aboitiz
Equity Ventures

ANNUAL REPORT
2005

Delivering On Our Promise

Our Brand
Promise >
Passion for better ways

Our Mission
To create long-term value for all our stakeholders

Our Cover
Ever since the refreshed Aboitiz brand was launched in April 2005, much of the company's efforts have been put into unleashing the power of the brand to energize our most important resource, our team members. We are preparing and empowering them to consistently deliver on our brand promise of **passion for better ways** – *driven to lead, driven to excel, and driven to serve.*

Contents

We are pleased to inform you that your company continues to perform well despite the uncertainties of the times.

– Roberto E. Aboitiz

Our team members have enthusiastically welcomed our new identity and accepted the challenge to

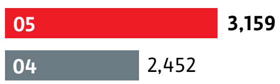
Deliver>

on our brand promise of **Passion for Better Ways**– to break through conventional barriers by thinking out of the box and daring to challenge the status quo. Moreover, our team members' acceptance has strengthened our commitment to service and product excellence for all our customers, and to continue to be low-cost producers.

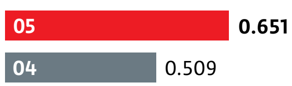
Financial Highlights

Revenues
(IN MILLION PESOS)

EBITDA
(IN MILLION PESOS)



Net Income to Common
(IN MILLION PESOS)



Earnings per share
(IN PESOS)

Total Assets
(IN MILLION PESOS)

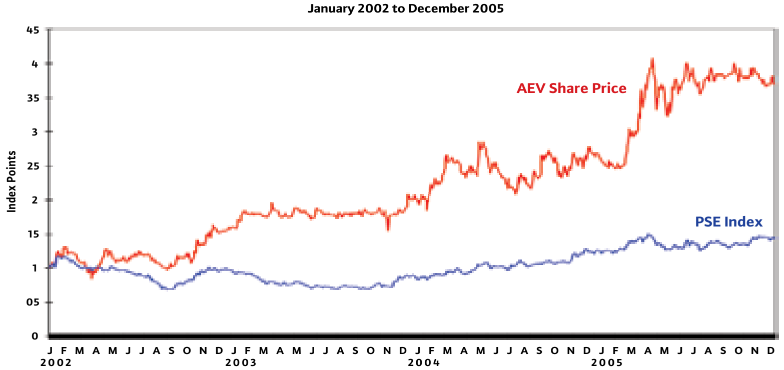
Cash & Cash Equivalents
(IN MILLION PESOS)

Equity Attributable to Equity Holders of the Parent
(IN MILLION PESOS)

Cash Dividend to Common
(IN MILLION PESOS)

Market Capitalization
(IN MILLION PESOS)

AEV Share Price vs PSE Index
January 2002 to December 2005



Financial Summary (in million pesos)

	2004 As restated *	2005	% change '05 vs. '04
For the Year			
REVENUES	**22,411**	**26,923**	20.1%
OPERATING PROFIT			
Operating profit from ordinary activities	1,811	**2,142**	18.3%
Equity in Net Earnings of Associates	1,532	**2,155**	40.7%
Other Charges	(107)	**(611)**	474.6%
Income before income tax	**3,236**	**3,686**	13.9%
Provision for income tax	(531)	**(469)**	-11.8%
Income before minority interest	**2,705**	**3,217**	18.9%
Minority interest	(162)	**(58)**	
Net Income for the year	**2,543**	**3,159**	24.2%
Dividend to Preferred	(91)	–	
Net Income to Common	**2,452**	**3,159**	28.8%
At Year End (in million pesos)			
Total Assets	36,592	**38,243**	4.5%
Total Liabilities **	18,223	**16,937**	-7.1%
Minority Interest	1,158	**1,178**	
Equity Attributable to Equity Holders of the Parent **	17,211	**20,128**	16.9%
EBITDA	5,860	**6,527**	11.4%
Per Share (in pesos)			
Earnings	0.509	**0.651**	28.1%
Book Value	3.57	**4.10**	14.8%
Cash Dividends (Common)	0.10	**0.12**	20.0%
Financial Ratios			
Current Ratio	1.31	**1.29**	-1.4%
Debt-to-Equity Ratio	1.06	**0.84**	-20.4%
Net Debt-to-Equity Ratio	0.55	**0.38**	-31.5%

* Figures were restated as a result of the full adoption of Philippine Financial Reporting Standards (PFRS) and of the reorganization of the Transport Group.
** 2004 figures were adjusted to treat redeemable preferred shares as debt, to be comparative with 2005 figures.

Report to our Stockholders
from your Chairman

Dear Shareholders and Friends,

We are pleased to report to you that your company despite a challenging year did exceptionally well in 2005.

It was a very busy year for us. We celebrated with Aboitiz & Company its 85th year as a corporation, and at the same time the launching of the refreshed Aboitiz brand essence, **Passion for Better Ways**, and a new corporate logo.

We rallied our teams throughout the group to ensure that we share a common purpose and a common understanding of our new identity and our new brand promise.

Aboitiz Equity Ventures continues to remain steadfast in creating long-term value for all stakeholders. Our team members have enthusiastically welcomed our new identity and accepted the challenge to live up to the brand promise of **Passion for Better Ways**, to break through conventional barriers by thinking out of the box and daring to challenge the status quo. Our team members' acceptance has strengthened our commitment to service and product excellence for all our customers, and to continue to be low-cost producers.

Today, the battlecry reverberates across the group. The passion spreads and fuels our mission to be the best at what we do.

It dictates how we behave and serves as a filter for ideas that we will continue to pursue, nurture, recognize and reward.

We embrace our new identity with the determination to champion our brand promise and prove to all that we are indeed driven to lead, driven to excel, and driven to serve. We move forward as one group with one vision.

To all our stakeholders, thank you for your continued support and confidence. To our teams, we express our gratitude for the efforts and contributions that you have given, and shall continue to give, in order for us to achieve our goals. In a company as diverse as ours, we cannot thank you enough for your unwavering support.

Roberto E. Aboitiz
CHAIRMAN OF THE BOARD

We embrace our new identity with the determination to champion our brand promise and prove to all that we are indeed driven to lead, driven to excel, and driven to serve. We move forward as one group with one vision.

Passion for Better Ways

Your company's strategic initiatives remain

focused

on enhancing and maximizing the value of our existing businesses. We will continue to invest in our core businesses and competencies while

- Continuing to operate as low-cost producers and service providers
- Maintaining a balanced portfolio, prudent debt levels, and a healthy cash flow to prepare us for growth opportunities in industries where we have proven competence
- Strengthening the Aboitiz brands and their positive image in order to build compelling and long-lasting brand relationships with different customers

Report to our Stockholders
from your President & Chief Executive Officer

Dear Shareholders and Friends,

We are very pleased to report that 2005 was a banner year for AEV as it posted a record profit of ₱3.16 billion, an increase of 29% over its 2004 restated earnings. Earnings per share increased 28% to 65 centavos. Return on equity was a record high 19%, and all operating companies under AEV performed exceptionally well, except for the transport group that under-performed as it was again affected by large fuel cost increases.

Your company's strategic initiatives remain focused on enhancing and maximizing the value of our existing businesses. We will continue to invest in our core businesses and competencies while

- Continuing to operate as low-cost producers and service providers
- Maintaining a balanced portfolio, prudent debt levels, and a healthy cash flow to prepare us for growth opportunities in industries where we have proven competence
- Strengthening the Aboitiz brands and their positive image in order to build compelling and long-lasting brand relationships with different customers.

POWER

In 2005, AEV's electric power investments again provided most of the company's earnings, contributing 61% of total earnings, up 32% over the previous year. The electricity generation and distribution businesses had almost equal sharing of these earnings.

It was a challenging year for power distribution, as higher rates depressed consumption, resulting in low volume sales growth across most of our distribution utilities and the industry as a whole. Despite these market conditions, all the distribution companies in the group were able to improve their earnings contributions through operating efficiencies and the full effects of rate unbundling and rate adjustments.

In the generation side, Luzon Hydro continued its strong financial performance and got an additional boost from the operation of its supplemental water project that adds about 10 million kwh to annual production. In January 2005, Hedcor took over the 3.5-MW Talomo mini hydro facility in Davao, the first NPC plant privatized under EPIRA.

We are very pleased to report that 2005 was a banner year for AEV as it posted a record profit of ₱3.16 billion, an increase of 29% over its 2004 restated earnings. Earnings per share increased 28% to 65 centavos. Return on equity was a record high 19%.

Driven to lead, serve and excel.

The plant has since then been rehabilitated to increase its production potential. In 2005, our mini-hydro plants in Luzon that sell their output to NPC ended the year with good revenue increases due to the increases in the NPC reference rate. All the companies were also merged into a single operating unit.

The thermal plants of Western Mindanao Power Corporation and Southern Philippines Power Corporation now play an increasing role in supporting the Mindanao grid as new loads are added without corresponding increases in supply.

BANKING

The Philippine banking sector generally performed well in 2005, and AEV's banking subsidiaries more than kept pace with the industry. UnionBank retained its position as among the top four in income, and number one in return on assets, return on equity, productivity and capital adequacy. By these measures, UnionBank has been the most efficient bank in the country over the last five years.

Our other banking investment, City Savings Bank, saw its deposit levels hit the billion-peso mark for the first time but growth did not dilute earnings as return on equity climbed to 20% and its past due ratio improved to just over 4%. City Savings broadened its reach in 2005 by continuing its expansion of branches, opening its first Mindanao branch in Davao City.

The combined earnings of UnionBank and City Savings accounted for 26.7% of AEV's net earnings.

TRANSPORT

Like other AEV companies, the Aboitiz Transport System (ATS) continued to improve its operational efficiency in 2005. It led the industry in fuel efficiency and reduced technical off-hire to a world-class level of 0.15%. However, greater efficiency was still not enough to offset the burden of increasing fuel prices, with a market incapable of absorbing all the cost increases in a timely manner through rate adjustments. Competition from airline promos, buses and short ferry roll-on and roll-off operators also put pressure on passage rates.

ATS also did its share of rationalization, integrating the more profitable freight forwarding, logistics & courier services, and international crewing & ship management operations to be

Like other AEV companies, the Aboitiz Transport System continued to improve its operational efficiency in 2005. It led the industry in fuel efficiency and reduced technical off-hire to a world-class level of 0.15%.

able to provide its customers with total transport and logistics solutions, as well as diversify the revenue mix. On the cost side, ATS also rationalized its capacity utilization, selling less efficient vessels and prioritizing contribution margin over market share.

FOOD

The food group provided another bright spot for AEV, contributing 11% to the company's profits, as all its businesses, from flour milling to yeast, feeds and swine production, were profitable. The flour milling capacity increased by 150 metric tons per day in 2005, bringing total daily capacity up to 1,310 metric tons. Pilmico became ISO 9000-certified and also received the HACCP accreditation for food safety.

Treasury Share Sale

In February 2005, your Board of Directors authorized the sale of 890 million treasury shares, representing approximately 15.6% of the company's stock. However, due to unfavorable market conditions in the middle of 2005, we were unable to place the shares at a price we felt represented value to shareholders. But we are committed to place these shares in the market at the right time not only to raise capital for our power projects but also to increase stock liquidity.

On a consolidated basis, the total number of shares held in treasury has declined. Davao Light & Power Company and Cotabato Light & Power Company took further steps toward business separation and unbundling of assets by disposing of their shares in AEV through both actual sales to the public and property dividends to AEV to remove non-utility assets from the regulated entity. We also distributed through a property dividend the UBP shares owned by these utilities to AEV parent.

OUTLOOK

After setting such a high performance standard in 2005, your company will find 2006 an even more challenging year.

In the power side, we have to deal not only with today's needs, but also with future supply, as our distribution utilities can no longer rely on NPC to be the default supplier. In fact, supply is already tight in the Visayas and Mindanao. It takes several years lead time for new capacity to come in so we have to contract in 2006 to meet our needs for 2009 or 2010. Wherever possible, we plan to build or acquire hydroelectric plants wherein over the years we have developed considerable expertise.

