>				
Income (loss) before income tax		<b>P107,795</b>	P 220,916	(P524,311)
Adjustments for:				
Provision for doubtful accounts	6	<b>20,700</b>	-	54,761
Depreciation and amortization	7	<b>214,413</b>	204,802	167,907
Discount amortization	17	<b>108,320</b>	179,221	130,985
Interest expense and financing charges	16	<b>53,063</b>	56,929	10,498
Provision for (reversal of) impairment loss	7	<b>(70,306)</b>	70,306	243,527
Interest income	17	<b>(3,540)</b>	(3,816)	(9,331)
Amortization of deferred credits	19	<b>(2,500)</b>	(2,500)	(2,500)
Unrealized foreign exchange gain		<b>(2,507)</b>	(9)	(53)
Gain from disposal		<b>(33)</b>	-	-
Income from condonation of debt		-	(115,544)	(57,409)
Mark-to-market loss on embedded derivatives		-	549	2,205
Operating income before working capital changes		<b>425,405</b>	610,854	16,279
Decrease (increase) in:				
Trade and other receivables		<b>40,935</b>	(77,082)	(54,205)
Inventories		<b>41,115</b>	(71,352)	408
Prepayments and other current assets		<b>(11,006)</b>	(11,501)	(5,784)
Decrease (increase) in:				
Trade and other current liabilities		<b>(162,988)</b>	(122,370)	149,271
Cash generated from operations		<b>333,461</b>	328,549	105,969
Interest received	17	<b>3,540</b>	3,816	9,331
Net cash provided by operating activities		<b>337,001</b>	332,365	115,300
<b>Cash flows from investing activities</b>				
Proceeds from sale of				
of noncurrent assets held-for-sale		-	68,185	-
Proceeds from disposal of property and equipment		<b>48</b>	-	-
Additions to property and equipment		<b>(398,268)</b>	(225,487)	(99,331)
Decrease (increase) in other noncurrent assets		<b>(31,435)</b>	5,996	44,361
Net cash used in investing activities		<b>(429,655)</b>	(151,306)	(54,970)
<b>Cash flows from financing activities</b>				
Increase (decrease) in:				
Deposit for future stock subscription		<b>180,310</b>	-	-
Cash bonds from agents		<b>1,338</b>	450	532
Payments of obligations under finance lease		<b>(42,477)</b>	(27,680)	(37,688)
Restructured debt		<b>(4,464)</b>	(42,482)	(52,420)
Advances from a related party		<b>8,027</b>	15,989	13,704
Net cash provided by (used in) financing activities		<b>142,734</b>	(53,723)	(75,872)
<b>Effect of foreign exchange rate changes</b>				
on cash and cash equivalents		<b>2,507</b>	9	53
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>52,587</b>	127,345	(15,489)
<b>CASH AND CASH EQUIVALENTS AT JANUARY 1</b>		<b>137,962</b>	10,617	26,106
<b>CASH AND CASH EQUIVALENTS AT DECEMBER 31</b>		<b>P190,549</b>	P137,962	P10,617

*See accompanying Notes to Financial Statements.*

**NEGROS NAVIGATION CO., INC. AND SUBSIDIARIES**  
*(A Majority Subsidiary of Negros Holdings & Management Corporation)*

**CONSOLIDATED STATEMENTS OF CHANGES IN CAPITAL DEFICIENCY**

For the Years Ended December 31, 2008, 2007 and 2006

	Notes	2008	2007	2006
		<i>(In Thousands)</i>		
<b>Share capital</b>	11	<b>P2,960,810</b>	P2,960,810	P2,960,810
<b>Additional paid-in capital</b>		<b>890,932</b>	890,932	890,932
<b>Deposit for future stock subscription</b>	19	<b>280,310</b>	100,000	100,000
<b>Change in fair value of available-for-sale investments</b>				
Balance at January 1		<b>656</b>	510	380
Change in fair value during the year		<b>(364)</b>	146	130
Balance at December 31		<b>292</b>	656	510
<b>Deficit</b>				
Balance at January 1, as previously reported		<b>(4,365,539)</b>	(4,664,265)	(4,161,243)
Prior period adjustments	25	<b>-</b>	1,014	(14,959)
Balance at beginning of the year, as restated		<b>(4,365,539)</b>	(4,663,251)	(4,176,202)
Net income (loss) for the year		<b>184,460</b>	297,712	(487,049)
Balance at December 31		<b>(4,181,079)</b>	(4,365,539)	(4,663,251)
		<b>(P48,735)</b>	(P413,141)	(P710,999)

*See accompanying Notes to Financial Statements.*

**NEGROS NAVIGATION CO., INC. AND SUBSIDIARIES**  
*(A Majority Subsidiary of Negros Holdings & Management Corporation)*

**NOTES TO FINANCIAL STATEMENTS**

December 31, 2008 and 2007

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**Note 1 – Corporate Information**

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Negros Navigation Co., Inc. (“Company” or NENACO) and its subsidiaries (collectively referred to as the “Group”) were incorporated and registered with the Philippine Securities and Exchange Commission (SEC) on various dates. The Company was organized and registered with the Philippine Securities and Exchange Commission (SEC) on July 26, 1932. The registration of the Parent Company was subsequently renewed prior to its expiration in July 1982.

The Company is primarily engaged in transporting passengers and cargoes at various ports of call in the Philippines, which is considered as one business segment. The principal activities of the subsidiaries, which were all incorporated in the Philippines, are as follows:

Name of Subsidiary	Principal Activity	Percentage of Ownership
Negrense Marine Integrated Services, Inc.	Hotel and allied services	100%
Brisk Nautilus Dock Integrated Services, Inc.	Arrastre	100%

On December 20, 2006, Metro Pacific Corporation (MPC), a domestic and publicly listed company, sold 84.55% of its 98.96% ownership in NENACO to Negros Holdings & Management Corporation (NHMC), a company organized in the Philippines, effectively giving an 83.68% of the economic and voting interest in the issued and outstanding common stock of the Company. On August 8, 2008, KGL Investment BV (KGLI BV) thru KGLI-NM Holdings, Inc. (KGLI-NM), became a strategic partner of NHMC when the remaining shares of MPC and Metro Pacific Management Services, Inc. (MPMSI), representing 15.29% and 0.07% of the economic and voting interest in the issued and outstanding common stock of NENACO, respectively, was acquired by KGLI-NM (see Note 19).

NHMC intends to contribute its 83.68% economic and voting interest in the issued and outstanding common stock of NENACO to KGLI-NM as full payment for its subscription to shares in KGLI-NM. Upon the transfer of said 83.68% of the economic and voting interest in the issued and outstanding common stock of NENACO to KGLI-NM, KGLI-NM shall become the owner of 99.04% of the issued and outstanding common stock of NENACO.

The registered office address of the Company is Pier 2, North Harbor, Tondo, Manila.

On May 14, 2008, NHMC and KGLI BV entered into an “Investment Agreement” whereby NHMC and KGLI BV agreed to cause KGLI-NM to acquire for a cash consideration of US\$13.50 million various loan receivables held by creditors of NENACO directly from the creditors, which KGLI-NM shall contribute to NENACO as additional paid-in capital without issuance of additional shares by NENACO, thereby reducing the capital deficiency of NENACO. As of December 31, 2008, certain liabilities were already acquired by KGLI-NM as disclosed in Notes 10 and 19.

The financial statements of the Group for the year ended December 31, 2008 were authorized for issue in accordance with a resolution of the Board of Directors (BOD) on February 6, 2009.

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**Note 2 – Corporate Rehabilitation**

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On March 29, 2004, the Company filed a Petition with Prayer for Suspension of Debt Payments and Approval of its Proposed Rehabilitation Plan with the Regional Trial Court (RTC) of Manila.

On April 1, 2004, the RTC of Manila issued a Stay Order relative to the Company's petition, which in part, placed on hold the enforcement of all claims, whether for money or otherwise, and whether such enforcement is by action or otherwise of the RTC of Manila, against the Company and prohibited the Company from making any payment of its liabilities outstanding as of the date of filing of the petition for corporate rehabilitation. The RTC of Manila also appointed a Rehabilitation Receiver to closely oversee and monitor the operations of the Company during the proceedings.

On October 4, 2004, the RTC of Manila approved the Company's Rehabilitation Plan, which implements the following: (1) a 10-year Business Plan aimed at restoring operational and business controls to optimize value and deliver quality service; and (2) a Debt Settlement Plan primarily designed to map out the short-term detailed milestones of the critical two years of rehabilitation (2005 and 2006).

On February 06, 2009, the Company filed with the RTC of Manila a Motion to Terminate Proceeding on Account of the Successful Implementation of the Court-Approved Rehabilitation Plan (see Note 26).

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**Note 3 – Summary of Significant Accounting and Financial Reporting Policies**

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**Basis of preparation***Basis of measurement*

The consolidated financial statements have been prepared on the historical cost basis, except for available-for-sale (AFS) investments and derivative financial instruments, which have been measured at fair value.

*Functional and presentation currency*

The consolidated financial statements are prepared in Philippine peso, which is also the Group's functional and presentation currency and all values are rounded up to the nearest thousand unless otherwise indicated.

*Statement of compliance*

The accompanying consolidated financial statements have been prepared in compliance with all applicable Philippine Financial Reporting Standards (PFRSs) issued by the Financial Reporting Standards Council (FRSC).

## Adoption of new accounting standards

The accounting policies adopted in the preparation of the Group's financial statements have been consistently applied in all years presented except as stated below.

### *Accounting standard and interpretations effective in 2008*

The following interpretations to existing standards, which are effective for annual periods beginning on or after January 1, 2008 but did not have any effect on the Group's financial statements:

- PFRS 7 Financial Instruments: Disclosures and PAS 39 Financial Instruments: Recognition and Measurement (Amendment), *Reclassification of Financial Assets—Effective Date and Transition* (Effective July 1, 2008)

The standard permit an entity to reclassify non-derivative financial assets out of fair value through profit and loss category in particular circumstances and to transfer from AFS category to the loans and receivables category that would have met the definition of loans and receivables if the entity has the intention and ability to hold that financial asset for the foreseeable future. These amendments have no impact on the Group's financial statements.

- Philippine Interpretation IFRIC 14, *PAS 19—The Limit on a Deferred Benefit Asset, Minimum Funding Requirements and their Interaction* (Effective January 1, 2008).

This interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under PAS 19, Employee Benefits. This interpretation has no impact on the financial position of the Group as the Group is in a benefit liability position.

- Philippine Interpretation IFRIC 12, *Service Concession Agreements* (Effective January 1, 2008)

This interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. This interpretation has no impact on the Group's financial statements.

- Philippine Interpretation IFRIC 11, *PFRS 2—Group and Treasury Share Transaction* (Effective for annual periods beginning on or after March 1, 2007)

This interpretation requires arrangements whereby an employee is granted rights to an entity's equity instrument to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The Group currently does not have any stock option plan and therefore, there is no significant impact on its financial statements.