We have identified two sites in Davao that will have a total generating capacity of 72MW and this will address Davao Light's incremental needs over the next five years. Construction on the first site is expected to begin in the first quarter of 2007, with the second site to follow shortly thereafter. In 2006, VECO will bid out a 200-MW coal plant to be operational in the first quarter of 2009.

Our other prospects for the power generation business include the possible acquisition of NPC plants being privatized. AEV has prepared for this, forming a joint venture with Norwegian company SN Power Invest AS to bid for NPC hydro assets in Luzon.

On the distribution side, we are also looking at improving efficiencies in the sub-transmission and distribution systems as a demand side solution to lower costs, and accommodate future growth. Although high energy prices have suppressed existing demand, there continues to be new prospects as our markets expand.

In food, we expect the group to continue to excel in 2006. With the flour mill capacity already increased, the focus will now shift to the feed and swine business, with the possibility of building a new mill in the South and expanding our swine-growing facilities. We also project swine production to increase with new breeder and finisher farms to be put up to meet demand.

The food group provided another bright spot for AEV, contributing 11% to the company's profits, as all its businesses, from flour milling to yeast, feeds and swine production, were profitable.

Pilmico's Iligan plant is equipped with the most modern facilities to ensure maximum efficiency.

In transport, we are looking at solutions on the cost side and the improvement of margins. Fuel prices will continue to play a crucial role in the profitability of the company and rates will need to reflect the true cost of operation. Our strategy is to improve utilization of our assets, select better margin cargoes, optimize routes and schedules, and reduce operating costs in all areas. Logistics, crewing, ship management and other related services are expected to continue to perform well.

Share Appreciation

In 2005, we saw a sharp increase in AEV's share value and increased trading on the stock market. The share price increased from ₱3.25 at the beginning of January to close at 4.80 by the end of December, or a 68% price appreciation for the year.

Volume of shares traded increased by 177% over 2004 to reach 429 million shares and value of transactions doubled to close to ₱2 billion, which demonstrated increased interest in our stock.

Cash Dividends

In February 2006, your Board of Directors approved a cash dividend of 15 centavos per share that was paid out on March 10, 2006. The dividend declaration was 23% higher than the 2005 dividend and is equivalent to approximately 23% of our earnings.

Moving forward, we feel that we can continue to maintain a very favorable cash dividend policy balancing growth with cash distribution to shareholders.

Corporate Social Responsibility

In consonance with one of our brand spikes, Driven to Serve, AEV through the Aboitiz Group Foundation, Inc., (AGFI) continues to be of service to stakeholders and communities. With special emphasis on education, the foundation continues to pursue its school building and computer donation programs. It also supports hundreds of scholars in all educational levels.

We are very pleased to report on the involvement of our team members in different AEV companies in the foundation's many outreach programs, demonstrating their commitment to serve.

Driven with a passion to serve, AGFI continues to reach out to as many beneficiaries, helping people help themselves.

Delivering on our Promise

2005 saw the strengthening of AEV's brand identity, with the launching of a new logo and refreshed brand essence **Passion for Better Ways**. We expect this recent strategic initiative to have the most powerful and sustainable impact. We embarked on an intensive brand cascade campaign to all our team members, rallying everyone to adopt this brand essence. Our thrust now is to inspire everyone to imbibe **Passion for Better Ways** to further recharge and leverage on all Aboitiz brands and realize their full potential. Moving forward, this will complement and strengthen our corporate strategies.

To all our team members in the AEV group, we thank you for your wholehearted support and for your continuing commitment to deliver the highest standards of service, always pursuing excellence, and continuously finding new and better ways of doing things.

To our stockholders, partners and customers, our sincerest gratitude for your continued trust, confidence and support. We take our brand essence to heart, committed to always strive to be the best at what we do. We will continue to be driven to lead, driven to excel and driven to serve.

Jon Ramon Aboitiz
PRESIDENT AND CHIEF EXECUTIVE OFFICER




Results of Operations

POWER DISTRIBUTION

Davao Light supervisors monitor live lineworks to ensure uninterrupted power.

DAVAO LIGHT & POWER COMPANY

Davao Light's contribution of

₱751M

in 2005 was **7%** higher than in 2004.

Results of Operations

from your Chief Operating Officer

Dear Shareholders and Friends,

Aboitiz Equity Ventures, Inc. (AEV) ended 2005 with revenues of ₱27 billion, 20% higher than its 2004 earnings. Earnings before interest, taxes, depreciation and amortization (EBITDA) was up by 11% hitting ₱6.53 billion. From the company's 2004 restated income[1] , net income attributable to equity holders in 2005 increased by 29% to ₱3.16 billion. This represents an earnings per share (EPS) of ₱0.65.

POWER GROUP

2005 was both a challenging and rewarding year for the AEV power group. Higher wholesale electricity prices mainly due to higher fuel costs, together with increases in other goods and services affected by the higher oil costs, sponged off a lot of disposable income from the Filipino consumer. We saw our customers cutting back where they could in their electricity consumption which resulted to lower electricity sales growth for all of AEV's distribution utilities. The implementation of the value added tax (VAT) on electricity sales effective November 1, 2005 raised the cost of electricity to our consumers even further.

We are fortunate that none of our IPPs were affected by the higher cost of fuel, as National Power Corporation (NPC) takes on the fuel risk and supplies us with the fuel. For our hydros, the higher cost of fuel actually works to our favor as we end up getting paid higher for our power and do not have the corresponding fuel costs.

Despite the challenges, the power group continued to be the largest contributor to AEV's income, turning in ₱2.12 billion, a 32% increase over the previous year. This represents 61% of the total income contribution from AEV's various business segments.

Despite the challenges, the power group continued to be the largest contributor to AEV's income, turning in ₱2.12 billion, a 32% increase over the previous year. This represents 61% of the total income contribution from AEV's various business segments.

[1] AEV's 2004 earnings were restated as a result of the full adoption of the Philippine Financial Reporting Standards (PFRS) and of the reorganization of the Transport Group. The 2004 figures were adjusted to treat redeemable preferred shares as debt, to be comparative with 2005 figures.

Delivering on our promise.

POWER DISTRIBUTION

VECO linemen, on call 24/7, assure Metro Cebu residents of reliable service and continuous power supply. The company recently opened its own skills training center for linemen and technical personnel.

VISAYAN ELECTRIC COMPANY

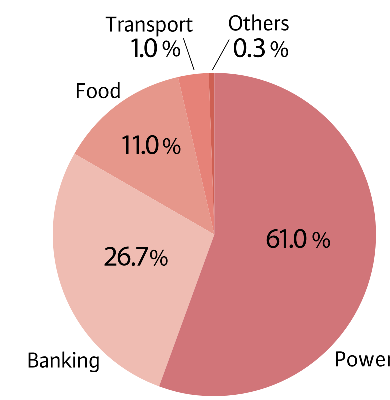
Visayan Electric Company's contribution of **₱158M** was
803%
higher than in 2004.

Results of operations

POWER GROUP

Distribution Companies

Income Contribution from AEV's Business Groups



The combined income of AEV's power distribution companies was up by 28% reaching ₱1.07 billion in 2005. Taking AEV's beneficial ownership in the various distribution companies, the group sold a total of 2,462 gigawatt-hours (Gwhrs) in 2005, an increase of 1.8% over 2004. Over the last 8 years our compounded annual growth rate was 7.7%. We are confident that the growth will come back to historical averages as our consumers get used to the higher electricity prices and as our economy grows.

Lower sales growth, however, was accompanied by higher margins across all utilities. This was due to the full-year effect of the distribution rate increases received in 2004 which were implemented at various times of the year, tight cost and capex control, and the rightsizing implemented in VECO towards the end of 2004.

Davao Light and Power Company (DLPC) turned in a profit contribution of ₱751 million in 2005, 7% higher than in 2004. DLPC sold 1,258 Gwhrs of electricity in 2005, up by 1% over its sales in the previous year. The number of customers increased slightly to 231,279. Peak load remained flat at 230 MW. Systems losses continued to creep down to 8.45% from 8.6% in 2004.

< As part of its modernization program to optimize maintenance and testing of substations, Davao Light acquired the Kelman-Transport X Portable Dissolved Gas Analyzer used primarily for dissolved gas and moisture analysis of oil-filled equipment. The apparatus allows condition-based monitoring of power transformers.

POWER DISTRIBUTION

Cotabato Light continues to support the street lighting program of the local government.

COTABATO LIGHT & POWER COMPANY

Cotabato Light contributed
₱77M
in 2005, up **31%** from 2004.

Results of operations

POWER GROUP

Driven by IT innovations, Davao Light develops almost all its own software for administrative and customer-focused systems, for engineering applications, and for its geographical information systems.

In December 2005, DLPC signed a 10-year transition supply contract (TSC) with NPC to assure its customers of adequate and reliable power supply. The Davao utility increased its contracted demand with NPC from 130 MW to 205 MW.

The company also signed an agreement with the National Transmission Corporation (TransCo) to purchase for ₱15 million some of its sub-transmission assets involving 15 circuit kilometers of 69 kilovolt (kV) lines within the DLPC franchise area.

To address the increasing power demand in its franchise area, DLPC built and energized in April 2005 its 21st substation located in Dumoy, Davao City with a transformation capacity of 33 MVA. The company has also started work on its second 138 kilovolt (kV) substation in Bunawan, Davao with a capacity of 50 MVA. This will serve the load growth of the northern part of DLPC's franchise, improve the power quality, and reduce systems loss. Completion is expected in the fourth quarter of 2006.

As part of its program to continuously reduce its outages, DLPC purchased in August 2005 a ₱38 million 33-MVA mobile substation. This enables an immediate back-up for any substation undergoing preventive maintenance or forced outage, thereby ensuring continuous supply of power.

Visayan Electric Company (VECO) posted an impressive turn-around in 2005 as it contributed ₱158 million, up by 803% from its 2004 contribution. Margins widened with the full-year implementation of distribution rates approved in 2004, as well as the drastic rightsizing of the work force. The latter brought labor costs down substantially. Systems losses were also brought down to 9.9% at the end of the 2005 versus 10.2% for the same period in 2004.

The Cebu-based utility sold 1,512 Gwhrs in 2005, up by 3% from the previous year. Number of customers increased by 4% to 276,497. Peak load increased by 1% to 291 MW.

In February 2005, VECO signed a five-year transition supply contract (TSC) with NPC, increasing its contracted demand from 120 MW to 170 MW, thus assuring its customers of a steady power supply. VECO is NPC's biggest customer in the Visayas and its contract period ends in December 2008. The company also signed an agreement to purchase TransCo's sub-transmission assets for ₱172 million which include two 100-MVA substations, making it the biggest sale of sub-transmission assets to any utility thus far.

VECO opened a full service center at the SM Mall in February 2005 and since then serves an average of 3,800 customers per day on weekdays. Fifty percent of bill payments for the whole utility is now done at the SM service center. A Call Center using Voice Over Internet Protocol (VOIP) technology and a Customer Relations Management System (CRMS) identical to the one used by Davao Light was put in place to support the company's efforts of improving customer service.

POWER
DISTRIBUTION

A SFELAPCO night crew does a maintenance check on electric poles to ensure uninterrupted power to the bustling city of San Fernando, Pampanga.

SAN FERNANDO ELECTRIC LIGHT AND POWER COMPANY

SFELAPCO's systems loss dropped further from **6.3%** to **5.3%**, one of the lowest in the country.

Results of operations

POWER GROUP

Subic EnerZone personnel test equipment at the Cubi Point substation.

On September 1, 2005, President Gloria Macapagal Arroyo signed into law R.A. 9339 extending VECO's franchise term for another 25 years.

Cotabato Light & Power Company (CLPC) contributed ₱77 million in 2005, up by 31% from the previous year. The company sold 114 Gwhrs in 2005, a 3% increase over 2004. The number of customers grew slightly by 1.1% to 26,379. Systems losses and peak demand remained flat for the year at 8.8% and 21 MW, respectively.

In January 2005, CLPC signed a transition supply contract (TSC) with NPC, increasing its contracted demand from 18 MW to 20 MW.

San Fernando Electric Light & Power Company (SFELAPCO) contributed ₱32.6 million in 2005, up by 5% from the previous year.

The company sold 358 Gwhrs, up by 3% from 2004. Its systems losses have further reduced to 5.32% from 6.3% in 2004, one of the lowest in the country. Peak load remained flat at 68 MW in 2005. The company's customers increased by 3% in 2005 to 64,012.

As part of its efforts to support the development of renewable power in the country, SFELAPCO extended its Electric Power Supply Agreement (EPSA) with HEDCOR. The agreement was originally signed in 2002 following the connection of the 4.3-MW Asin hydroelectric power plants to the national grid.

Subic EnerZone Corporation (SEZ) contributed ₱35 million in 2005, up by 38% from its 2004 earnings.

In 2005, the company sold 167 Gwhrs and reached a peak demand of 31 MW, more or less equivalent to the previous year. In just two years, after a major rehabilitation program and the installation of new systems and equipment, SEZ has lowered systems loss by almost 55%, dropping it to 6.3% in 2005 from 14.1% in October 2003 when the company took over the power distribution system at the Subic Freeport Zone. This represented a drop in power costs of ₱0.56 per kwhr (₱0.40 decrease in the distribution charge and ₱0.16 from the reduction in systems loss), which the company passed on totally to its customers.

To further improve the reliability and stability of power within the zone, SEZ signed a contract with TransCo in June to purchase the latter's 100-MVA substation in Subic for ₱102 million. Two months earlier, SEZ also acquired 7 circuit-kilometers of 69 KV sub-transmission lines from TransCo for ₱29 million. These acquisitions give SEZ more control over its power distribution system and provides a larger revenue base for the utility.

POWER GENERATION

Luzon Hydro, the project holding company of the 70-MW Bakun AC power plant, is a joint venture between AEV and Pacific Hydro Limited of Australia. The plant is the first build-operate-transfer hydro project of the National Power Corporation.

LUZON HYDRO CORPORATION

Luzon Hydro contributed

₱806M,

up **28%** from the previous year.

Results of operations

POWER GROUP

Luzon Hydro personnel conduct a maintenance check on the turbines inside the Bakun AC plant.

In September 2005, SEZ renewed its power supply contract with NPC resulting in savings of ₱0.50/kwhr, which the company passed on to its customers. It also denominated the contract in US dollars, giving its locators who are mostly exporters a natural hedge on their power costs.

SEZ is currently bracing itself for the entry of the shipbuilding facilities of Hanjin Heavy Industries in the Redondo Peninsula. Once completed, this will make the Philippines the fourth largest shipbuilder in the world. Hanjin will also be SEZ's biggest customer, eventually growing to a total demand of 40 MW.

Generation Companies

In 2005, the combined income of the power generating companies rose to ₱1.05 billion, 36% higher than its combined contribution in 2004. The generation group produced a total of 1,022 Gwhrs, a 15% increase over the previous year.

AEV's hydro group will continue its efforts to develop and market renewable energy which has a marked price advantage. Being VAT zero-rated means lower costs to the ultimate consumer of this power.

Luzon Hydro Corporation (LHC) turned in a net income contribution of ₱806 million in 2005, up by 28% from the previous year. LHC generated 230 Gwhrs, an 8% reduction from 2004, mainly caused by lower rainfall and less available water.

In May 2005, LHC completed the US$3.5 million supplemental water project for its 70-MW Bakun AC plant. The project adds approximately 10 Gwhrs to the plant's annual production.

LHC cash flows remain very strong and continue to pay down its debt quite rapidly. From an original loan of $100 million, its debt at the end of 2005 stood at $29.8 million.

Hedcor, Inc. contributed ₱144 million, up by 161% from the previous year. This was mainly due to the increase in Hedcor's total power output by 11% to 146 Gwhrs and a 15% increase in the average selling price of its power. The average selling price of power in 2005 was ₱4.12 versus ₱3.59 in 2004.

In its efforts to streamline operations and its organization, AEV merged all of its mini-hydro electric power companies into one single unit - Hedcor, Inc. The following companies were involved in the merger that took place in June 2005: Benguet Hydropower Corporation (BHC), Hydro Electric Development Corp. (Hedcor) and Northern Mini Hydro Corp. (NMHC).

POWER GENERATION

■ Hedcor engineers surveying potential hydro sites. The company is currently developing two projects in Davao.

HEDCOR, INC.

Hedcor's contribution of **₱144 million** was a **161%** increase from 2004.

Results of operations

POWER GROUP

< Southern Philippines Power Corporation and Western Mindanao Power Corporation, now play an increasing role in supporting the Mindanao grid.

Hedcor, Inc. now has over ₱3.3 billion worth of generating assets under its umbrella and interests, which include 19 hydropower plants with a total installed capacity of 113 MW. The plants, eight of which are ISO 9001 and ISO 14001 certified, supply clean energy to customers in Benguet, Ilocos Sur, Pampanga, and Davao.

In January 2005, Hedcor took over the 3.5 MW-Talomo hydroelectric facility in Tugbok, Davao, making it the first NPC generation asset to be privatized. Hedcor is also currently developing two hydropower projects in Davao-the 42-MW plant in Sibulan and a 25.6-MW plant in Tamugan.

In July 2005, AEV and Norwegian company SN Power Invest AS (SN Power) agreed to jointly bid for the hydroelectric plants of NPC. SN Power was founded by two partners: Statkraft and the Norwegian Investment Fund for Developing Countries (Norfund). Statkraft is Europe's second largest producer of hydroelectric power, with ownership in more than 90 power plants having a total capacity of 12,000 MW.

Western Mindanao Power Corporation (WMPC) and **Southern Philippines Power Corporation (SPPC)** had a combined contribution of ₱86 million in 2005, up by 23% from the previous year. WMPC's power output increased by 31% from 305 Gwhrs in 2004 to 401 Gwhrs in 2005, while SPPC posted a 3% increase in generation producing 244 Gwhrs.

BANKING

- Higher brand awareness, a stronger sales culture, innovative products and services, and a more flexible IT platform have boosted UnionBank's fund generation business.

UNIONBANK OF THE PHILIPPINES

UnionBank deposits reached **₱60B** in 2005, **11%** higher than the previous year.

Results of operations

BANKING GROUP

UnionBank's new regional headquarters in Cebu City houses a branch office and a separate Business Class lounge for high net worth clients.

BANKING

The banking group's contribution to AEV's income in 2005 increased by 11% to ₱930 million, representing 27% of the total income contribution from the company's various business segments.

It was a milestone year for **UnionBank of the Philippines (UnionBank)** as it contributed ₱911 million, an 11% increase from the previous year's contribution. The bank's return on average equity increased to 15.4% in 2005 from 14.2% in 2004, while its return on average assets stood at 2.6%, the highest in the industry. Improved profitability was achieved on top of the 20% increase in provisions for loan losses of ₱421 million in 2005.

Total resources continued to expand ending the year at ₱108 billion, boosted by a 27% growth in the fund float business and the expansion in its regular deposits. Deposits reached ₱60 billion. Higher brand awareness, a stronger sales culture, innovative products & services, and a more flexible IT platform have been propping up UnionBank's fund generation business.

Strong internal capital generation pushed its equity base up 27% to ₱19.5 billion in 2005. UnionBank remained among the soundest banks in the industry with a credit risk-adjusted capital adequacy ratio of 46%.

UnionBank also had major achievements in 2005. The bank issued and operationalized 1.2 million GSIS e-cards nationwide. It simultaneously went live with the implementation of the Finacle core banking platform in all of its 112 branches nationwide. This new customer-centric open banking system is critical in realizing UnionBank's objective of having an IT platform that can support its various marketing groups while still remaining the low-cost producer of the industry. The migration from a mainframe legacy system to this new open system is a first in the Philippine banking industry.

BANKING

- **UnionBank doubled its customer base in 2005, reaching 2.1 million customers by yearend.**

UNIONBANK OF THE PHILIPPINES

UnionBank contributed

₱911M,

up **11%** from its 2004 contribution.

Results of operations

BANKING GROUP

In February 2005, UnionBank launched OneHub.Gov, the first integrated web service that enables corporations to pay online their obligations to government institutions such as the BIR, SSS, Philhealth, Pag-IBIG and the Bureau of Customs.

For the fourth time, www.unionbankph.com won the Best Banking and Finance Website award at the 8th Philippine Web Awards, and the People's Choice award for the fifth straight year.

UnionBank also moved to its new head office building at the Ortigas Center, Pasig City.

City Savings Bank (CSB) contributed ₱18 million to AEV's income in 2005, up by 11% from the previous year. CSB's return on equity improved to 20.3% in 2005 from 18.5% in 2004. Its return on assets stood at 4% in 2005.

Total deposits grew by 25% to ₱1.07 billion in 2005, allowing the bank to expand its loan portfolio to ₱860 million, up by 23%, and still maintaining a strong capital adequacy ratio that ended the year at 25.2%. At the end of 2005, the bank's resources reached ₱1.4 billion, a 20% increase from 2004. CSB continues to maintain high-quality assets as its non-performing loan portfolio decreased to 4.10% in 2005 from 5.26% in 2004.

CSB opened its new branch in Davao City in November 2005, bringing to 14 the total number of branches in the Visayas and Mindanao for both City Savings Bank and CSB Finance. With the issuance of a BSP circular lifting the moratorium on branch expansion, CSB is planning to open more branches where needed.

< UnionBank issued and operationalized 1.2 million GSIS e-cards nationwide in 2005. A first in the Philippines, the GSIS e-card is a multi-functional VISA debit-ATM-ID card for government employees.

TRANSPORT

SuperFerry's highly-trained officers and crew assure passengers of safe travel.

ABOITIZ TRANSPORT SYSTEM

Aboitiz Transport System carried
4.7M
passengers in 2005.

Results of operations

TRANSPORT GROUP

SuperFerry promises passengers a "happy trip".

TRANSPORT

In 2005, **Aboitiz Transport System Corporation (ATS)** contributed ₱32 million to AEV's bottom line, 1% of the total income contributed by AEV's business units. Higher fuel costs squeezed away ATS' margins and stiff competition did not allow the company to recover all its increased costs. The company focused on cutting costs where possible and selling its less efficient vessels, thus sacrificing market share for higher operating income.

In 2005, ATS' SuperFerries carried a total of 3.3 million passengers, down by 7% from the previous year. Freight volume also decreased by 10% to 285,905 TEUs (twenty equivalent units). Both freight and passage rates were increased at various times in 2005, including the implementation of a bunker surcharge.

The company embarked on various initiatives to end the year with a leaner yet more competitive transport group.

ATS reduced fuel consumption by operating vessels at optimal speed, thus lessening the impact of rising fuel prices.

To increase efficiencies, ATS disposed of its less productive assets by selling the Our Lady of Rosary and Super RORO 500. It also stopped operating the Our Lady of Fatima and the Our Lady of Guadalupe.

To maximize synergy, streamline operations and backroom processes, and increase its revenue base, ATS consolidated its transportation-related businesses by acquiring five affiliate companies in May 2005. The company acquired 100% of Aboitiz One, Inc., 62.5% of Aboitiz Jebsen Bulk Transport Corp., 62.5% of Aboitiz Jebsen Manpower Solutions, Inc., 62.5% of Jebsen Maritime, Inc., and 50% of Jebsen Management Ltd.

In the latter part of the year, the implementation of the expanded value added tax subjected ATS' passage revenues to 10% VAT instead of the 3% common carriers tax it used to pay the government, thus creating further burden to the company.

SuperCat Fast Ferry Corporation's (SFFC) operating profit was also significantly affected by the increase in fuel costs. Consequently, it contributed a loss of ₱2.8 million in 2005. With two operating vessels, the company transported 1.4 million passengers in 2005, down by 46% from 2004. SFFC embarked on a major rationalization in 2005, by reducing its number of operating vessels to two from seven in the previous year.