- Philippine Interpretation IFRIC 12, *Service Concession Agreements* (Effective January 1, 2008)

This interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. This interpretation has no impact on the Group's financial statements.

- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes* (Effective for annual periods beginning on or after July 1, 2008)

This interpretation requires customers loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. This interpretation has no impact on the Group's financial statements.

*Future standard, amendment and interpretations*

The Group opted not to early adopt the relevant new standard, amendment and interpretation to existing standards that are effective for periods subsequent to 2008.

- Philippine Financial Reporting Standard (PFRS) 8, Operating Segments

The Standard applies to listed companies and therefore, is not relevant to the Group. It will replace PAS 14, Segment Reporting and requires an entity to adopt the 'management approach' to reporting on the financial performance of its operating segments. Generally, the information to be reported would be what management uses internally for evaluating segment performance and deciding how to allocate resources to operating segments.

- Amendments to PFRS 7, Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments (Effective January 1, 2009)

The amendments improve the disclosure requirements about fair value measurements and reinforce existing principles for disclosures about the liquidity risk associated with financial instruments. It introduces a three-level hierarchy for fair value measurement disclosures and requires entities to provide additional disclosures about the relative reliability of fair value measurements. These disclosures will help to improve comparability between entities about the effects of fair value measurements. As of the reporting date, the management could not yet measure the likely effect of adopting these amendments in the future.

- Revised PFRS 3, Business Combinations, and PAS 27, Consolidated and Separate Financial Statements (Effective July 1, 2009)

The changes to PFRSs have been relatively small. The revised PFRS 3 reinforces the existing PFRS 3 model but remedies problems that have emerged in its application. Management believes that this Interpretation would not have any significant impact in the Group's financial statements when it becomes effective in the future.

- Amendments to PFRS 2, Share-based Payment – Vesting Conditions and Cancellations (Effective January 1, 2009)

The Amendments deal with two matters. They clarify that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. They also specify that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. These Amendments would most likely have no significant impact when it becomes effective since the Group does not normally enter into share-based payment transactions.

- Revised Version of PFRS 1, First-time Adoption of Philippine Financial Reporting Standards (Effective July 1, 2009)

The revised version has an improved structure but does not contain any technical changes and therefore, would not have any effect on the Group when it becomes effective. It was restructured to make it easier for the reader to understand and to allow it to accommodate more easily any future changes that might be necessary.

- PFRS 1, First-time Adoption of Philippine Financial Reporting Standards and PAS 27, Consolidated and Separate Financial Statements (Effective January 1, 2009)

The amendments are relevant to first-time adopters of PFRS and thus, are not applicable to the Group. It will allow first-time adopters to use a deemed cost of either fair value or the carrying amount under previous accounting practice to measure the initial cost of investments in subsidiaries, jointly controlled entities and associates in the separate financial statements; and it removes the definition of the cost method from IAS 27 and replacing it with a requirement to present dividends as income in the separate financial statements of the investor.

- Amendments to PAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items (Effective for annual periods beginning on or after July 1, 2009)

The amendment provides additional guidance on what can be designated as a hedged item. It focused on developing application guidance to illustrate how the principles underlying hedge accounting should be applied in those situations. These amendments would most likely not affect the Group when it becomes effective as it does not usually enter into hedging activities.

- Amendments to PAS 32, Financial Instruments: Presentation, and PAS 1, Presentation of Financial Statements (revised 2007) – Puttable Financial Instruments and Obligations Arising on Liquidation (Effective January 1, 2009)

The Amendments are intended to improve the accounting for particular types of financial instruments that have characteristics similar to ordinary or common shares but are at present classified as financial liabilities. The amendments to PAS 32 address this issue and provide that puttable financial instruments will be presented as equity only if all of the following criteria are met: the holder is entitled to a pro-rata share of the entity's net assets on liquidation; the instrument is in the class of instruments that is the most subordinate and all instruments in that class have identical features; the instrument has no other characteristics that would meet the definition of a financial liability; and the total expected cash flows attributable to the instrument over its life are based substantially on the profit or loss, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of the instrument itself). Profit or loss or change in recognized net assets for this purpose is as measured in accordance with relevant PFRSs. Management believes that this Interpretation would not have any significant impact in the Group's financial statements when it becomes effective since it has not issued any puttable financial instruments and obligations.

- PAS 23 (Amendment), *Borrowing Cost* (Effective on January 1, 2009) - requires capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalized on qualifying assets with a commencement date after January 1, 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.
- Revised PAS 1, Presentation of Financial Statements (Effective January 1, 2009)

The changes made will require information in financial statements to be aggregated on the basis of shared characteristics and to introduce a statement of comprehensive income. This will enable readers to analyze changes in a Group's equity resulting from transactions with owners in their capacity as owners (such as dividends and share repurchases) separately from 'non-owner' changes (such as transactions with third parties). Management believes that such revision would most likely have no significant impact to the Group when it becomes effective.

- Philippine Interpretation IFRIC-18, Transfers of Assets from Customers (Effective to transfers of assets from customers received on or after 1 July 2009)

The Interpretation is particularly relevant for the utility sector and therefore, would not have a significant impact on the Group when it becomes effective. The interpretation clarifies: the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset), the recognition of revenue; and the accounting for transfers of cash from customers.

- Philippine Interpretation IFRIC-17, Distributions of Non-cash Assets to Owners (Effective for annual periods beginning on or after 1 July 2009)

It will standardize practice in the accounting treatment of distribution of non-cash assets to owners. The Interpretation clarifies that: a dividend payable should be recognized when the dividend is appropriately authorized and is no longer at the discretion of the entity; an entity should measure the dividend payable at the fair value of the net assets to be distributed; and an entity should recognize the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. Management could not yet assess the impact of this Interpretation as currently it sustains a net capital deficiency and therefore, is not yet in a financial position to distribute any asset to its owners.

- Philippine Interpretation IFRIC-16, Hedges of a Net Investment in a Foreign Operation (Effective for annual periods beginning on or after October 1, 2008)

The Interpretation applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and that apply hedge accounting in accordance with IAS 39. It does not apply to other types of hedge accounting. Management believes that this Interpretation would not have any significant impact in the Group's financial statements when it becomes effective in the future.

- Philippine Interpretation IFRIC -15, Agreements for the Construction of Real Estate (Effective January 1, 2012)

The Interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors and therefore, would most likely not have any impact on the Group when it becomes effective. It provides guidance on the recognition of revenue among real estate developers for sales of units, such as apartments or houses, 'off plan', i.e., before construction is complete. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11, Construction Contracts, or IAS 18, Revenue, and when revenue from the construction should be recognized.

## **Basis of Consolidation**

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries. The financial statements of the subsidiaries are prepared for the same reporting year as the company, using consistent accounting policies.

All intra-company balances, transactions, income and expenses and profits and losses resulting from intra-company transactions that are recognized in assets, are eliminated in full.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases.

## **Financial Instruments**

### *Initial recognition*

Financial assets and financial liabilities are recognized in the balance sheet when the Group becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done at trade date, which is the date on which the Group commits to purchase or sell the asset.

Financial instruments are recognized initially at fair value plus transaction costs except for those designated at fair value through profit and loss (FVPL).

### *Classification of financial instruments*

The Group classifies its financial assets in the following categories: held-to-maturity (HTM) investments, available-for-sale (AFS) investments, financial assets at FVPL, and loans and receivables. Financial liabilities are classified as financial liabilities at FVPL and other liabilities. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

### *Determination of fair value*

The fair value of financial instruments traded in active markets is based on their quoted market price or dealer price quotation (bid price for long positions and ask price for short positions). 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.

If the financial instruments are not listed in an active market, the fair value is determined using appropriate valuation techniques which include recent arm's length market transactions, net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models. The fair values of the Group's financial instruments are presented in Note 22.

## **Financial assets**

### *Financial assets at FVPL*

Financial assets at FVPL include financial assets held for trading purposes, financial assets designated upon initial recognition as at FVPL, and derivative instruments. Financial assets are classified as held for trading if they are acquired for the purpose of selling and repurchasing in the near term. Included in this classification are debt and equity securities which have been acquired principally for trading purposes.

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

- a. 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; or
- b. The assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- c. The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

The Group has no asset under this category.

#### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are carried at cost or amortized cost, less impairment in value. Amortization is determined using the effective interest rate method. Gains and losses are recognized in income when the loans and receivables are derecognized or impaired, as well as through amortization process. Unearned discount is recognized as income over the life of the loan using the effective interest method.

This category includes the Group's cash and cash equivalents, and trade and other receivables.

#### *HTM investments*

HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group has the positive intention and ability to hold to maturity. After initial measurement, these investments are measured at amortized cost using the effective interest rate method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. Gains and losses are recognized in the statement of income when the HTM investments are derecognized or impaired, as well as through the amortization process.

The Group has not designated any financial asset as HTM investment.

#### *AFS investments*

AFS investments are non-derivative financial assets that are either designated in this category or are not classified in any of the other categories. AFS investments are carried at fair value in the balance sheet. Changes in the fair value of such assets are reported in the members' equity section of the balance sheet until the investment is derecognized or the investment is determined to be impaired.

On derecognition or impairment, the cumulative gain or loss previously reported in equity is transferred to the consolidated statements of income. Interest earned on holding AFS investments are recognized in the consolidated statements of income using the effective interest rate method

The Group's investments in golf shares are classified in this category.

### **Financial Liabilities**

### *Financial liabilities at FVPL*

Financial liabilities are classified in this category if these result from trading activities or when the Group elects to designate a financial liability under this category.

The Group has not designated any financial liability at FVPL.

### *Other financial liabilities*

This classification pertains to financial liabilities that are not held for trading or not designated as at FVPL upon the inception of the liability. Included in this category are liabilities arising from operations or borrowings.

The financial liabilities are recognized initially at fair value and are subsequently carried at amortized cost, taking into account the impact of applying the effective interest rate method of amortization (or accretion) for any related premium, discount and any directly attributable transaction costs.

All of the Group's liabilities, except for estimated retirement cost and deferred tax liabilities, are classified as other financial liabilities.

### **Embedded Derivatives**

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

### **Derecognition of Financial Assets and Liabilities**

#### *Financial asset*

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized when: a) the rights to receive cash flows from the asset have expired; b) the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or c) the Group has transferred its rights to receive cash flows from the asset and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset.

#### *Financial liability*

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

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange

or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

## **Impairment of Financial Assets**

### *Assessment of impairment*

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired. It assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. 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. 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.

The determination of impairment losses for financial assets is inherently subjective because it requires material estimates, including the amount and timing of expected recoverable future cash flows. These estimates may change significantly from time to time, depending on available information.

### *Evidence of impairment*

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

### *Impairment on assets carried at amortized cost*

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of loss shall be recognized in the consolidated statements of income.

### *Impairment on assets carried at cost*

If there is objective evidence of an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or of 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.

### *Reversal of impairment loss*

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the statement of income, to the extent that the carrying value of the asset does not exceed its cost or amortized cost at the reversal date.

## **Classification of financial instruments between debt and equity**

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest relating to a financial instrument or a component that is a financial liability is reported as expenses.

A financial instrument is classified as debt if it provides for a contractual obligation to: (a) deliver cash or another financial assets to another entity; or (b) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Company; or (c) satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

## **Offsetting of financial instruments**

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

## **Inventories**

Inventories consisting of fuel, lubricants, materials and supplies are carried at the lower of cost and net realizable value. Cost is accounted for using the first-in, first-out method. Net realizable value of such inventories is the current replacement cost.

## **Property and equipment**

Property and equipment, except land, are carried at cost, excluding day to day servicing, and less accumulated depreciation, amortization and impairment in value. Such cost includes the cost of replacing part of such property and equipment when that cost is incurred if the recognition criteria are met. Land is stated at cost less any impairment in value. Depreciation is computed on a straight line method over the property and equipment's useful lives.

The carrying values of property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Drydocking costs, consisting mainly of main engine overhaul, steel plate replacement of the vessels' hull and related expenditures, are capitalized as part of "Property and equipment - net" account in the consolidated balance sheet and amortized over a period of two to three years. When significant drydocking expenditures are incurred prior to the end of the amortization period, the unamortized balance of the original drydocking costs is expensed in the month of subsequent drydocking.

Vessels under refurbishment, if any, include the acquisition cost of the vessels, the cost of ongoing refurbishments and other direct costs, less any impairment in value. Construction in-progress, if any, represents structures under construction and is stated at cost, less any impairment value. This includes cost of construction and other direct costs. Vessels under refurbishment and construction in progress are not depreciated until such time that the relevant assets are completed and put into operational use.

Vessel on lay-over, if any, represents vessel for which drydocking has not been done pending availability of the necessary spare parts. Such vessel, included under the “Property and equipment - net” account in the consolidated balance sheet is stated at cost less accumulated depreciation and any impairment in value.

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

Property and equipment that qualifies as noncurrent assets held for sale are reclassified to current account. The Group does not depreciate such item of property and equipment while it is classified as held for sale.

The property and equipment’s residual values, useful lives and depreciation and amortization method are reviewed and adjusted if appropriate, at each financial year end.

### **Impairment of non-financial assets**

The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets and cash-generating units are written down to their recoverable amount. The recoverable amount of the asset is the greater of net selling price or value in use. The net selling price is the amount obtainable from the sale of an asset in an arm’s-length transaction less cost of disposal. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment loss is recognized in the consolidated statements of income.

Reversal of impairment loss recognized in prior period is recorded when there is an indication that the impairment loss recognized for the asset no longer exists or has decreased. The reversal is recorded as income. However, the increased carrying amount of an asset due to reversal of an impairment loss is recognized only to the extent that it does not exceed the carrying amount that would have been determined had the impairment loss not been recognized for that asset in prior years.

### **Provisions**

Provisions, if any, are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, 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. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. When discounting is used, the increase due to the passage of time is recognized as interest expense but classified as additional provisions.

## **Revenues**

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

*Revenue from Shipping Operations.* Passage and freight revenues are recognized when the related services are rendered. Customer payments for services which have not been rendered are recognized as “Unearned passage and freight revenue” and are included in “Trade and other current liabilities” account in the consolidated balance sheets.

*Other revenues: Arrastre and Stevedoring.* Arrastre and stevedoring revenues are recognized when related services are rendered.

*Food and beverages.* Revenue is recognized upon delivery and acceptance by customers.

*Rent.* Rent from operating leases is recognized on a straight-line basis. Advance collections are recognized as liability and are included in “Deferred credits” account in the consolidated balance sheets.

*Interest.* Revenue is recognized as the interest accrues using effective rate method.

## **Leases**

*Group as Lessee.* Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term. Operating lease payments are recognized as an expense in the consolidated statement of income on a straight-line basis over the lease term.

*Group as Lessor.* Leases where the Group retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same bases as rental income.

For income tax purposes, rental income and expense are taxable or deductible based on the provisions of the lease contracts.

## **Borrowing costs**

Borrowing costs are expensed as incurred.

## **Retirement costs**

The Group has a funded, contributory defined benefit retirement plan. The cost of providing benefits under the defined benefit plan is determined using the projected unit credit method. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for the plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at

that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The 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 are already vested immediately following the introduction of, or changes to, a retirement plan, past service cost is recognized immediately.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not recognized reduced by past service cost not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

### **Foreign currency translations and transactions**

The Group determines its own functional currency, and items included in the financial statements are measured using that functional currency. Transactions in foreign currencies are recorded in the functional currency rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statement of income with the exception of differences on foreign currency borrowings that are regarded as adjustment to interest cost, which are capitalized as part of property and equipment during the construction period. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

For income tax reporting purposes, exchange gains and losses are treated as taxable income or deductible expenses in the year these are realized.

### **Income taxes**

*Current Tax.* Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date.

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

Deferred tax liabilities are recognized for all taxable temporary differences, carryforward benefits of the minimum corporate income tax (MCIT) and the net operating loss carry over (NOLCO) to the extent that it is probable that taxable income will be available against which the deductible temporary differences, carryforward benefits of the excess of the MCIT and NOLCO can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized.

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

### **Contingencies**

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

### **Events after the balance sheet date**

Post-year-end events that provide additional evidence of conditions that existed at the balance sheet date (adjusting events) if any are reflected in the consolidated financial statements. Post-year-end events that are indicative of conditions that arose after balance sheet date (non-adjusting events) are disclosed in the notes to consolidated financial statements, if material.

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## **Note 4 – Significant Accounting Judgments and Estimates**

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The preparation of the consolidated financial statements in compliance with PFRS requires management to make estimates and assumptions that affect certain reported amounts and disclosures. In preparing the Group's consolidated financial statements, management has made its best judgments and estimates of certain amounts, giving due consideration to materiality. The estimates and assumptions used in the consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from those estimates, and such estimates will be adjusted accordingly.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group believes that the following represent a summary of these significant judgments and estimates and related impact and associated risks in the consolidated financial statements.

### **Judgments**

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

#### *Financial assets and liabilities*

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

The fair values of financial assets and liabilities are set out in Note 22.

### *Leases*

The evaluation whether an arrangement contains a lease is based on its substance. An arrangement is, or contains a lease when the fulfilment of the arrangement depends on a specific asset or assets and the arrangement conveys the right to use the asset.

The Group has entered into operating lease arrangement as a lessor and as a lessee. The Group, as a lessee, has determined that the lessor retains substantial risks and rewards of ownership of these properties, which are on operating lease agreements. As a lessor, the company retains substantially all the risks and benefits of ownership of the assets.

The Group has also entered into a finance lease agreements covering certain property and equipment. The Group has determined that it bears substantially all the risks and benefits incidental to ownership of said properties which are on finance lease agreements.

The carrying amount of the property and equipment under finance lease amounted to P334.07 million and P34.77 million as of December 31, 2008 and 2007, respectively (see Note 9).

### *Legal contingencies*

The Group is a party to certain lawsuits or claims arising from the ordinary course of business. However, the Group's management and legal counsel believe that the eventual liabilities under this lawsuits or claims, if any, will not have material effect on the consolidated financial statements. Accordingly, no provision for probable losses arising from legal contingencies was recognized in 2008 and 2007 (see Note 21).

### **Estimates**

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

#### *Allowance for doubtful accounts*

The Group assesses its receivables at each reporting date whether an allowance for impairment should be recorded in the consolidated statements of income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors that affect collectibility and actual results may differ, resulting in future changes to the allowance. The Group also makes a collective impairment allowance which is based on the Group's historical loss experience, taking into account other factors such as current industry and economic trends.

The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The allowance is established by charges to income in the form of provision for doubtful accounts. The amount and timing of recorded expenses for any period would therefore differ based on the judgments or estimates made. An increase in provision for doubtful accounts would increase the Group's recorded expenses and decrease current assets.

Trade and other receivables, net of allowance for doubtful accounts, amounted to P263.53 million and P487.12 million as of December 31, 2008 and 2007, respectively. Allowance for doubtful accounts amounted to P147.00 million and P126.30 million as of December 31, 2008 and 2007, respectively (see Note 6).

Provision for doubtful accounts amounted to P20.7 million, -nil- and P54.76 million in 2008, 2007 and 2006, respectively, and reversal of allowance for doubtful account amounted to P2.26 million in 2007 (see Notes 6, 12 and 13)

#### *Estimated useful lives*

The useful life of each of the Group's item of property and equipment is estimated based on the period over which the asset is expected to be available for use until it is derecognized. Such estimation is based on a collective assessment of similar businesses, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed periodically and updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any item of property and equipment would increase the recorded operating expenses and decrease the carrying value of property and equipment.

There is no change in the estimated useful lives of property and equipment during the year.

Property and equipment, net of accumulated depreciation, amortization and impairment loss, amounted to P1.51 billion and P1.0 billion as of December 31, 2008 and 2007, respectively (see Note 7).

#### *Estimated residual value*

The residual value of the Group's property and equipment is estimated based on the amount that would be obtained from disposal of the asset, after deducting estimated costs of disposal, if the assets are already of the age and in the condition expected at the end of its useful life. Such estimation is based on the prevailing price of scrap steel. The estimated residual value of each asset is reviewed periodically and updated if expectations differ from previous estimates due to changes in the prevailing price of scrap steel.

The estimated residual value of the vessels in operations amounted to P83.6 million and P171.5 million in 2008 and 2007, respectively. This was excluded in the computation of depreciable costs and depreciation expense.

#### *Impairment of non-financial assets*

Impairment review is performed when certain impairment indicators are present. Determining the fair value of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. Fair value of noncurrent assets held for sale requires the estimation of cash flows from selling price less costs to sell.

In 2008, the Company reversed the impairment loss previously recognized amounting to P70.31 million. In 2007, based on Company's annual test of impairment, an impairment loss for property and equipment amounting to P70.31 million was recognized (see Note 7).

#### *Deferred tax asset.*

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax assets to be utilized. However, there is no assurance that sufficient taxable income will be generated to allow all or part of the deferred tax assets to be utilized.

The Company has recognized deferred tax asset on NOLCO and MCIT amounted to P53.97 million in 2008. However, temporary differences for which no deferred tax assets are recognized amounted to P234.54 million and P674.94 million as of December 31, 2008 and 2007, respectively (see Note 18).

#### *Retirement cost*

The determination of the obligation and retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 15 and include among others, discount rate and rate of compensation increase. Actual results

that differ from the Company's assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While it is believed that the Company's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Company's retirement obligations.

The discount rate and the expected rate of return on plan assets are determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

Estimated retirement cost amounted to P17.66 million and P24.68 million as of December 31, 2008 and 2007, respectively (see Note 15).