SFFC was awarded by SGS Philippines, Inc. for its implementation of the Quality Management System (QMS) in compliance with the requirements of ISO 9001:2000. The certification covers both the shipboard and shore-based processes.

FOOD

Under the government's Sangkap Pinoy Program, all Pilmico flour products are fortified with vitamin A and iron for better nutrition.

PILMICO FOODS CORPORATION

Pilmico contributed

382M,

a **13%** increase from 2004.

Results of operations

F O O D G R O U P

FOOD

The food group performed well in 2005 with all its units posting profits. **Pilmico Foods Corporation (PFC)** posted a 13% increase in income contribution to AEV, turning in ₱382 million in 2005. This represents 11% of the total income from AEV's business segments. Although volumes in the flour business were slightly down, margins were kept at similar levels to 2004.

PFC completed the expansion of its C-Mill in October 2005, adding 150 metric tons (MT) per day to its rated capacity, reducing utilization to 70% and allowing more time for preventive maintenance. The company is now poised to address any increase in the demand of its products.

Fil-Am Foods' sales grew nearly 38%, resulting in better operating margins. However, the company's 2005 net income of ₱121 million was 22% lower than in the previous year because of higher freight charges due to increased fuel costs, and the expiry of Fil-Am's income tax holiday.

The expanded Fil-Am Foods feed mill facility began operations in January 2005. The expansion doubled its capacity ending the year with a total annual feed milling capacity of 240,000 MT.

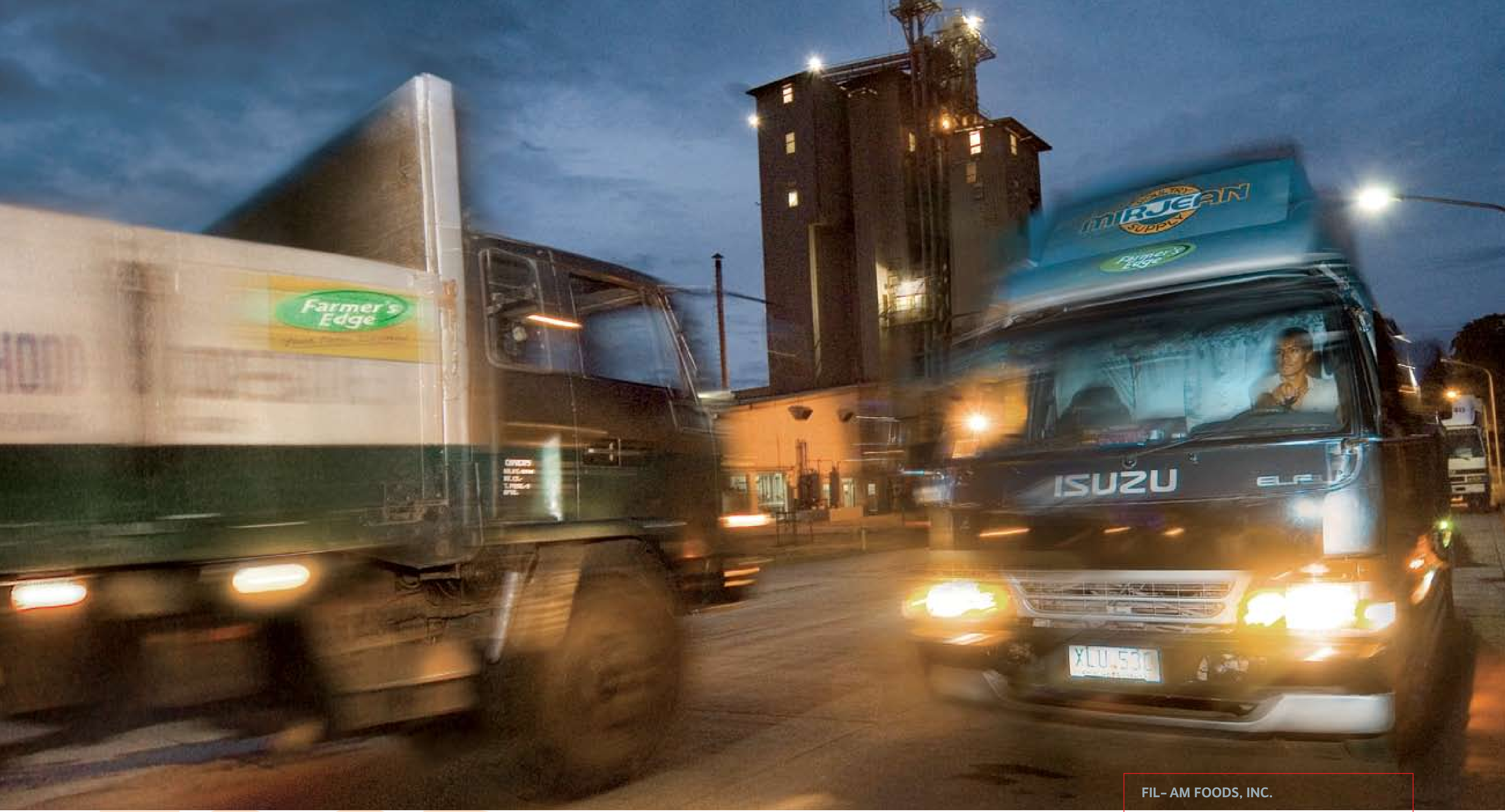
Pilmico's Iligan plant received its ISO 9001:2000 and Hazard Analysis Critical Control Point (HACCP) accreditation in 2005.

OTHER INVESTMENTS

The combined profit of AEV's other investments increased by 28% to ₱12 million in 2005.

We would like to take this opportunity to thank all AEV team members for their contributions and commitment to achieve the group's goals. To our shareholders, partners and other stakeholders, we thank you for your continued trust and confidence.

Erramon I. Aboitiz
EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER



FOOD

■ **Fil-Am Foods' sales grew nearly 38%, resulting in better operating margins.**

FIL- AM FOODS, INC.

Fil-Am Foods doubled its annual feed milling capacity to

240,000

metric tons in 2005.

Report to our Stockholders
from your Chief Financial Officer

Dear Shareholders and Friends,

The Year 2005 was the final transition year for the Philippines to adopt the International Financial Reporting Standards (IFRS). To prepare our teams to cope with the large number of changes and the complexity of the new accounting standards, SGV was commissioned to train the group in the implementation of these standards. This initiative paid off as it made the process much less difficult than we had anticipated.

I am happy to report that Aboitiz Equity Ventures (AEV) is fully compliant with the new standards, not only at the parent company level, but also across the whole group, including associate companies.

The company ended the year with a strong balance sheet, having a consolidated net debt-to-equity ratio of .38, and a current ratio of 1.29. The parent company received ₱1.65 billion in cash dividends throughout the year from its various subsidiaries and associate companies, more than sufficient to handle debt service, cash dividends, and operating expenses.

I am happy to report that your company is fully compliant with the new standards, not only at the parent company level, but also across the whole group, including affiliate companies.

Total cash dividends received increased by 31% over the year before, and we ended the year with ₱4.6 billion in cash and cash equivalents. Earnings before interest, taxes, depreciation and amortization (EBITDA) improved by 11% to ₱6.53 billion.

AEV's financial performance over the 5-year period from 2000 to 2005 is laudable. During this period, the percentage compounded annual growth rate (CAGR) in the following key financial measures were achieved:

• Total Revenues	19%
• Net Income	23%
• EBITDA	23%
• Market Capitalization	27%

Your company's market capitalization stood at ₱23.8 billion at the end of 2005.

In the first quarter of 2006, AEV secured a five-year term loan of ₱2.2 billion from several domestic banks. A number of new projects are planned for this year, and management felt it was prudent to build up its cash reserves in anticipation of these new projects, especially in light of the favorable interest rate environment. This is the initial phase of our capital raising program for the year, which may include a sale of treasury shares to the public.

We look at 2006 as a year of challenges, as the full effect of the value added tax and the high-energy-price environment take its toll on the consumer wallet. But we are also capitalizing on several opportunities that we are confident will add value to AEV in the medium term.

Stephen G. Paradies
SENIOR VICE PRESIDENT/CHIEF FINANCIAL OFFICER

Creating long-term value

Report to our Stockholders

from your Chief Compliance Officer

Commitment to Corporate Governance

Your company continues to uphold the values of integrity, trust and fairness to all our stakeholders–values that have remained the cornerstone for corporate governance of the Aboitiz Group for over a century now. Today, the Board of Directors, Management, Employees, and Shareholders of AEV operate with the conviction that good corporate governance is an integral part of the Aboitiz business model that constitutes the meaning of sound strategic business management. Hence, every effort will be taken to faithfully preserve this from generation to generation, as well as be responsive to the changing times.

Compliance with the Code

As reported in our 2002 annual report, your company started and formalized that year several good governance initiatives in compliance with the Securities & Exchange Commission's (SEC) Resolution No. 135. These initiatives included the submission of the Manual of Corporate Governance and the Anti-Money Laundering Statement of Policies and Procedures to the Philippine SEC; the implementation of a Code of Ethics and Business Conduct, the creation of the Audit and Nomination Committees; the appointment of independent directors using clear guidelines defining the qualifications and processes in electing directors for the company; and the appointment of a Compliance Officer tasked to monitor compliance with the provisions of the Corporate Governance Manual.

The manual standardizes best-practice good governance systems from among publicly listed companies to ensure a high degree of transparency, check and balance and accountability. It defines the basis for the selection, as well as the role and responsibilities, of the Compliance Officer, Board of Directors, Management and Executive Officers. The manual also defines how these offices are to work in a system such that they conform to the standards of good governance set by the SEC. Moreover, it requires the disclosure of Board members' interests, Independent Directors, key Board Committees, conflicts of interest, internal and external audit processes, stockholder's rights and interests, the responsibilities of management to communicate and update all stakeholders of all relevant corporate matters.

Board Governance

As in past years, the roles of the non-executive Chairman and the Chief Executive Officer are clearly defined, ensuring a balance of power and authority between the two. In 2005, Roberto E. Aboitiz was appointed as the new non-executive Chairman of AEV, replacing Luis M. Aboitiz Jr., who had served as Chairman since AEV went public in 1994. To strengthen the good governance process, a second Independent Director, Retired Justice Jose C. Vitug, was appointed in 2005. Once the sole Independent Director, Roberto R. Romulo continues to serve on the Board since his election in 2001.

Board Committees

The Board maintains four working committees: the Nomination Committee, the Compensation and Remuneration Committee, the Audit Committee and the Investor Relations Committee. The Nominations Committee reviews the profiles, duties and responsibilities of nominees for the Company's Board of Directors and key management positions for the ensuing year. Currently, its members are: AEV President Jon Ramon Aboitiz (Committee Chairman), AEV Chief Operating Officer Erramon I. Aboitiz, AEV Independent Director Roberto R. Romulo and AEV Senior Vice-President-Human Resources Xavier J. Aboitiz (ex-officio). The Compensation Committee sets the standard for a formal and transparent mechanism for developing the remuneration packages related to senior management and key personnel. Members of this Committee are: AEV President Jon Ramon Aboitiz (Committee Chairman), AEV Chairman of the Board Roberto E. Aboitiz and AEV Independent Director Jose C. Vitug. The Audit Committee oversees the Company's internal control, risk management, and financial reporting processes, including the adoption of the new International Accounting Standards (IAS). It is headed by AEV Independent Director Roberto R. Romulo with AEV Chairman Roberto E. Aboitiz and AEV Director Justo A. Ortiz as members. The Investor Relations Committee ensures that all shareholders have access to officially disclosed corporate and relevant information, and provides a mechanism for all reasonable queries as regards AEV and a feedback mechanism for all investors and stakeholders. Its members are AEV Chief Operating Officer Erramon I. Aboitiz (Committee Chairman), AEV President Jon Ramon Aboitiz, AEV Corporate Information Officer Stephen G. Paradies, AEV Compliance Officer and Corporate Secretary Jasmine Oporto, and AEV Vice-President-Corporate Communications Ferdinand T. Escobal.