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#### **Note 5 – Cash and Cash Equivalents**

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This account consists of the following:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Cash on hand	<b>P7,321</b>	P11,173
Cash in banks	<b>41,341</b>	54,496
Short-term investments	<b>141,887</b>	72,293
	<hr/>	<hr/>
Total (see Note 22)	<b><u>P190,549</u></b>	<b><u>P137,962</u></b>

Cash in bank earns interest at the prevailing bank deposit rates. Short-term investments pertain to placement in special savings deposits with maturity of less than 90 days and have interest rates ranging from 3.55% to 4.80% in 2008 and 5.25% to 5.50% in 2007. Interest income from these placements including interest from regular bank savings account is credited directly to the consolidated statements of income.

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#### **Note 6 – Trade and Other Receivables - net**

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This account consists of the following:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Trade	<b>P348,020</b>	P347,185
Advances to officers and employees	<b>19,775</b>	12,758
Due from customers and suppliers	<b>9,203</b>	22,236
Others	<b>33,528</b>	31,242
	<hr/>	<hr/>
	<b>410,526</b>	413,421
Less: Allowance for doubtful accounts	<b>147,000</b>	126,300
	<hr/>	<hr/>
Total (see Note 22)	<b><u>P263,526</u></b>	<b><u>P287,121</u></b>

Receivables amounting to P92.0 million as of December 31, 2008 and 2007 were assigned to secure certain outstanding long-term debt of the Group (see Note 10). The credit term of trade receivables range from 30 to 90 days.

The movements in the allowance for doubtful account are as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
At January 1	<b>P126,300</b>	P128,556
Add: provision for the year (see Notes 12 and 13)	<b>20,700</b>	–
Less: accounts written-off	–	2,256
	<hr/>	<hr/>
At December 31	<b>P147,000</b>	P126,300
	<hr/>	<hr/>

## **Note 7 – Property and Equipment - net**

This account consists of the following:

	<b>Land</b>	<b>Vessels and Improvements</b>	<b>Leasehold Improvements</b>	<b>Containers</b>	<b>Terminal Equipment</b>	<b>Furniture, Fixtures and Other Equipment</b>	<b>Total</b>
	<i>(In Thousands)</i>						
<b>Cost</b>							
At January 1, 2007	P3,064	P1,426,935	P281,026	P698,731	P318,167	P277,767	P3,005,690
Additions	–	178,528	386	20,587	6,024	19,962	225,487
At January 1, 2008	3,064	1,605,463	281,412	719,318	324,191	297,729	3,231,177
Additions	–	543,803	1,000	44,266	35,393	14,908	639,370
Disposals	–	(93,718)	–	(80)	–	(275)	(94,073)
At December 31, 2008	3,064	2,055,548	282,412	763,504	359,584	312,362	3,776,474
<b>Accumulated depreciation and amortization</b>							
At January 1, 2007	–	548,887	221,853	661,660	284,125	242,275	1,958,800
Depreciation and amortization	–	113,193	5,114	44,319	8,101	34,075	204,802
Impairment loss	–	70,306	–	–	–	–	70,306
At January 1, 2008	–	732,386	226,967	705,979	292,226	276,350	2,233,908
Depreciation and amortization	–	181,787	5,076	11,284	7,141	9,125	214,413
Disposals	–	(93,718)	–	(80)	–	(260)	(94,058)
Adjustment relating to disposals	–	–	–	(13,567)	–	–	(13,567)
Reversal of impairment loss	–	(70,306)	–	–	–	–	(70,306)
At December 31, 2008	–	750,149	232,043	703,616	299,367	285,215	2,270,390
<b>Net book value</b>							
<b>December 31, 2008</b>	<b>P3,064</b>	<b>P1,305,399</b>	<b>P50,369</b>	<b>P59,888</b>	<b>P60,217</b>	<b>P27,147</b>	<b>P1,506,084</b>
December 31, 2007	P3,064	P873,077	P54,445	P13,339	P31,965	P21,379	P997,269
January 1, 2007	P3,064	P878,048	P59,173	P37,071	P34,042	P35,492	P1,046,890

Vessels and improvements, containers and terminal equipments include assets acquired under finance lease arrangements (see Note 9). The related depreciation for these leased assets was computed based on the Company's depreciation policy for owned assets.

Depreciation and amortization of this account is recognized and presented in the consolidated statements of income under the following accounts:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Direct costs and expenses (see Note 12)	<b>P205,359</b>	P191,764
General and administrative expenses (see Note 13)	<b>9,054</b>	13,038
	<hr/>	<hr/>
	<b>P214,413</b>	P204,802
	<hr/>	<hr/>

In 2008, the Group's operating vessels turned out to be operating at higher utilization rates relative to its projections which proves to be less drastic than initially expected by management. As a result, management re-assessed its previous impairment analysis. This favorable change requires the Group to re-estimate the recoverable amount of the vessels. The favorable change in the estimates used to determine the recoverable amount of the vessels since the last impairment loss was recognized. Therefore, in accordance with PAS 36, "Impairment of Assets", the Group recognized a reversal of the impairment loss recognized in 2007 amounting to P70.31 million in the consolidated statements of income.

The recoverable amount was based on the value in use and was determined at the cash-generating unit level (i.e., business operations of each vessel). In determining the value in use for the cash-generating unit, the cash flows projected to be generated by each vessel was discounted using the Group's weighted average cost of capital, on a pretax basis.

The following properties are mortgaged to secure certain obligations of the Group as of December 31, 2008 and 2007 (see Note 10):

	Carrying Value	
	2008	2007
	<i>(In Thousands)</i>	
Land	<b>P3,064</b>	P3,064
Vessels and improvements		
M/S St. Joseph the Worker	<b>270,570</b>	285,602
M/S St. Peter the Apostle	<b>201,941</b>	205,492
M/S San Paolo	<b>127,481</b>	103,577
M/V Nossa Senhora de Fatima	<b>51,215</b>	53,349
M/V San Sebastian	<b>19,449</b>	25,932
M/V San Augustin Uno*	<b>274,180</b>	-
Containers*	<b>59,888</b>	20,768
Terminal equipment *	-	14,000

*\*Properties under finance lease (see Note 9)*

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

	Estimated Useful Lives in Years
Vessels and improvements	5-30
Leasehold improvements	5 to 20 or lease term, whichever is shorter
Containers	5 to 10
Terminal equipment	10
Furniture, fixtures and other equipment	5

The Group determined the depreciation charges for each significant part of its property and equipment.

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**Note 8 – Trade and Other Current Liabilities**

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This account consists of the following:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Trade	<b>P254,554</b>	P277,670
Accrued taxes, interest and other expenses	<b>135,002</b>	214,126
Unearned passage and freight revenue	<b>16,799</b>	20,105
Others	<b>9,523</b>	6,128
	<hr/>	<hr/>
Total (see Note 22)	<b><u>P415,878</u></b>	<b><u>P518,029</u></b>

Terms of trade payables range from 30 to 90 days

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**Note 9 – Obligations under Finance Lease**

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The Group entered into various finance lease arrangements with third parties for the lease of forklifts, containers and a vessel. The lease agreements provide for the transfer of ownership to the Group at the end of the lease term, which among other considerations, met the criteria for a finance lease, therefore, the leased assets were capitalized.

The future minimum lease payments on the obligations under finance lease together with the present value of the net minimum lease payments are as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Within one year	<b>P67,056</b>	P30,606
After one year but not more than five years	<b>199,433</b>	42,787
More than five years	<b>13,846</b>	–
	<hr/>	<hr/>
Total minimum lease payments	<b>280,335</b>	73,793
Less: discount on lease payable	<b>8,708</b>	14,480
	<hr/>	<hr/>
Present value of minimum lease payments	<b>271,627</b>	58,913
Less: current portion	<b>63,662</b>	30,522
	<hr/>	<hr/>
Total	<b><u>P207,965</u></b>	<b><u>P28,391</u></b>

The net carrying amount of property and equipment held by the Group under finance leases are summarized as follows (see Note 7):

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Containers	<b>P59,888</b>	P20,768
Vessel	<b>274,180</b>	–
Terminal equipment	<b>–</b>	14,000
	<hr/>	<hr/>
Total	<b><u>P334,068</u></b>	<b><u>P34,768</u></b>

The interest expense recognized related to this account amounted to P16.37 million, P6.13 million and P1.85 million in 2008, 2007 and 2006, respectively, under “Interest and financing charges” account in the consolidated statements of income (see Note 16).

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### Note 10 – Restructured Debt

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As discussed in Note 2 to the consolidated financial statements, certain liabilities outstanding as of October 4, 2004, which relate to transactions entered into by the Group prior to March 29, 2004, were reclassified to the “Restructured debt” account in the consolidated balance sheets.

The secured and unsecured portions of the restructured debt as of December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Secured	<b>P442,645</b>	P409,235
Unsecured	<b>535,923</b>	479,566
	<u><b>978,568</b></u>	<u>888,801</u>
Less: current portion	<b>132,934</b>	–
Total	<u><b>P845,634</b></u>	<u>P888,801</u>

The outstanding restructured debt, which is presented at discounted value as of December 31, 2008 and 2007, in the balance sheets, is accounted for as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Trade and other payables	<b>P445,295</b>	P392,587
Notes payable	<b>55,691</b>	51,856
Long-term debt	<b>473,721</b>	442,625
Obligations under capital lease	<b>3,861</b>	1,733
Total	<u><b>P978,568</b></u>	<u>P888,801</u>

The effective interest of the restructured debt ranges from 6.69% to 15.21% for both years ended December 31, 2008 and 2007. Total interest expense recognized on restructured debts amounted to P36.69 million and P35.43 million (see Note 16) for the years ended December 31, 2008 and 2007, respectively.

The terms of the restructured debt are as follows:

Facility	Long-term Notes
Payment term	Ten years, inclusive of four years grace period on principal repayment
Interest rates	<ul style="list-style-type: none"> <li>▪ 5.0% per year from Year 1 (2005) to Year 4 on secured debt and past due lease/rentals equipment/container vans. The interest rate beginning Year 5 will be increased to 7.5%; and the accrual of the 2.5% interest differential shall begin in Year 5, but shall be paid in Year 10.</li> </ul>

Facility	Long-term Notes
	<ul style="list-style-type: none"> <li>▪ 2.5% per year on unsecured obligations.</li> </ul>
Interest payments	<ul style="list-style-type: none"> <li>▪ Interest due in Year 1 will be paid in 5-year redeemable preferred shares.</li> <li>▪ Cash payment on interest and dividends shall start in Year 2 and shall be remitted on a quarterly basis.</li> </ul>
Principal repayment	<ul style="list-style-type: none"> <li>▪ Payment to start in Year 5 on a quarterly basis under the following annual distribution (as percentage of the beginning principal balance): <ul style="list-style-type: none"> <li>Year 5 to 8    15% each year</li> <li>Year 9 to 10   20% each year</li> </ul> </li> </ul>
Security	<ul style="list-style-type: none"> <li>▪ Secured creditors will keep the properties that they hold as security to their credits.</li> </ul>

The terms of the Approved Rehabilitation Plan provides that interest expense for the first year of rehabilitation will be settled through the issuance of redeemable preferred shares. However, on June 20, 2007, the Group filed with the RTC of Manila a motion to alter/modify such provision for settlement of interest for Year 1, due to its difficulty in obtaining the preferred shares' subscription requirement from the SEC and raising enough funds to create a sinking fund for the eventual redemption of the above-mentioned preferred shares.

Under the above-mentioned motion, the Group proposes that instead of issuing redeemable preferred shares as payment for the interest for Year 1 of its restructured debt obligations, the Group shall restructure the said interest with terms and conditions substantially the same as the key features of the said preferred shares, to wit:

- i. the Year 1 interest shall be payable in five year 5;
- ii. the Year 1 interest will earn interest at rates of five percent (5%) per annum for the secured creditors and two point five percent (2.5%) per annum for the unsecured creditors;
- iii. in case the Company has excess cash, it will pay the said Year 1 interest prior to the payment of unscheduled principal amortization; and
- iv. the Year 1 interest may, at the option of the creditor, be convertible into common shares of the Company within the five-year period.

As of December 31, 2008, the above-mentioned petition has yet to be approved by the RTC of Manila.

As provided in the Rehabilitation Plan, all unpaid interest as of March 31, 2004 and interest accruals at new interest rates shall form part of the principal. Interest accrual for each creditor shall start on the date of the signing of the respective executory documents. The court - appointed Rehabilitation Receiver is also of the opinion that interest should indeed start to accrue at the time of the signing of the new settlement agreement.

For the years ended December 31, 2008 and 2007, the Group accrued interest only for those creditors who have signed the settlement agreement, which amounted to P36.69 million and P32.27 million, respectively.

In various dates in 2008, KGLI-NM acquired certain restructured debts of the Group with total discounted value of P419.28 million; subject to same credit arrangements.

Certain liabilities under the restructured debt account, after reconciliation with creditors, were reversed in 2007 and 2006 amounting to P11.0 million and P42.3 million, which includes unamortized discounts of P4.0 million and 24.3 million, respectively.

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### Note 11 – Share Capital

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Movements in the Company's common shares are as follow:

	Number of Shares			Amounts		
	2008	2007	2006	2008	2007	2006
	<i>(In Thousands)</i>					
Authorized – P1 par value per share	<u>4,000,000</u>	<u>4,000,000</u>	<u>4,000,000</u>	<u>P4,000,000</u>	<u>P4,000,000</u>	<u>P4,000,000</u>
Issued and subscribed - net of subscription receivable of P64,923	<u>3,025,733</u>	<u>3,025,733</u>	<u>3,025,733</u>	<u>P2,960,810</u>	<u>P2,960,810</u>	<u>P2,960,810</u>

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### Note 12 – Direct Cost and Expenses

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This account consists of the following:

	2008	2007	2006
	<i>(In Thousands)</i>		
Fuel and lubricants	<b>P840,617</b>	P743,138	P855,263
Depreciation and amortization (see Note 7)	<b>205,359</b>	191,764	149,661
Personnel costs (see Note 14)	<b>135,379</b>	144,182	154,563
Repairs and maintenance	<b>133,015</b>	134,478	126,290
Cost of food and beverages	<b>65,700</b>	63,813	58,667
Cargo handling and port charges	<b>54,033</b>	85,187	102,389
Rent (see Note 20)	<b>48,640</b>	46,623	58,113
Outside services	<b>32,069</b>	15,526	25,878
Advertising and promotion	<b>29,880</b>	26,439	24,318
Materials and supplies used	<b>23,195</b>	17,846	9,300
Communication, light and water	<b>20,924</b>	31,930	29,753
Insurance	<b>20,247</b>	25,794	23,508
Provision for doubtful accounts	<b>18,452</b>	–	52,291
Food and subsistence	<b>13,284</b>	13,721	14,020
Commission	<b>9,366</b>	24,791	39,194
Professional and legal fees	<b>3,834</b>	21,136	20,232
Provision for impairment loss (see Note 7)	<b>–</b>	70,306	243,527
Others	<b>41,445</b>	96,856	56,441
Total	<u><b>P1,695,439</b></u>	<u>P1,753,530</u>	<u>P2,043,408</u>

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**Note 13 – General and Administrative Expenses**

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This account consists of the following:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Personnel costs (see Note 14)	<b>P53,628</b>	P53,654	P51,026
Provision for inventory write-down	<b>29,644</b>	–	2,470
Professional and legal fees	<b>15,360</b>	16,318	15,776
Communication, light and water (see Note 19)	<b>10,748</b>	7,647	9,488
Depreciation and amortization (see Note 7)	<b>9,054</b>	13,038	18,246
Entertainment, amusement and recreation	<b>7,997</b>	9,247	9,004
Transportation and travel	<b>4,584</b>	8,698	10,393
Corporate rehabilitation costs	<b>4,054</b>	7,343	6,393
Repairs and maintenance	<b>4,641</b>	3,750	3,022
Materials and supplies used	<b>3,269</b>	3,366	2,432
Provision for doubtful accounts	<b>2,248</b>	–	2,470
Rent (see Note 20)	<b>1,859</b>	1,218	2,139
Outside services	<b>1,584</b>	2,249	2,410
Taxes and licenses	<b>1,073</b>	750	1,440
Insurance	<b>337</b>	1,414	2,534
Advertising and promotion	<b>30</b>	1,457	1,422
Others	<b>7,006</b>	5,415	68,674
Total	<b><u>P157,116</u></b>	<b><u>P135,564</u></b>	<b><u>P209,339</u></b>

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**Note 14 – Personnel Costs**

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This account consists of the following:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Salaries and wages	<b>P141,511</b>	P142,642	P183,989
Retirement costs (see Note 15)	<b>9,800</b>	15,357	5,291
Other employee benefits	<b>37,696</b>	39,837	16,309
Total	<b><u>P189,007</u></b>	<b><u>P197,836</u></b>	<b><u>P205,589</u></b>

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**Note 15 – Retirement Costs**

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The retirement benefit cost is equivalent to 100 percent of the employee's monthly salary as of the date of retirement multiplied by the total years of credited service. This may be given in lump sum or in yearly installments but not exceeding five annual installments, at the Company's option.

Each employee and the Company shall contribute regularly to the Plan as follows:

- Employee - 2% of total annual basic salary, such contribution shall be made through equal deductions by the Company from the participant's salary on each payday.

- Company - 6% of the participant's total annual basic salary, such contributions shall be paid by the Company to a designated Trustee once a month but not later than the 10th day of the following month.

As of December 31, 2008 and 2007, the Company's outstanding obligation on the above mentioned contribution scheme amounted to P1.6 million and P1.5 million, respectively, which represents 2% of the contribution from employees and included in "Estimated retirement costs" direct costs and expenses and in the consolidated balance sheets.

The following tables summarize the components of retirement costs included in "General and administrative expenses" in the consolidated statements of income and "Estimated retirement costs" in the consolidated balance sheets, which are based on the latest actuarial valuation of 2008:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	<i>(In Thousands)</i>		
Composition of estimated retirement costs:*			
Current service cost	<b>P3,783</b>	P3,998	P2,146
Interest cost on benefit obligation	<b>5,244</b>	3,451	6,762
Expected return on plan assets	<b>(202)</b>	(152)	(75)
Net actuarial gain recognized	<b>(6,793)</b>	(108)	(13,122)
Amortization of transitional liability	<b>9,380</b>	9,658	9,580
<b>Total</b>	<b><u>P11,412</u></b>	<b><u>P16,847</u></b>	<b><u>P5,291</u></b>

\*Included in personnel costs in Note 14.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	<i>(In Thousands)</i>		
Estimated retirement costs:			
Balance at January 1	<b>P24,678</b>	P16,744	P21,797
Retirement costs			
Employer	<b>9,800</b>	15,357	3,914
Employee	<b>1,612</b>	1,490	1,377
Actual contributions	<b>(18,435)</b>	(2,502)	(1,474)
Payments made out of Company funds	<b>—</b>	(6,411)	(8,857)
<b>Balance at December 31</b>	<b><u>P17,655</u></b>	<b><u>P24,678</u></b>	<b><u>P16,757</u></b>

Movements in the present value of retirement obligation (PVRO) are as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	<i>(In Thousands)</i>		
Balance at beginning of year	<b>P54,058</b>	P53,280	P67,819
Current service cost	<b>3,783</b>	3,998	2,146
Interest cost on benefit obligation	<b>5,244</b>	3,451	6,762
Actuarial gain	<b>(5,750)</b>	(260)	(13,185)
Benefits paid	<b>(3,500)</b>	(6,411)	(10,262)
<b>Total</b>	<b><u>P53,835</u></b>	<b><u>P54,058</u></b>	<b><u>P53,280</u></b>

Movement in the fair value of plan assets (FVPA) is as follows:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Balance at January 1	<b>P10,103</b>	P7,601	P7,507
Expected return on plan assets	<b>202</b>	152	75
Actual contributions	<b>18,435</b>	2,502	1,487
Actuarial gain/(loss)	<b>1,011</b>	(152)	(63)
Benefits paid	<b>(3,270)</b>	–	(1,405)
Balance at December 31	<b><u>P26,481</u></b>	<u>P10,103</u>	<u>P7,601</u>

The reconciliation of the PVRO and FVPA to the estimated retirement costs recognized in the Company's balance sheets is as follows:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
PVRO	<b>P53,835</b>	P54,058	P53,280
Fair value of plan asset	<b>26,481</b>	(10,103)	(7,601)
Unfunded PVRO	<b>27,354</b>	43,955	45,679
Unamortized transitional liability	<b>(9,699)</b>	(19,277)	(28,935)
Estimated retirement costs	<b><u>P17,655</u></b>	<u>P24,678</u>	<u>P16,744</u>

The allocation of the fair value of the beneficial trust fund's assets for the Group's defined benefit plan as follows:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>
Cash in banks	<b>P568</b>	P7,601
Investments in temporary placements	<b>5,397</b>	–
Receivables	<b>20,516</b>	2,502
Balance at December 31	<b><u>P26,481</u></b>	<u>P10,103</u>

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled.

The principal assumptions used to determine pension benefit obligations as of December 31, 2008, 2007 and 2006 are as follows:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Discount rate	<b>9.00%</b>	9.72%	6.38%
Rate of increase in compensation	<b>3.00%</b>	3.00%	5.00%
Expected rate of return of plan assets	<b>2.00%</b>	2.00%	2.00%

The actual return on plan assets follows:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Expected return on plan assets	<b>P202</b>	P152	P75
Actuarial gain/(loss)	<b>1,011</b>	(152)	(63)
Actual return on plan assets	<b><u>P1,213</u></b>	<u>P-</u>	<u>P12</u>

For the period from January 1, 2009 to December 31, 2009, the Group expects to make contributions to the fund paid at the beginning of each month starting January 1, 2009 in the amount of P0.52 million based on the latest funding requirements report dated January 23, 2009.