Internal Control Environment

The Board is committed to maintaining a sound internal control structure to govern the manner in which the company and its employees conduct themselves. The key controls include the review of the roles and responsibilities of all key positions in the organization, and a review of organizational policies and procedures across the group. Also required are a strict adherence to an annual strategic plan review and a more frequent budget-performance monitoring. The Audit Committee also reviews the effectiveness of the internal control environment, and the risk management process in place.

M. Jasmine S. Oporto

Jasmine S. Oporto
CHIEF COMPLIANCE OFFICER

Delivering on our Promise

POWER

DISTRIBUTION

DAVAO LIGHT & POWER COMPANY

Davao Light's new 33-MVA mobile substation brings service reliability to a higher level.

Davao Light & Power Company

Power substation on wheels

In 2005, Davao Light took a big step forward in fulfilling its promise to provide total customer satisfaction with its acquisition of a new 33-MVA mobile substation to ensure continuous electricity service to customers.

Imported from Pauwels Contracting N.V. in Mechelen, Belgium, the ₱31-million fully equipped compact substation is mounted on semi-trailers making it possible to be transported from one place to another. It has the capability to rapidly integrate and easily form part of Davao Light's electric distribution system, which currently covers 21 substations.

The mobile substation is ideal to use when a permanent substation is out of service or under maintenance, to ensure uninterrupted power supply. It can also be used to transform power at locations such as large construction sites.

Delighting customers

"DLPC delivers prompt action and response to our service calls, is pro-active in preventive maintenance, voltage monitoring and energy consumption. We really hope that it would continue with the way it is handling our account and we look forward to working hand in hand with DLPC in improving both our businesses now and in the future. Thank you."

– Alberto G. Santos, Corporate Engineering Manager
New City Commercial Corporation, Davao City

A DLPC crew conducts meter testing using the Power Analyzer Tester (CALPORT 200) at the APL refrigerated container yard.

POWER

DISTRIBUTION

VISAYAN ELECTRIC COMPANY

A VECO team works round the clock.

Visayan Electric Company (VECO)

Partner in progress

As VECO enters its second century of serving the people of Metro Cebu, it renews its promise to be a responsive and active partner in the city's progress. The company is committed to reliable power supply, the continuous improvement of its customer service, and the upgrading of skills and equipment of its team.

State-of-the-art customer service

In February 2005, to improve its customer service, VECO opened a full service center at SM Cebu, which includes a Call Center utilizing a Voice Over Internet Protocol (VOIP) telephone system–today's state-of the-art in telephony.

The system allows customers to reach VECO through a single, easy to recall number, 230-VECO, where their inquiries are promptly attended to by courteous call center operators aided by an in-house developed custom software–the Customer Relation Management System (CRMS). The CRMS links and integrates into a history all transactions and records of each customer.

POWER

DISTRIBUTION

SUBIC ENERZONE CORPORATION

Subic EnerZone linemen energize the new Cubi Point substation.

Subic EnerZone Corporation (SEZ)

Aiming for world-class standards

In just two years, Subic Enerzone has transformed the Subic Bay Freeport Zone's electric distribution system and brought service delivery closer to world-class standards. Systems losses have been drastically reduced and service reliability, including emergency response, have dramatically improved. Infrastructure is staying ahead of growth.

In 2003, SEZ contractually committed to invest in fixed projects over five years to improve the power distribution system in Subic. It has completed all contractual infrastructure projects on time. To guarantee a more reliable and stable power supply, the company signed a Subtransmission Purchase Agreement in 2005 for TransCo's sub-transmission lines as well as for its 100-MVA 230KV substation.

SEZ's systems loss in 2005 dropped to 6.3% from 14.1% in October 2003 when the company took over the power distribution system from the Subic Bay Metropolitan Authority (SBMA). As a result, rates have since been reduced by 16 centavos per kilowatt-hour. SEZ expects systems losses to be further reduced as more infrastructure projects are brought on line.

Emergency response times are looking better with 80% of calls responded to within 30 minutes while outages have been reduced by more than half the number since 2003. To better serve its customers, the company moved into its brand new office in late 2005.

Subic EnerZone's new headquarters is a testament to the company's commitment to the Freeport Zone.

POWER

DISTRIBUTION

COTABATO LIGHT & POWER

Cotabato Light linemen doing maintenance work on facilities near an Islamic school and a mosque in Sultan Kudarat.

Aboitiz Power Solutions, Inc. (APSI)

> Delivering integrated customer solutions

APSI consistently delivers on its promise to provide integrated customer solutions that reduce power costs, promotes energy efficiency and improves the electrical system performance of industrial, commercial, and electric cooperative customers.

An APSI engineer installs capacitor banks to improve the electrical system of an industrial client. >

POWER

ABOITIZ POWER SOLUTIONS, INC.

POWER GENERATION

LUZON HYDRO CORPORATION

Clean, renewable and environmentally friendly energy is generated from the waters of the Bakun River and the Kayapa Creek, Luzon Hydro's newly-commissioned supplemental water project that will add 10 Gwhrs of new energy annually.

Luzon Hydro Corporation (LHC)

> In the forefront of renewable energy production

Luzon Hydro is in the forefront of hydro power generation in the Philippines. Applying best practices in the operations and maintenance of its 70-MW Bakun AC power plant, the company has contributed significantly to the production of renewable energy in the country.

Since the start of operations, LHC has produced a total of 1,100 gigawatt-hours of clean energy, sparing the environment the equivalent discharge of 605,000 tons of carbon dioxide had a coal-fired plant produced the same energy. It has saved the country from importing 1,833,700 barrels of oil, which, using the May 2006 price of sweet light crude of around $75/barrel in New York, means a savings in foreign exchange of US$ 137,527,500.

The Bakun AC Plant uses a newly upgraded monitoring and control system for a more reliable and efficient operations. >

POWER GENERATION

HEDCOR, INC.

Hedcor leads in the development of clean and renewable energy, always on the lookout for fresh opportunities and new hydropower sources.

Hedcor, Inc.

Committed to produce clean energy for Mindanao

With Mindanao's demand for energy growing, Hedcor, Inc. is gearing up to help avert an impending power crisis in the region. The largest private mini-hydro developer in the Philippines, the company is currently working on two projects In Davao: the 42.5-MW Sibulan and the 25.6-MW Tamugan-Suawan plants.

The deregulation of the power industry with the enactment of the Electric Power Industry Reform Act of 2001, prompted Hedcor to start the study on the Sibulan hydro potential in March 2003. The project, which consists of two plants, will tap the waters of the Sibulan and Baroring Rivers. Estimated to cost ₱4 billon, the plants are expected to generate 230 million kwhrs of clean energy annually for the Mindanao grid. Target completion is 2009.

The Tamugan-Suawan project also consists of two plants tapping the waters of the Tamugan and Suawan Rivers. The ₱3.5-billion project, which is expected to generate 168 million kwhrs annually, will be completed in 2009.

Both projects will use the run-of-river system, wherein there is no need to impound water, flood vast tracks of land, or displace people in order to generate energy. The natural flow of the river is used and water is diverted to the plant.

Meanwhile, Hedcor's 3.5-MW Talomo facility in Davao, the first NPC generation asset to be privatized and turned over to the company in January 2005, has been rehabilitated and sells its power to Davao Light and Power Company.

Hedcor's Talomo plant in Davao sells its power output to Davao Light.

BANKING

UNIONBANK OF THE PHILIPPINES

A UnionBank Relationship Manager attends to a high net worth client.

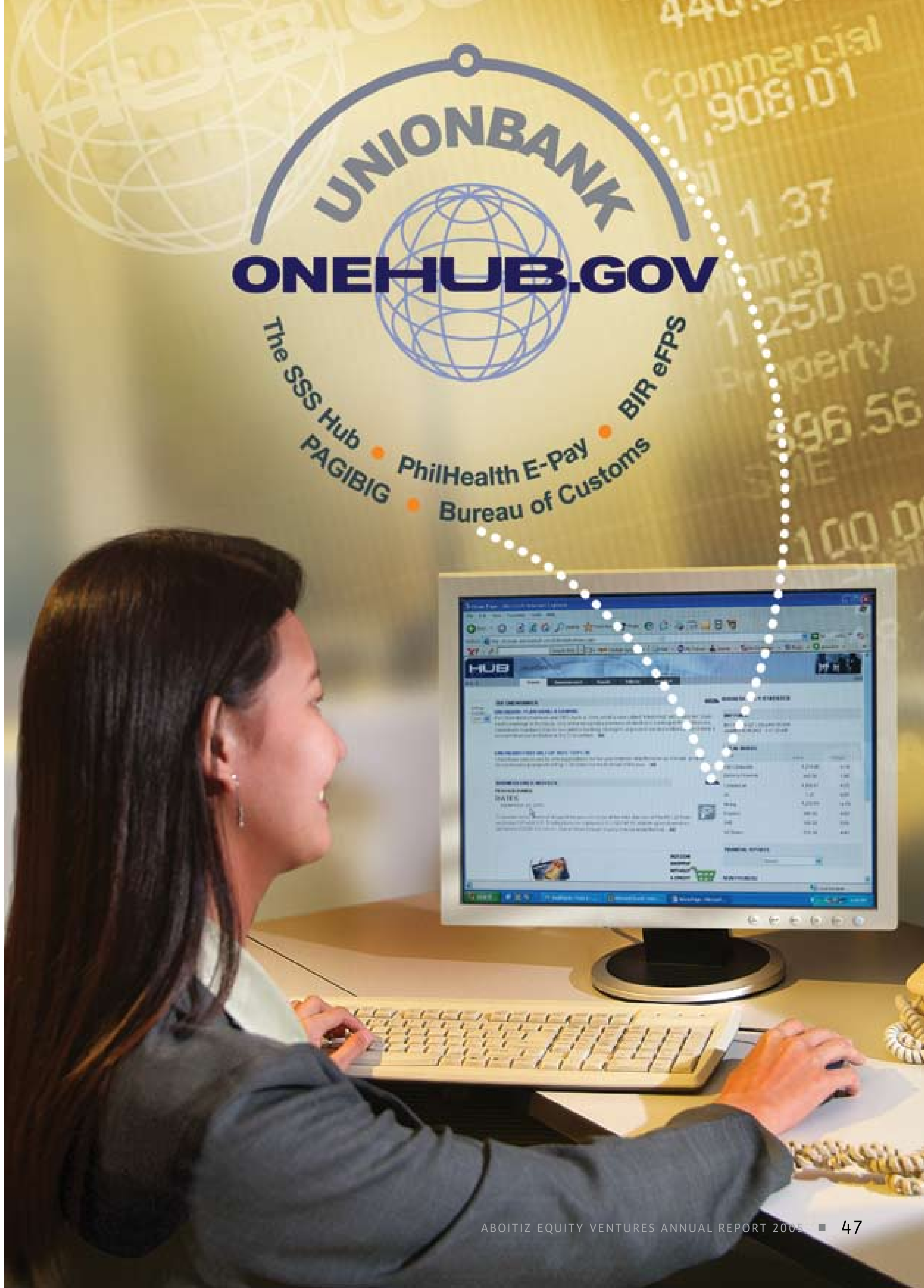
UnionBank

OneHub.Gov: Linking customers to government services >

In February 2005, UnionBank launched OneHub.Gov, in line with the bank's continued commitment to be a vital link to government's e-initiatives by providing the essential settlement and payment gateway facility.

OneHub.Gov is the first integrated web platform that enables corporations to pay their obligations with the BIR, SSS, Philhealth, Pag-Ibig and the Bureau of Customs. Accessible at onehub.gov.unionbankph.com, clients simply log in to file their premium contributions, loan payments, tax returns, and view and settle all pending payments online. With OneHub.Gov, online transactions and financial settlements become simple, fast, reliable, efficient and cost effective.

The portal also offers sophisticated features such as post authorization for time or date specified, and an e-payment history that is available online for three months. It also allows users to view all pending payments on a single screen. An auto e-mail reminder and confirmation of e-payments are also sent to users. OneHub.Gov utilizes the 256-bit SSL encryption and Verisign® certification for UnionBank's servers that assure clients of safe and secure transactions.