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#### **Note 16 – Interest and Financing Charges**

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This account consists of the following:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Restructured debt (see Note 10)	<b>P36,689</b>	P35,433	P8,652
Obligations under finance lease (see Note 9)	<b>16,374</b>	6,131	1,846
Notes payable (see Note 19)	–	15,365	–
Total	<b><u>P53,063</u></b>	<u>P56,929</u>	<u>P10,498</u>

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#### **Note 17 – Other Income (Expenses)**

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This account consists of the following:

	<u>2008</u>	<u>2007</u> <i>(In Thousands)</i>	<u>2006</u>
Discount amortization	<b>(P108,320)</b>	(P179,221)	(P130,985)
Income from reversal of excess accruals and condonation of debt (see Notes 10 and 19)	<b>59,105</b>	279,958	57,409
Reversal of impairment loss (see Note 7)	<b>70,306</b>	–	–
Interest Income	<b>3,540</b>	3,816	9,331
Foreign exchange gain (losses) and others – net	<b>7,995</b>	46,151	(3,743)
Total	<b><u>P32,626</u></b>	<u>P150,704</u>	<u>(P67,988)</u>

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#### **Note 18 – Income Tax**

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The provision for current income tax pertains to MCIT in 2008, 2007 and 2006.

In 2008, based on the re-assessment made by management, the Company recognized the previously unrecognized deferred tax assets amounting to P140.32 million arising from NOLCO and MCIT in previous years. The improvement on the results of operations of the Company in

2008 makes management believe that the Company will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria. The components of the Company's deferred tax assets and liability are as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
<b>Deferred Tax Assets:</b>		
NOLCO	P28,160	P –
MCIT	25,807	–
	<u>P53,967</u>	<u>P –</u>
<b>Deferred Tax Liabilities:</b>		
Excess of the original value over the discounted value of:		
Restructured debt and advances from a related party	P123,904	P157,693
Obligations under finance leases	3,089	
Change in fair value on AFS investments	8	275
Unrealized foreign exchange gain	–	1,132
	<u>P127,001</u>	<u>P159,100</u>

The following are the Group's other deductible temporary differences relating to certain balance sheet items for which deferred tax assets have not been recognized because management believes that it is not probable that future taxable income will be available against which the deferred tax assets can be utilized:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Allowance for doubtful accounts	P147,017	P126,317
Provision for inventory obsolescence	4,324	4,324
Interest expense under PAS 39, net of accretion	30,681	30,681
Unearned passage and freight revenue	16,799	20,105
Accrued retirement costs	17,419	24,493
Accrued sick leave	7,379	8,424
Unrealized foreign exchange loss	2,507	–
NOLCO	8,414	351,949
Provision for impairment loss	–	70,307
MCIT	–	20,964
Derivative liability	–	361
Excess of rent expense under operating lease agreements computed on a straight-line basis over the amount based on lease agreement	–	17,013
	<u>P234,540</u>	<u>P674,938</u>

MCIT amounting to P3.76 million and P0.20 million has expired in 2008 and 2007, respectively. NOLCO amounting to P247.16 million and P265.78 million has expired in 2008 and 2007, respectively.

As of December 31, 2008, MCIT that can be deducted against regular income tax due, and NOLCO that can be claimed as deduction from regular taxable income, with their respective expiry dates, are as follows:

<u>Year Paid/ Incurred</u>	<u>Expiry Date</u>	<u>MCIT</u>	<u>NOLCO</u>
		<i>(In Thousands)</i>	
December 31, 2006	December 31, 2009	P5,148	P93,868
December 31, 2007	December 31, 2010	12,056	–
December 31, 2008	December 31, 2011	8,603	–
		<u>P25,807</u>	<u>P93,868</u>

Reconciliation between the provision for income tax computed at statutory income tax rates of 35% in 2008 and 2007, respectively and provision for income tax as shown in the statements of income is as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
		<i>(In Thousands)</i>	
Income (loss) before income tax	<u>P107,795</u>	<u>P220,916</u>	<u>(P524,311)</u>
Provision for income tax at statutory rate	<b>P37,729</b>	P77,321	(P183,509)
Adjustments for:			
Recognition of previously unrecognized deferred tax assets	<b>(140,323)</b>		
Interest income subject to final tax	<b>(1,262)</b>	(278)	(29)
Expired portion of MCIT	<b>3,760</b>	–	6,125
Nondeductible expenses	<b>763</b>	141	15
Nontaxable income	–	(69,120)	–
Write off of allowance for doubtful accounts	–	–	24,955
Applied/expired NOLCO	<b>25,248</b>	(93,746)	–
Unrecognized deferred tax assets	<b>(10,217)</b>	33,042	115,181
Effect of change in tax rate	<b>7,637</b>	(24,156)	–
	<u><b>(P76,665)</b></u>	<u>(P76,796)</u>	<u>(P37,262)</u>

On May 24, 2005, Republic Act No. 9337 (the Act) was enacted into law, to be effective commencing on November 1, 2005. Among the significant changes in the Act include the increase in the regular corporate income tax for domestic corporations from 32% to 35% beginning November 1, 2005 and the reduction of the same to 30% beginning January 1, 2009. Under the Act, all other laws, acts, decrees, executive orders, issuances and rules and regulations or parts thereof which are contrary to and inconsistent with any provisions of the Act were repealed, amended or modified.

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#### **Note 19 – Related Party Transactions**

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Enterprises and individuals that directly, or indirectly through one or more intermediaries, control, or are controlled by, or under common control with the Group, including holding companies, subsidiaries and fellow subsidiaries, are related parties of the Group. Associates and individuals owning, directly or indirectly, an interest in the voting power of the Group that gives them significant influence over the enterprise, key management personnel, including directors and

officers of the Group and close members of the family of these individuals and companies associated with these individuals also constitute related parties.

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

The following is a summary of the Group's transactions with related parties:

- KGLI-NM (a fellow subsidiary of the Company)

KGLI-NM was organized and incorporated under and by virtue of the laws of the Philippines and act primarily as a holding company for various interests and investments.

The following summarizes the transactions and balances made within the year:

Nature of Transaction	Note	Restructured debt as of December 31		Advances from a related party as of December 31		Deposit for future stock subscription as of December 31		Common stock as of December 31	
		2008	2007	2008**	2007*	2008**	2007*	2008**	2007*
<i>(in thousand)</i>									
Common stock	(i)	P –	P –	P –	P –	P –	P –	<b>P462,496</b>	P462,496
Cash advances	(ii)	–	–	<b>210,061</b>	193,342	–	–	–	–
Notes payable	(iii)	–	–	<b>119,394</b>	119,435	–	–	–	–
Deposit for future stock subscription	(iv)	–	–	–	–	<b>280,310</b>	100,000	–	–
Restructured debts	(v)	<b>419,282</b>	–	–	–	–	–	–	–
		<b>P419,282</b>	P –	<b>P329,455</b>	P312,777	<b>P280,310</b>	P100,000	<b>P462,496</b>	P462,496

\* These are balances held by MPC and MPMSI as of and prior to the date of the "Purchase Agreements."

\*\* Balances acquired by KGLI-NM by virtue of the Purchase Agreements

Notes:

- (i) On May 23, 2008, MPC and MPMSI executed Purchase Agreements with KGLI-NM Holdings, Inc. whereby MPC and MPMSI sold, transferred and conveyed to KGLI-NM its 15.29% and 0.07% equity share of the outstanding common stock, deposit for future stock subscription, cash advances and notes payable from the Group, for a total consideration of P304.35 million P0.66 million, respectively, broken down as follows:

Acquired from MPC and MPMSI	Purchase price of MPMSI	Purchase price of MP
<i>(In Thousands)</i>		
Common stock	P656	P140,475
Deposit for future stock subscription	–	33,142
Cash advances	–	75,320
Notes payable	–	55,408
	<b>P656</b>	<b>P304,345</b>

- (ii) In prior years, MPC granted cash advances amounting to P258.26 million to settle the Group's tax liabilities and for working capital requirements. These advances bear annual interest rate of 5% for the first five years and 7.5% thereafter, payable over 10 years with a grace period of four years, similar to the terms of the Group's structured obligations to the secured creditors.

The outstanding cash advances account from MPC, including the related accrued interest, which is presented at discounted value in the consolidated balance sheets, is accounted for as follows:

	2008	2007
	<i>(In Thousands)</i>	
Discounted balance at January 1	P193,342	P177,353
Discount amortization	<u>16,179</u>	<u>15,989</u>
Discounted balance at December 31	<u>P210,061</u>	<u>P193,342</u>

- (iii) As of December 31, 2008, the P119.40 million formed part of the “Advances from a related party” account, which in 2007 was presented under the “Notes payable” account in the consolidated balance sheets. The Group recognized a reversal of all the accrued interest arising from the notes payable in 2008 amounting to P14.33 million and presented under “Other Income” account in the consolidated statements income.
- (iv) In 2008, KGLI-NM made an additional deposit to the Company amounting to P180.31 million with the plan of conversion for future stock subscription, pending application for conversion with SEC and issuance of the shares.
- (v) Pursuant to the Investment Agreement entered on May 1, 2008 (see Note 1); KGLI-NM acquired certain restructured debts of the Company’s creditors, subject to same credit arrangements. As of December 31, 2008, the restructured debts' discounted value and its related finance charges and discount amortizations are as follows:

Restructured debts	Finance charges in 2008	Discount amortization in 2008	Balance as of December 31, 2008
	<i>(In Thousands)</i>		
Loans payable	P20,794	P24,829	P344,918
Accounts payable	<u>—</u>	<u>7,926</u>	<u>74,364</u>
	<u>P20,794*</u>	<u>P32,755**</u>	<u>P419,282</u>

\* Included under “Restructured debt” of the “Interest and financing charges” account in the consolidated statements of income.

\*\* Included under “Discount amortization” of the “Other income -net” account in the consolidated statements of income.

- Other related parties

The transactions with Philippine Long Distance Telephone Company (PLDT) and SMART Communication, Inc. (SMART) and corresponding outstanding balances are as follows:

Related Party	Nature of Transaction	For the Years Ended December 31		Due to Related Parties as of December 31		Deferred credits as of December 31	
		2008	2007	2008	2007	2008	2007
PLDT	Telephone bills and leased lines	P—	P19,919*	P—	P7,175	P—	P—
SMART	Rental income of space for telecommunication equipment	—	2,500**	—	89	12,083	P14,583

\* Included under “Communication, light and water” of the “Direct costs and expenses” and “General and administrative expenses” accounts in the consolidated statements of income.

\*\* Included under “Others” of the “Revenues” account in the consolidated statements of income.

In 2008, the related party relationship of PLDT (an affiliate of MPC) and SMART (a subsidiary of PLDT) with the Company ceased upon the sale and exchange of the common stock of MPC with KGLI-NM.

In November 2003, the Company entered into a memorandum of agreement with SMART whereby SMART will install telecommunications equipment within the Company's vessels to provide cellular coverage to passengers. Under the agreement, the Company shall not allow any other telecommunications operator to put a similar project on board its vessels for 10 years. The Company collected P25.0 million as consideration for this agreement. The unearned balance amounting to P12.08 million and P14.60 million as of December 31, 2008 and 2007, respectively, is included in "Deferred Credits" account (current and noncurrent) in the balance sheets.

Compensation of key management personnel of the Group is as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Short-term employee benefits	<b>P25,904</b>	P23,206
Retirement costs	<b>1,391</b>	855
	<b><u>P27,295</u></b>	<u>P24,061</u>

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#### **Note 20 – Lease Commitments**

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The future aggregate minimum lease payments under several operating leases as of December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Within one year	<b>P21,768</b>	P37,773	P37,773
Within two to four years	<b>15,964</b>	115,101	115,101
Five years and onwards	<b>2,494</b>	78,401	78,401
	<b><u>P40,226</u></b>	<u>P231,275</u>	<u>P231,275</u>

Total rentals recognized under operating leases amounted to P50.5million, P47.8million and P60.3million for December 31, 2008, 2007 and 2006, respectively.

Below are the terms of the significant lease agreements:

- On November 8, 2002, the Group entered into a lease agreement with Bank of Commerce (lessor) for the lease of the latter's land with a total area of 29,709 square meters at Barangay Banago, Bacolod City. The lease agreement provides for an annual escalation of P1.0 million beginning on the second year of the lease term. The term of the lease is for five years up to December 5, 2007. The agreement required for the payment of an advance deposit and rental, which is presented as part of "Other noncurrent assets - net" account in the balance sheet. In 2005, the lease contract was amended reducing the rental fee to P440,000 per month. In 2007, the lease contract was extended for another 5 years up to August 2012 and was further amended, whereby the total area was reduced to 14,655 square meters with a monthly rental of P0.3 million starting on August 2007. The amendment provides for an annual escalation of 5% beginning on August 2008.

Total rentals charged to by Bank of Commerce to operations amounted to P3.2 million, P4.2 million and P5.3 million in 2008, 2007 and 2006, respectively.

- On April 1, 2001, the Company entered into an agreement with GE Sea Co. (lessor) for the lease of 1,516 units of 20-footer dry freight containers for three years commencing on the date of delivery of the containers at rates agreed upon by both parties. Thereafter, the lease shall, unless negotiated 90 days prior to termination, remain in full force until terminated by either party. As of December 31, 2008, the lease has not yet been terminated by either party.

Total rentals charged by GE Sea Co. to operations amounted to P10.5 million, P9.2 million and P13.6 million in 2008, 2007 and 2006, respectively.

- The Company has an annual foreshore lease agreement with the Republic of the Philippines represented by the Department of Environment and Natural Resources (DENR) (lessor) for the lease of a 16,985 square meter parcel of offshore land located at Banago sea lane, Bacolod City, which the Company uses as a shipping port. The term of the lease shall be for a period of 25 years up to August 9, 2009 for an annual rental based on the appraised value of the land and the improvements thereon. The land will be appraised every 10 years and the annual rental after every appraisal shall not be less than 3% of the appraised value of the land plus 1% of the value of the improvement.

Total rentals charged by DENR to operations amounted to P0.7 million, P1.4 million and P1.4 million in 2008 and 2007, respectively.

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## **Note 21 – Provision and Contingencies**

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### Income and Other Internal Revenue Taxes

In 2007, the Philippine Government, through the Department of Finance, enacted Republic Act No. 9480, otherwise known as “Tax Amnesty Act of 2007” allowing qualified persons and/ or entities to avail of the tax amnesty covering all unpaid internal revenue taxes, except for those items exempted by the Act (e. g withholding tax liabilities), for the taxable year 2005 and prior years, with or without assessments duly issued therefore, that have remained unpaid as of December 31, 2005. Considering its favorable consequences, on February 14, 2008, the Group availed itself of the said tax amnesty program.

The recurring losses incurred by the Group resulted in serious liquidity problems. As a result, the Group defaulted in the payment of certain of its tax liabilities, among which were corporate income, value-added, common carriers’, fringe benefits and documentary stamp taxes. In addition, the Group was unable to remit to the Bureau of Internal Revenue (BIR) taxes withheld at source from its suppliers. As specified in the Rehabilitation Plan, such liabilities are excluded from the Debt Settlement Plan. In 2008, the Group was able to clear its tax liabilities to the BIR arising from the above taxes.

### Tsuneishi Heavy Industries, Inc. (Tsuneishi)

On February 9, 2004, Tsuneishi filed against the Company a complaint, with a prayer for the issuance of a Writ of Preliminary Attachment, with the RTC of Cebu for unpaid liabilities of the Company totaling P36.0 million in connection with drydocking and repairs services rendered. Thereafter, on March 19, 2004, Tsuneishi served a Writ of Attachment and Levy against a vessel of the Company, M/S St. Peter the Apostle, which caused the temporary grounding of such vessel since the Philippine Ports Authority would no longer issue any clearance for the vessel to sail. Due to the issuance by the RTC of Manila of the Stay Order in the rehabilitation proceedings, Tsuneishi, on April 6, 2004, amended its complaint to make it an admiralty case and included a further claimed of P69.0 million for drydocking and repair charges for the grounded vessel. The RTC of Cebu ordered all law enforcement agencies and institutions to attach and seize five

vessels of the Company, namely: M/S St. Peter the Apostle, M/S Princess of Negros, M/V San Sebastian, M/V Nossa Senhora de Fatima and M/S St. Joseph the Worker. A series of business interruptions occurred, although the Company was able to obtain a clearance from the Maritime Industry Authority.

In order to protect its interest, Tsuneishi, on April 29, 2004, obtained a Temporary Restraining Order (TRO) from the Court of Appeals (CA), enjoining the implementation of the Stay Order, which prevented the Company's vessels from sailing. However, on May 5, 2004, the Supreme Court issued a TRO enjoining the CA and Tsuneishi from implementing the TRO dated April 29, 2004.

On October 6, 2004, the CA promulgated a Decision in C.A. G.R. S.P. No. 83526 dismissing the petition of Tsuneishi, which effectively upheld the Stay Order issued by the RTC of Manila against the maritime liens of Tsuneishi, as well as the admiralty jurisdiction of the RTC of Cebu. On December 10, 2008, the Supreme Court issued a Decision, affirming the above-mentioned decision of the CA in C.A. G.R. S.P. No. 83526.

The total claim of Tsuneishi amounted to P104.6 million as of December 31, 2004 and is included in the "Restructured debt" account in the balance sheet. In 2008, this liability was acquired by KGLI-NM from Tsuneishi (see Notes 10 and 19).

#### Others

In the normal course of business, other than the matters discussed in Note 2, the Group has contingent liabilities arising from labor cases filed by former employees for alleged illegal transfer, suspension and dismissal which are pending before the courts and are presently being contested. Based on the advice of its legal counsel, an adverse judgment in any of these cases, if any, will not have any significant effects on the financial condition, results of operations or cash flows of the Group as of and for the years ended December 31, 2008, 2007 and 2006.

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### **Note 22 – Financial Assets and Liabilities**

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The following table sets forth the carrying values and estimated fair values of accompanying financial assets and liabilities recognized as of December 31, 2008 and 2007.

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	<i>(In Thousands)</i>			
Financial Assets				
Cash in bank and cash equivalents	P190,549	P190,549	P137,962	P137,962
Trade and other receivables - net	263,526	263,526	287,121	287,121
Available-for-sale financial assets*	836	836	836	836
Long-term receivables from customers*	20,527	14,871	23,597	40,579
	<b>P475,438</b>	<b>P469,782</b>	P449,516	P466,498
Financial Liabilities				
Trade and other current liabilities	415,878	415,878	517,668	517,668
Due to suppliers	3,781	3,781	4,724	4,724
Derivative liabilities**	—	—	361	361
Obligations under finance lease	271,627	192,190	58,913	69,870
Restructured debt	978,568	1,375,824	888,801	1,183,061
Advances from a related party	329,455	475,306	312,777	303,340
	<b>P1,999,309</b>	<b>P2,462,979</b>	P1,783,244	P2,079,024

\* Included in "Other Noncurrent Assets - net" account in the Company balance sheets.

\*\* Included in "Trade and Other Current Liabilities" account in the Company balance sheets.

### Fair Value of Financial Instruments

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 and other current liabilities and due to suppliers:* Due to the short-term nature of transactions, the fair values of these instruments approximate the carrying amount as of balance sheet date.

*Derivative liabilities:* The fair values were determined using forward exchange market rates at the balance sheet date.

*Available-for-sale financial assets:* The fair values were determined by reference to market bid quotes as of balance sheet date.

*Long-term receivables from customers:* The fair value is estimated as the present value of all future cash flows discounted using the prevailing market rate of interest for a similar instrument.

*Obligations under finance lease and advances from a related party:* The estimated fair values were determined based on the discounted cash flows using the market interest rates.

*Restructured debt:* The fair value of these loans were estimated as the present value of all future cash flows discounted using the applicable rates for similar types of loans. Discount rates used ranged from 5.75% to 7.20%.

### Embedded Derivatives

Embedded foreign currency forwards were bifurcated from a US Dollar (USD) denominated Equipment Purchase Agreement entered into by the Company in 2005 whereby the Company agreed to pay the supplier in Philippine Peso at an exchange rate of USD1:P56 but decreased to USD1:P46 in 2007. The agreement provides for weekly payments up to 2008. The unpaid balance amounted to nil and USD0.04 million as of December 31, 2008 and 2007, respectively. Unrealized marked-to-market loss amounted to P0.4 million in 2007.

The net movements in fair value changes of the above embedded derivatives are as follows:

	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>	
Derivative liability, beginning	<b>P361</b>	P2,155
Net changes in fair value during the year	–	549
Fair value of settled contracts	<u><b>(361)</b></u>	<u>(2,343)</u>
Derivative liability, end	<u><b>P –</b></u>	<u>P361</u>

The net changes in fair value are included in “Others Income (Expenses)” account in the consolidated statements of income.

The balance is presented in the consolidated balance sheets under “Trade and Other Current Liabilities” account.

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### **Note 23 – Financial Risk Management Objectives and Policies**

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The Group’s principal financial instruments comprise of cash, notes payable, obligations under finance lease, restructured debt and advances from a related party. The main purpose of these financial instruments is to raise financing for the Group’s operations. The Group has other

various financial assets and liabilities such as trade receivables and trade payables which arise directly from operations.