FOOD

PILMICO FOODS CORPORATION

With its steadfast commitment to establish long-term customer relationships, Pilmico has deployed a large sales force all over the country to provide responsive technical and after-sales support services to its valued clientele.

Pilmico

Towards becoming a world-class company >

Pilmico Foods Corporation and Pilmico Mauri Foods Corporation have joined the ranks of world-class organizations as they are now ISO 9001:2000- and HACCP-certified.

Hazard Analysis Critical Control Point (HACCP) is a system that identifies, evaluates and controls hazards that are significant to food safety. This safety tool examines every step in food operations, identifying specific hazards as well as implementing effective control measures and verification procedures.

The two certifications are testaments to Pilmico's commitment to deliver on its promise to pursue world-class standards.

A Pilmico laboratory technician inspects the Brabender Extensograph Machine used to check flour samples to determine the extensibility and elasticity of dough. >

TRANSPORT

ABOITIZ TRANSPORT SYSTEM

The RoRo system guarantees the flexibility of cargo movement through the use of trucks.

Aboitiz Transport System

2GO: Giving customers the power of choice >

①③⑥™ This leadtime-based service aims to give control to customers by giving them the power of choice. They can efficiently plan their order-to-delivery schedules to meet their need and requirements.

Customers can choose to get their cargo to its destination within 1, 3, 6 days. Rates are flexible based on the leadtime requirements.

Utilizing its nationwide fleet of aircraft, sea vessels, delivery vehicles and equipment, only 2GO has the infrastructure that enables it to deliver on its ①③⑥ promise.

The pioneer in leadtime-based service, this service has redefined the movement of loose cargo nationwide.

RoRo This self-driven service gives customers control over the movement of their goods, including priority loading, resulting in faster delivery leadtime and reduced costs. It also simplifies the transportation process and rate structure. The 15-phase containerized process is reduced to 3 easy steps: pick up at warehouse, loading into the vessel, unloading and direct delivery to the customer.

RoRo guarantees the flexibility of cargo movement through the use of trucks. After pick-up from the client's warehouse, trucks are directly loaded into the vessel two hours before departure. Upon reaching its destination, the trucks are the first to be unloaded and delivered straight to its recipient an hour after the vessel arrives.

This system, which reduces the travel time of produce coming from Mindanao and Visayas to 3 days from the usual 6 days, delivers the freshest and most affordable goods at the fastest possible time.

CORPORATE SOCIAL RESPONSIBILITY

The Aboitiz Group Foundation allocates more than 50 percent of its annual budget to support education-related initiatives. The Foundation has hundreds of scholars, including those from the Science & Technology Center (STEC) in Cebu, the highest-rated public high school in the province.

Aboitiz Group Foundation, Inc.

Helping people help themselves

In 2005, the Aboitiz Group Foundation, Inc. (AGFI) continued to focus on implementing programs that created the most impact on the lives of its beneficiaries. It actively worked in the areas of Education, Enterprise Development, and Primary Health and Childcare.

As in previous years, the Foundation allocated more than 50 percent of its annual budget to support education-related initiatives, considering these programs as social investments whose real benefits will accrue more to the next generation of Filipinos. Preparing the next generation is imperative if we expect our country to progress and uplift the general standard of living of its people.

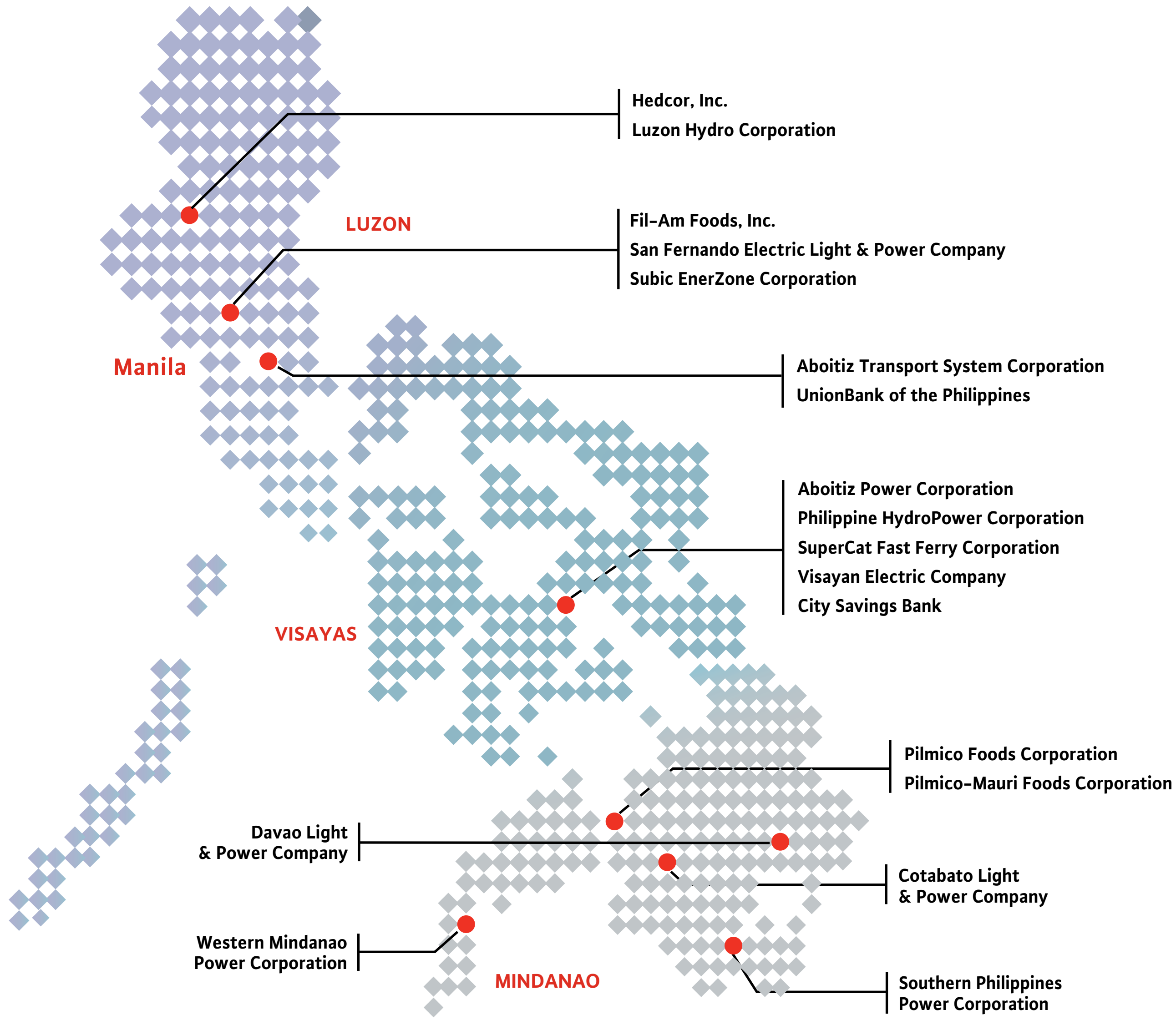
The Aboitiz corporate ethos stresses the importance of sharing with the less unfortunate, but in working with its partners, the Foundation likewise emphasizes that all are stakeholders with obligations to these donations.

According to AGFI president Erramon Aboitiz, the Foundation is being true to its mission of “helping people help themselves,” of “teaching people how to fish, rather than just feeding them”.

AGFI will pursue its mission by making possible a process not only to transmit knowledge but more importantly to transform people sharing a common vision for the common good.

AGFI project officers visit members of the Lusaran Alayon Farmers Multi-purpose Cooperative at the coop's training center. The Foundation's loan assistance helps farmers' groups meet their capital build-up requirements. >

Location of Operations



Corporate Structure

	(in %)
POWER	
Distribution companies:	
Davao Light & Power Company	99.9
Cotabato Light & Power Company	99.9
Visayan Electric Company	54.7
San Fernando Electric Light & Power Company	43.8
Subic EnerZone Corporation	64.3
Aboitiz PowerSolutions, Inc.	100.0
Generation companies:	
Aboitiz Power Corporation	100.0
Philippine HydroPower Corporation	100.0
Hedcor, Inc.	100.0
Luzon Hydro Corporation	50.0
Western Mindanao Power Corporation	20.0
Southern Philippines Power Corporation	20.0
BANKING	
UnionBank of the Philippines	42.1
City Savings Bank	34.4
TRANSPORT	
Aboitiz Transport System Corporation	76.1
SuperCat Fast Ferry Corproration	49.7
FOOD	
Pilmico Foods Corporation	100.0
Fil-Am Foods, Inc.	100.0
Pilmico-Mauri Foods Corporation	50.0
PORTFOLIO INVESTMENTS	
AEV Aviation, Inc.	100.0
Cebu Praedia Dev. Corporation	100.0
Cebu International Container Terminal*	20.0

*No commercial operations

Board of Directors

Roberto E. Aboitiz
CHAIRMAN OF THE BOARD

Jon Ramon M. Aboitiz
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Erramon I. Aboitiz
EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER

Enrique M. Aboitiz, Jr.
DIRECTOR

Justo A. Ortiz
DIRECTOR

Roberto R. Romulo
INDEPENDENT DIRECTOR
CHAIRMAN OF THE AUDIT COMMITTEE

Jose C. Vitug
INDEPENDENT DIRECTOR

Corporate Officers

Stephen G. Paradies
SENIOR VICE PRESIDENT/ CHIEF FINANCIAL OFFICER

Juan Antonio E. Bernad
SENIOR VICE PRESIDENT– ELECTRICITY REGULATORY AFFAIRS

Mikel A. Aboitiz
SENIOR VICE PRESIDENT – CHIEF INFORMATION OFFICER

Xavier J. Aboitiz
SENIOR VICE PRESIDENT – HUMAN RESOURCES

Gabriel T. Mañalac
FIRST VICE PRESIDENT – TREASURY SERVICES

Luis Miguel O. Aboitiz
FIRST VICE PRESIDENT

Jasmine S. Oporto
FIRST VICE PRESIDENT – LEGAL /CORPORATE SECRETARY / CHIEF COMPLIANCE OFFICER

Benjamin A. Cariaso, Jr.
VICE PRESIDENT – BUSINESS DEVELOPMENT

Corporate Officers

Ferdinand T. Escobal
VICE PRESIDENT – CORPORATE COMMUNICATIONS

Melinda Rivera-Bathan
VICE PRESIDENT/ COMPTROLLER

Elsa R. Divinagracia
ASSISTANT CORPORATE SECRETARY

Nancy S. Lim
ASSISTANT VICE PRESIDENT – HUMAN RESOURCES

Delia Y. Maderazo
ASSISTANT VICE PRESIDENT –*i*CSD

Stella Olive Sucalit
ASSISTANT VICE PRESIDENT – CORPORATE FINANCE

Caroline Ballesteros
ASSISTANT VICE PRESIDENT – BRANDING

Financial Statements

SGV & Co

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

Phone: (632) 891-0307
Fax: (632) 819-0872
www.sgv.com.ph

BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-F

Report of Independent Auditors

The Stockholders and the Board of Directors
Aboitiz Equity Ventures, Inc.
Aboitiz Corporate Center
Gov. Manuel A. Cuenco Avenue, Cebu City

We have audited the accompanying consolidated balance sheets of Aboitiz Equity Ventures, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Philippine Hydropower Corporation and Subsidiaries, Aboitiz Powersolutions, Inc., Cebu Praedia Development Corporation, AEV Aviation Inc., and Jebsen Management (BVI) Limited and Subsidiaries, which statements reflect total assets and total revenues of 12.4% and 10.7% in 2005 and 9.9% and 2.6% in 2004, respectively, of the related consolidated totals. Also, we did not audit the financial statements of Visayan Electric Company, Inc. and City Savings Bank the investments in which represent 7.0% and 7.2% of the total consolidated assets as of December 31, 2005 and 2004, respectively, and the Group's equity in net earnings represents 5.5% and 1.1% of the net income for 2005 and 2004, respectively. Those statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based solely on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aboitiz Equity Ventures, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the Philippines.