The Group's activities expose it to a variety of financial risks: Credit, Liquidity and Market risks (foreign exchange and interest-rate risks). The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance. It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

### Credit Risk

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the balance sheet (or in the detailed analysis provided in the notes to the financial statements, balances as of December 31, 2008 and 2007, respectively, are summarized below:

	Carrying Value	Within 1 year	1 - 2 years	3 - 5 years	> 5 years
Cash and cash equivalents	P190,549	P190,549	P–	P–	P–
Trade and other receivables – net	263,526	263,526	–	–	–
Available-for-sale financial assets*	836	836	–	–	–
Long-term receivables from customers*	20,527	–	–	20,527	–
<b>As at December 31, 2008</b>	<b>P475,438</b>	<b>P454,911</b>	<b>P–</b>	<b>P20,527</b>	<b>P–</b>
Cash and cash equivalents	P137,962	P137,962	P–	P–	P–
Trade and other receivables – net	287,121	287,121	–	–	–
Available-for-sale financial assets*	836	836	–	–	–
Long-term receivables from customers*	23,597	4,810	9,659	9,128	–
As at December 31, 2007	P449,516	P430,729	P9,659	P9,128	P–

\* Included in "Other noncurrent assets - net" account in the balance sheets.

The aging analysis of trade and other receivables:

Account	Carrying Value	Not past due nor impaired	Past due but not impaired			Past due and impaired
			1 - 60 days	61 - 90 days	> 90 days but not > 360 days	> 360 days
Trade	P348,020	P156,425	P31,579	P16,996	P21,788	P121,232
Advances to officers and employees	19,775	19,719	56	–	–	–
Due from customers and suppliers	9,203	3,062	469	128	4,789	755
Others	33,528	30,021	–	2,462	–	27,559
	410,526	209,227	32,104	19,586	26,577	149,546
Allowance for doubtful accounts	(147,000)	–	–	–	–	(147,000)
<b>As at December 31, 2008</b>	<b>P263,526</b>	<b>P209,227</b>	<b>P32,104</b>	<b>P19,586</b>	<b>P26,577</b>	<b>P2,547</b>
Trade	P347,185	P149,536	P38,198	P22,410	P32,762	P104,279
Advances to officers and employees	12,758	12,758	–	–	–	–
Due from customers and suppliers	22,236	11,929	2,203	8,104	–	–
Others	31,242	9,221	–	–	–	22,021
	413,421	183,444	40,401	30,514	32,762	126,300
Allowance for doubtful accounts	(126,300)	–	–	–	–	(126,300)
As at December 31, 2007	P287,121	P183,444	P40,401	P30,514	P32,762	P–

To manage credit risk, the Group has policies in place to ensure that all customers who wish to trade on credit terms are subject to credit verification procedures and approval of the Credit Committee. In addition, receivable balances are monitored on an ongoing basis to reduce the Group's exposure to bad debts. The Group has policies that limit the amount of credit exposure to any particular customer.

### Liquidity Risk

The Group manages its liquidity profile to be able to finance its capital expenditures and service its maturing debts by maintaining sufficient cash during the peak season of the passage business.

The Group regularly evaluates its projected and actual cash flow generated from operations.

As at December 31, 2008 and 2007, the Group's financial liabilities have maturities which are presented below:

	Carrying Value	Within 1 year	1 – 2 years	3 - 5 years	> 5 years
Trade and other current liabilities	P415,878	P415,878	P–	P –	P –
Due to suppliers	3,781	P3,781	–	–	–
Obligations under finance lease	271,627	63,662	95,120	98,999	13,846
Restructured debt	978,568	106,760	231,743	640,065	–
Advances from related party	329,455	76,133	125,922	127,400	–
<b>As at December 31, 2008</b>	<b>P1,999,309</b>	<b>P666,214</b>	<b>P452,785</b>	<b>P866,464</b>	<b>P13,846</b>
Trade and other current liabilities	P517,668	P517,668	P –	P –	P –
Due to suppliers	4,724	4,724	–	–	–
Derivative liabilities	361	361	–	–	–
Obligations under finance lease	58,913	30,522	27,747	644	–
Restructured debt	888,801	–	133,320	399,960	355,521
Advances from related party	312,777	–	29,001	206,439	77,337
<b>As at December 31, 2007</b>	<b>P1,783,244</b>	<b>P553,275</b>	<b>P190,068</b>	<b>P607,043</b>	<b>P432,858</b>

\* Included in "Trade and other current liabilities" account in the balance sheets.

The corresponding maturities of trade and other current liabilities are as follows:

Account	Carrying Value	Payments due by period			
		Current	1 - 60 days	61 - 90 days	> 90 days but not > 360 days
Trade	P254,554	P73,046	P33,894	P18,325	P129,289
Accrued taxes, interest and other expenses	135,002	85,790	5,552	3,105	40,555
Unearned passage and freight revenue	16,799	16,799	–	–	–
Others	9,523	9,523	–	–	–
<b>As at December 31, 2008</b>	<b>P415,878</b>	<b>P185,158</b>	<b>P39,446</b>	<b>P21,430</b>	<b>P169,844</b>
Trade	P277,670	P139,455	P23,819	P12,052	P102,344
Accrued taxes, interest and other expenses	214,125	171,730	3,152	3,863	35,380
Unearned passage and freight revenue	20,105	20,105	–	–	–
Others	6,129	4,779	827	–	523
<b>As at December 31, 2007</b>	<b>P518,029</b>	<b>P336,069</b>	<b>P27,798</b>	<b>P15,915</b>	<b>P138,247</b>

## Foreign Exchange Risk

The Group has recognized in its statements of income foreign exchange revaluation loss and gains of P2.74 million and P3.2 million on its foreign-currency denominated liabilities in 2008 and 2007, respectively. This resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

December 31, 2007	P41.411* : USD 1
December 31, 2008	P47.647* : USD 1

\* *The exchange rate used to translate the U.S. dollar amounts into Philippine peso as quoted through the Philippine Dealing System.*

While all of the Group's revenues is neither linked to nor denominated in foreign currencies, minor part of the Group's debt, capital expenditures and operating expenses are denominated in US dollars.

In translating the foreign currency-denominated monetary liabilities into peso amounts, the Group used the exchange rates as shown on the table above.

As of December 31, 2008, approximately 0.39% of the Group's total debts are denominated in US dollars. Thus, a weakening of the peso against the US dollar will increase both the principal amount of the Group's foreign currency-denominated debts, and interest on the Group's debt in peso terms. In addition, many of the Company's financial ratios and other financial tests will be negatively affected.

## Interest Rate Risk

As of December 31, 2008, the Group has no significant floating rate financial assets. The Group's operating cash flows are substantially independent of changes in market interest rates.

The Group has no borrowings issued at variable rates thus, the Group is not subject to cash flow interest-rate risk. However, borrowings issued at fixed rates expose the Group to fair value interest-rate risk. As of December 31, 2008, P1.1 billion of borrowings was at fixed rates ranging from 2.5% to 7.5% for ten years. Interest accrual re-starts only upon signing by the creditors of the settlement agreements. Accrual of interest for 2008 and 2007 amounted to P33.06 million and P37.23 million, respectively.

Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument. The other financial instruments of the Group that are not included in the following tables are noninterest-bearing and are therefore not subject to interest rate risk.

	Carrying Value	Within 1 year	1 - 2 years	3 - 5 years	> 5 years
Cash and cash equivalents	P 190,549	P190,549	P-	P-	P-
Obligations under finance lease	271,627	63,662	95,120	98,999	13,846
Restructured debt	978,568	106,760	231,743	640,065	-
Advances from related party	329,455	76,133	125,922	127,400	-
<b>As at December 31, 2008</b>	<b>P1,770,199</b>	<b>P437,104</b>	<b>P452,785</b>	<b>P866,464</b>	<b>P13,846</b>
Cash and cash equivalents	P137,962	P137,962	P-	P-	P-
Obligations under finance lease	58,913	30,522	27,747	644	-
Restructured debt	888,801	-	133,320	399,960	355,521
Advances from related party	312,777	-	29,001	206,439	77,337
<b>As at December 31, 2007</b>	<b>P1,398,453</b>	<b>P168,484</b>	<b>P190,068</b>	<b>P607,043</b>	<b>P432,858</b>

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**Note 24 – Capital Risk Management Objectives and Policies**

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The Group's capital management objectives are:

- To ensure the Group's ability to continue as going concern, so that it can continue to provide returns for shareholders and benefits for others stakeholders and produce adequate and continuous opportunities to its employees; and
- To provide an adequate return to shareholders by pricing products/services commensurately with the level of risk; and

The Group sets the amount of capital in proportion to risk. It manages the capital structure and makes adjustments in the light of changes in economic conditions and the risk characteristics of the underlying assets, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or sell assets to reduce debt.

Since the Group is undergoing Corporate Rehabilitation, its strategy, which is consistent from 2006, was to improve and eventually achieve a positive capital ratio, in order to secure access to finance at a reasonable cost by maintaining a credit worthy rating.

The Group monitors capital on the basis of the carrying amount of equity as presented on the face of the balance sheet. The capital ratios are as follows:

	<u>2008</u>	<u>2007</u>
Assets financed by:		
Creditors	102%	126%
Stockholders	<u>(2%)</u>	<u>(26%)</u>

The improvement in the capital ratio during the year resulted primarily from the extinguishment of liabilities.

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**Note 25 – Subsequent Events**

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The Group's financial statements have been restated due to the following:

Separate presentation and discounting of obligations under finance lease, the effects of the restatements in 2006 are as follows:

	<u>Increase (Decrease)</u>
Obligations under finance lease	P70,657
Restructured debt	(30,816)
Advances from Metro Pacific Corporation	(12,913)
Deferred tax liability	(10,955)
Net loss	(65,682)
Retained earnings, January 1, 2005	(81,655)

Adjustment to inventory amounting to P1.0 million due to availment of the Tax Amnesty Act of 2007 (see Note 21). The adjustment increased the inventory account and decreased the deficit with the same amount.

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**Note 26 – Subsequent Events**

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**Corporation Rehabilitation**

As discussed in Note 2, on February 6, 2009, the Company filed with the RTC of Manila a Motion to Terminate Proceeding on Account of the Successful Implementation of the Court-Approved Rehabilitation Plan (Motion to Terminate Rehabilitation Plan).

The Motion to Terminate Rehabilitation Plan outlines the successful implementation of Company's business operations pursuant to the approved Rehabilitation Plan on its (i) 10-year Business Plan and (ii) the Debt Settlement Plan.

**Corporate Re-organization**

On February 17, 2009, NHMC and KGLI-NM executed a Deed of Exchange wherein NHMC's investment, representing 83.68% of the outstanding common shares of NENACO, will be transferred to KGLI-NM in exchange for the transferee's own shares of stock (see Note 1).