SYCIP GORRES VELAYO & CO.

Ladislao Z. Avila Jr.

Ladislao Z. Avila, Jr.
Partner
CPA Certificate No. 69099
SEC Accreditation No. 0111-A
Tax Identification No. 109-247-891
PTR No. 4180807, January 2, 2006, Makati City

April 5, 2006

Statement of Management's Responsibility for Financial Statements

SECURITIES & EXCHANGE COMMISSION
SEC Building, EDSA Greenhills
Mandaluyong, Metro Manila

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

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

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

SyCip, Gorres, Velayo & Co., the independent auditors appointed by the stockholders and the Board of Directors, have examined the consolidated financial statements of the Company in accordance with auditing standards generally accepted in the Philippines and have expressed their opinion on the fairness of presentation upon completion of such examination in its report to the Board of Directors and stockholders.

ROBERTO E. ABOITIZ	JON RAMON M. ABOITIZ	STEPHEN G. PARADIES
Chairman of the Board	President & Chief Executive Officer	SVP – Chief Finance Officer
CTC No. 08280953	CTC No. 21142423	CTC No. 08317215
Date/Place Issued: 01/24/06; Cebu City	Date/Place Issued: 02/07/06; Cebu City	Date/Place Issued: 02/16/06; Cebu City

Republic of the Philippines)
City of Cebu ....) S.S.

SUBSCRIBED AND SWORN TO before me this April 18, 2006 in the City of Cebu, Philippines. Affiants exhibited to me their respective Community Tax Certificates with details shown above.

Doc. No. 271 ;
Page No. 56;
Book No. 5;
Series of 2006.

ELSA R. DIVINAGRACIA
Notary Public
Until December 31, 2007
PTR No. 5102481/Cebu City/01.10.06
IBP Lifetime Membership No. 01766 Roll No. 34032

ABOITIZ EQUITY VENTURES, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Amounts in Thousands)

	December 31	
	2005	2004 (As restated, Notes 2 and 3)
ASSETS		
Current Assets		
Cash and cash equivalents (Notes 4 and 27)	**₱4,622,676**	₱4,567,791
Trade and other receivables – net (Notes 5 and 27)	**3,367,854**	3,609,651
Inventories – net (Notes 6 and 8)	**1,376,383**	1,325,806
Other current assets (Note 7)	**904,667**	718,770
Total Current Assets	**10,271,580**	10,222,018
Noncurrent Assets		
Property, plant and equipment – net (Notes 9 and 17)	**11,203,404**	11,046,720
Investment properties	**391,860**	418,444
Investments and advances (Note 11)	**14,504,622**	13,248,293
Available-for-sale (AFS) investments	**149,835**	–
Goodwill (Note 12)	**784,883**	784,831
Pension asset (Note 13)	**45,414**	34,806
Deferred income tax assets (Note 26)	**317,185**	244,731
Other noncurrent assets (Note 14)	**573,923**	592,733
Total Noncurrent Assets	**27,971,126**	26,370,558
TOTAL ASSETS	**₱38,242,706**	₱36,592,576
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Bank loans (Note 15)	**₱1,299,353**	₱1,982,710
Trade and other payables (Note 16)	**4,595,416**	3,925,927
Dividends payable	**16,147**	14,228
Income tax payable	**142,103**	215,600
Current portion of long-term debt (Note 17)	**1,756,246**	1,568,790
Current portion of obligations under finance lease (Notes 9 and 19)	**140,393**	134,273
Total Current Liabilities	**7,949,658**	7,841,528

	December 31	
	2005	2004 (As restated, Notes 2 and 3)
Noncurrent Liabilities		
Long-term debt – net of current portion (Note 17)	**5,810,786**	7,106,929
Obligations under finance lease – net of current portion (Notes 9 and 19)	**210,490**	372,566
Customers' deposits (Note 18)	**1,016,253**	911,893
Redeemable preferred shares (Note 20)	**1,886,940**	–
Pension liability (Note 13)	**40,863**	27,859
Deferred income tax liability (Note 26)	**21,253**	77,240
Total Noncurrent Liabilities	**8,986,585**	8,496,487
Equity Attributable to Equity Holders of the Parent		
Capital stock (Note 20)	**5,694,600**	5,881,300
Additional paid-in capital	**1,201,051**	2,466,792
Net unrealized gain on AFS	**1,656**	–
Unrealized losses on noncurrent marketable equity securities	**–**	(1,024)
Cumulative translation adjustments	**(2,097)**	–
Share in cumulative translation adjustments of associates	**452,617**	639,242
Share in net unrealized gains (losses) on AFS investments and underwriting accounts of an associate (Note 11)	**122,290**	(383,473)
Retained earnings (Note 21)	**14,234,479**	12,203,380
Treasury stock at cost	**(1,576,463)**	(1,710,084)
	20,128,133	19,096,133
Minority interests	**1,178,330**	1,158,428
Total Stockholders' Equity	**21,306,463**	20,254,561
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**₱38,242,706**	₱36,592,576

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

(Amounts in Thousands, Except Per Share Amounts)

	Years Ended December 31	
	2005	2004 (As restated, Notes 2 and 3)
REVENUES		
Sale of:		
Power and electricity (Note 22)	**₱8,106,300**	₱6,583,131
Goods	**7,037,184**	6,168,828
Freight – net	**6,036,995**	4,307,115
Passage	**3,613,667**	3,733,132
Service fees	**1,402,563**	1,459,255
Others	**726,115**	159,463
	26,922,824	22,410,924
COST AND EXPENSES (Note 23)		
Operating expenses	**9,946,932**	7,708,747
Cost of goods sold	**6,020,658**	5,393,761
Cost of purchased power	**5,217,348**	4,093,411
Overhead expenses	**1,546,014**	1,436,009
Terminal expenses	**1,225,752**	1,108,354
Depreciation of ships	**824,070**	860,053
	24,780,774	20,600,335
GROSS PROFIT	**2,142,050**	1,810,589
Share in net earnings of associates (Note 11)	**2,155,343**	1,532,131
Interest income	**244,744**	217,041
Interest expense (Notes 15, 17, 18, and 19)	**(1,256,738)**	(1,144,898)
Other income (Note 25)	**400,663**	821,467
INCOME BEFORE INCOME TAX	**3,686,062**	3,236,330
PROVISION FOR INCOME TAX (Note 26)	**468,569**	531,113
NET INCOME	**₱3,217,493**	₱2,705,217
ATTRIBUTABLE TO:		
Equity holders of the parent	**₱3,159,132**	₱2,542,887
Minority interests	**58,361**	162,330
	₱3,217,493	₱2,705,217

EARNINGS PER SHARE (Note 32)		
Basic, for income for the year attributable to ordinary equity holders of the parent	**₱0.651**	₱0.527
Diluted, for income for the year attributable to ordinary equity holders of the parent	**₱0.651**	₱0.527

See accompanying Notes to Consolidated Financial Statements.

ABOITIZ EQUITY VENTURES, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

(Amounts in Thousands)

	Attributable to equity holders of the parent											
	Capital Stock											
	Common	Preferred	Additional Paid-in Capital	Net Unrealized Gain on AFS	Unrealized Losses on Noncurrent Marketable Equity Securities	Cumulative Translation Adjustments	Share in Cumulative Translation Adjustments of Associates	Share in Net Unrealized Gains (Losses) on AFS Investments and Underwriting Accounts and of an Associate	Retained Earnings	Treasury Stock	Minority Interests	Total
Balance at January 1, 2004, as previously stated	₱5,694,600	₱100,000	₱2,100,640	₱–	₱–	₱–	₱–	(₱320,707)	₱10,690,878	(₱1,707,985)	₱312,908	₱16,870,334
Effects of adoption of new accounting standards (Note 3)	–	–	–	–	–	–	639,242	–	(312,075)	–	906	328,073
Effect of reorganization of transport group (Note 10)			(414,148)	–	(1,024)	–	–		(130,516)	–	682,284	136,596
Balances at January 1, 2004, as restated	5,694,600	100,000	1,686,492	–	(1,024)	–	639,242	(320,707)	10,248,287	(1,707,985)	996,098	17,335,003
Net income for the year, as restated	–	–	–	–	–	–	–	–	2,542,887	–	162,330	2,705,217
Issuance of capital stock		86,700	780,300	–	–	–	–			–	–	867,000
Cash dividends												
Common – ₱0.12 per share	–	–	–	–	–	–	–	–	(497,280)	–	–	(497,280)
Preferred – ₱0.73 per share	–	–	–	–	–	–	–	–	(90,514)	–	–	(90,514)
Share in unrealized loss on AFS of an associate	–	–	–	–	–	–	–	(62,766)	–	–	–	(62,766)
Purchase of treasury shares	–	–	–	–	–	–	–	–	–	(2,099)	–	(2,099)
Balances at December 31, 2004, as restated	₱5,694,600	₱186,700	₱2,466,792	₱–	(₱1,024)	₱ –	₱639,242	(₱383,473)	₱12,203,380	(₱1,710,084)	₱1,158,428	₱20,254,561
Balances at December 31, 2004, as previously stated	₱5,694,600	₱186,700	₱2,880,940	₱–	₱–	₱–	₱–	(₱383,473)	₱12,524,858	(₱1,710,084)	₱352,455	₱19,545,996
Effect of reorganization of transport group (Note 10)	–	–	(414,148)	–	(1,024)	–	–	–	(51,567)	–	804,975	338,236
Effects of adoption of new accounting standards (Note 3)	–	–	–	–	–	–	639,242	–	(269,911)	–	998	370,329
Balances at December 3 1, 2004, as restated	₱5,694,600	₱186,700	₱2,466,792	₱–	(₱1,024)	₱–	₱639,242	(₱383,473)	₱12,203,380	(₱1,710,084)	₱1,158,428	₱20,254,561
Effects of adoption of PAS 39 (Note 3)	–	(186,700)	(1,680,300)	(1,024)	1,024	–	–	–	(461,232)	–	(28,748)	(2,356,980)
Balances at January 1, 2005	5,694,600	–	786,492	(1,024)	–	–	639,242	(383,473)	11,742,148	(1,710,084)	1,129,580	17,897,581
Net income for the year	–	–	–	–	–	–	–	–	3,159,132	–	58,361	3,217,493
Movement of unrealized valuation gains of AFS investments	–	–	–	2,680	–	–	–	–	–	–	985	3,665
Movement of cumulative translation adjustments	–	–	–	–	–	(2,097)	–	–	–	–	(659)	(2,756)
Total recognized income for the year	–	–	–	2,680	–	(2,097)	–	–	3,159,132	–	58,687	3,218,402
Effects of reorganization of transport group (Note 10)	–	–	94,515	–	–	–	–	–	(70,199)	–	(10,037)	14,279
Sale of treasury shares	–	–	320,044	–	–	–	–	–	–	133,621	–	453,665
Cash dividends	–	–	–	–	–	–	–	–	(596,602)	–	–	(596,602)
Share in unrealized valuation gains on AFS investments of an associate	–	–	–	–	–	–	–	505,763	–	–	–	505,763
Share in movement of cumulative translation adjustment of an associate	–	–	–	–	–	–	(186,625)	–	–	–	–	(186,625)
Balances at December 31, 2005	₱5,694,600	₱–	₱1,201,051	₱1,656	₱–	(₱ 2,097)	₱452,617	₱122,290	₱14,234,479	(₱1,576,463)	₱1,178,330	₱21,306,463

See accompanying Notes to Consolidated Financial Statements.

ABOITIZ EQUITY VENTURES, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Amounts in Thousands)

	Years Ended December 31	
	2005	2004 (As restated, Notes 2 and 3)
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	**₱3,686,062**	₱3,236,330
Adjustments for:		
Depreciation	**1,829,003**	1,760,634
Interest expense	**1,256,738**	1,144,898
Franchise tax expense	**145,450**	108,937
Share in net earnings of associates	**(2,155,343)**	(1,532,131)
Gain on sale of:		
Property and equipment	**(99,662)**	(420,653)
Marketable equity securities	**–**	(15,696)
Interest income	**(244,744)**	(217,041)
Unrealized foreign exchange loss (gain)	**100,865**	(19,368)
Unrealized gain on recovery of marketable equity securities	**–**	(11,661)
Operating income before working capital changes	**4,518,369**	4,034,249
Increase in:		
Trade and other receivables	**(1,105)**	(1,346,948)
Inventories	**(50,577)**	(477,118)
Other current assets	**(185,897)**	(403,378)
Pension asset	**(10,608)**	–
Increase in:		
Trade and other payables	**339,738**	1,335,732
Customers' deposits	**104,360**	82,783
Pension liability	**13,004**	–
Net cash generated from operations	**4,727,284**	3,225,320
Interest paid	**(927,325)**	(1,102,422)
Income and final taxes paid	**(693,982)**	(417,620)
Franchise taxes paid	**(145,112)**	(98,058)
Net cash flows from operating activities	**2,960,865**	1,607,220

(Forward)

	Years Ended December 31	
	2005	2004 (As restated, Notes 2 and 3)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of property and equipment	**₱166,692**	₱1,559,274
Dividends received	**734,104**	687,132
Interest received	**485,436**	163,943
Proceeds from sale of marketable equity securities	**–**	26,763
Cash of newly acquired subsidiary	**308,750**	–
Investment property	**26,584**	–
Reductions in (additions to):		
Investments and noncurrent advances to associates	**934**	(41,773)
Property, plant and equipment	**(2,019,572)**	(2,959,458)
Available for sale investments	**(97,193)**	–
Decrease (increase) in:		
Other noncurrent assets	**(315,333)**	(287,493)
Marketable equity securities	**–**	58
Net cash flows used in investing activities	**(709,598)**	(851,554)
CASH FLOWS FROM FINANCING ACTIVITIES		
Reissuance (acquisition) of treasury shares	**454,738**	(2,099)
Net proceeds from (payments of):		
Long-term debt	**(1,108,687)**	(483,402)
Bank loans	**(683,357)**	518,507
Cash dividends paid	**(594,683)**	(578,356)
Payments of obligations under capital lease	**(155,956)**	–
Increase (decrease) in minority interest	**19,902**	(722)
Proceeds from issuance of capital stock	**–**	867,000
Net cash flows from (used in) financing activities	**(2,068,043)**	320,928
NET INCREASE IN CASH AND CASH EQUIVALENTS	**183,224**	1,076,594
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(128,339)**	21,736
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**4,567,791**	3,469,461
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱4,622,676**	₱4,567,791

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

1. Corporate Information

Aboitiz Equity Ventures, Inc. (the Company) and its subsidiaries (collectively referred to as "the Group") were incorporated in the Republic of the Philippines. The Company is the publicly-listed holding and management company of the Group. The Group is engaged in various business activities mainly in the Philippines, including power generation and distribution, food manufacturing, banking and financial services, and transportation (see Note 34). The registered office address of the Company is Aboitiz Corporate Center, Gov. Manuel A. Cuenco Avenue, Cebu City.

The consolidated financial statements of the Group as of and for the years ended December 31, 2005 and 2004, were authorized for issue by the Board of Directors (BOD) of the Company on April 5, 2006.

2. Basis of Preparation

General Basis

The consolidated financial statements of the Group have been prepared in conformity with accounting principles generally accepted in the Philippines as set forth in Philippine Financial Reporting Standards (PFRS). PFRS comprise standards named PFRS and Philippine Accounting Standards (PAS) and Interpretations issued by the Philippine Accounting Standards Council. These are the Group's first financial statements prepared in conformity with PFRS.

The Group prepared its consolidated financial statements until December 31, 2004 in conformity with Statements of Financial Accounting Standards (SFAS) and Statements of Financial Accounting Standards/International Accounting Standards (SFAS/IAS).

The Group applied PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*, in preparing the consolidated financial statements, with January 1, 2004 as the date of transition. The Group applied the accounting policies set forth below to all the years presented except those pertaining to financial instruments. An explanation of how the adoption of PFRS has affected the reported financial position, financial performance and cash flows of the Group is provided in Note 3.

The consolidated financial statements of the Group have been prepared on a historical cost basis, except for available-for-sale investments and derivatives which are measured at fair value. The consolidated financial statements are presented in Philippine peso and all values are rounded to the nearest thousand except as otherwise indicated.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of Aboitiz Equity Ventures, Inc. and its subsidiaries as at 31 December of each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group 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 Group obtains control, and continue to be consolidated until the date that such control ceases.

Minority interests represent the portion of profit or loss and net assets in the subsidiaries not held by the Group and are presented separately in the consolidated statements of income and within stockholders' equity in the consolidated balance sheets, separately from the equity attributable to equity holders of the parent.

Significant Accounting Judgments and Estimates

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:

Functional currency

Based on the economic substance of the underlying circumstances relevant to the Group, the functional currency of the Group has been determined to be the Philippine peso. The Philippine peso is the currency of the primary economic environment in which the Group operates. It is the currency that mainly influences the sale of goods and services and the costs of manufacturing and selling the goods and the rendering of services.

Operating lease commitments - Group as lessor

The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

Biological assets

In applying PAS 41, *Agriculture,* the Group has made a judgment that market-determined prices or values of bearers and growing stocks are not available and for which alternative estimates of their fair values are clearly unreliable and, accordingly, measured such biological assets at accumulated cost less any accumulated depreciation and accumulated impairment losses. These biological assets amount to ₱69,182 as of December 31, 2005 and ₱57,745 as of December 31, 2004 (see Note 8).

Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty 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.

Estimating allowances for doubtful accounts

The Group's allowance for doubtful accounts relates substantially to trade receivables. The Group evaluates specific accounts where the Group has information that certain customers are unable to meet their financial obligations. Factors such as the Group's length of relationship with the customers and the customers' current credit status are considered to determine the amount of reserves that will be recorded in the trade receivables account. These reserves are re-evaluated and adjusted as additional information becomes available. Allowance for doubtful accounts as of December 31, 2005 and 2004 amounted to ₱324,071 and ₱298,022, respectively. Trade receivables, net of valuation allowance, amounted to ₱2,567,658 and ₱2,586,158 as of December 31, 2005 and 2004, respectively (see Note 5).

Allowance for possible losses of investments and advances to associates

Investments are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amounts of the investments amounted to ₱14,504,622 and ₱13,248,293 as of December 31, 2005 and 2004, respectively. The allowance for impairment loss amounted to ₱28,995 as of December 31, 2005 and 2004 (see Note 11).

Estimating allowance for inventory obsolescence

The Group estimates the allowance for inventory obsolescence based on the age of inventories. The amounts and timing of recorded expenses for any period would differ if different judgments or different estimates are made. An increase in allowance for inventory obsolescence would increase recorded expenses and decrease current assets. As of December 31, 2005 and 2004, allowance for inventory obsolescence amounted to ₱1,643 and ₱1,505, respectively. The carrying amount of the inventories, net of valuation allowance, amounted to ₱1,376,383 and ₱1,325,806 as of December 31, 2005 and 2004 respectively (see Note 6).

Deferred income tax assets

The Group reviews the carrying amounts of deferred income tax assets at each balance sheet date and reduces deferred income tax assets to the extent that it is no longer probable that sufficient income will be available to allow all or part of the deferred income tax assets to be utilized. The Group has deferred income tax assets amounting to ₱317,185 as of December 31, 2005 and ₱244,731 as of December 31, 2004 (see Note 26).

Pension and other retirement benefits

The determination of the Group's obligation and cost of pension is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 13 – Pension Benefit Plans and include, among others, discount rates, expected rates of return on plan assets and rates of future salary increase. In accordance with PAS 19, Employee Benefits, actual results that differ from the Group's assumptions are accumulated and amortized over future periods and therefore, generally affect the Group's recognized expenses and recorded obligation in such future periods. While management believes that its assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect the Group's pension and other post-employment obligations. Retirement benefit expense amounted to ₱47,178 and ₱27,332 in 2005 and 2004, respectively. The Group's pension liability amounted to ₱40,863 and ₱27,859 as of December 31, 2005 and 2004, respectively. Pension assets amounted to ₱45,414 and ₱34,806 as of December 31, 2005 and 2004, respectively.

Estimating useful lives of property, plant and equipment

The Group estimates the useful lives of property, plant and equipment based on the period over which assets are expected to be available for use. The estimated useful lives of property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets. In addition, the estimation of the useful lives of property, plant and equipment is based on collective assessment of internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in the factors and circumstances mentioned above. As of December 31, 2005 and 2004, the aggregate net book values of property, plant and equipment amounted to ₱11,203,404 and ₱11,046,720, respectively.

In 2005, the Group extended the estimated useful lives of ships in operation and improvements from 10-20 years to 15-30 years from the date of acquisition. The change in estimated useful life has reduced depreciation expense by ₱37,297 in 2005 (see Note 9).

Estimating residual value

The residual value of the Group's property, plant and equipment is estimated based on the amount that the entity would obtain from disposal of the asset, after deducting estimated costs of disposal, if the asset is 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 scrapped 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 scrapped steel.

In 2005, the Group estimated the residual value of ships in operation and improvements to be ₱962,128 and considered such estimate in the computation of depreciable cost as of January 1, 2005. The change in estimated residual value reduced depreciation expense by ₱77,974 in 2005 (see Note 9).

Impairment of Available-for-Sale financial assets

The determination of impairment loss for available-for-sale financial assets requires an estimation of the present value of the expected future cash flows and the selection of an appropriate discount rate. An impairment issue arises when there is an objective evidence of impairment, which involves significant judgment. In applying this judgment, the Group evaluates the financial health of the issuer, among others. In the case of available-for-sale equity instruments, the Group expands its analysis to consider changes in the issuer's industry and sector performance, legal and regulatory framework, changes in technology, and other factors that affect the recoverability of the Group's investments.

Fair value of consumable biological assets

The Group determines the most reliable estimate of fair value of its consumable biological assets. Fair value reflects the most recent market transaction price provided that there has been no significant change in economic circumstances between the date of transaction and balance sheet date. Point-of-sale cost is estimated based on recent transactions and is deducted from the fair value in order to measure the biological assets at balance sheet date.

Impairment of property, plant and equipment

Philippine GAAP requires that an impairment review be performed when certain impairment indicators are present. Determining the value of property, plant and equipment, which require the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires the Group to make estimates and assumptions that can materially affect its consolidated financial statements. Future events could cause the Group to conclude that the property, plant and equipment are impaired. Any resulting impairment loss could have a material adverse impact on the consolidated financial condition and results of operations. As of December 31, 2005 and 2004, the aggregate net book values of property, plant and equipment amounted to ₱11,203,404 and ₱11,046,720, respectively. No impairment losses were recognized in 2005 and 2004.

Financial assets and liabilities

PFRS requires that certain financial assets and liabilities be carried at fair value, which requires the use of accounting judgment and estimates. While significant components of fair value measurement are determined using verifiable objective evidence (e.g. 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 net income or loss and equity. Fair value of financial assets and liabilities as of December 31, 2005 amount to (in millions) ₱8,141 and ₱17,047, respectively (see Note 31).

Summary of Significant Accounting Policies

Foreign Currency Translation

The consolidated financial statements are presented in Philippine peso, which is the Group's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded in the functional currency at the rate ruling at the date of the 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 profit or loss. 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.

The functional currency of Luzon Hydro Corporation (LHC), Western Mindanao Power Corporation (WMPC) and Southern Philippines Power Corporation (SPPC), associates, is the United States Dollar. As at the reporting date, the assets and liabilities of these associates are translated into the presentation currency of the Group (the Philippine peso) at the rate of exchange ruling at the balance sheet date and their statements of income are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to a separate component of stockholders' equity. On disposal of the associate, the deferred cumulative amount recognized in stockholders' equity relating to that particular associate is recognized in the consolidated statement of income.

Cash and Cash Equivalents

Cash and cash equivalents in the balance sheet consist of cash at banks and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Financial Assets and Liabilities

Effective January 1, 2005, the Group adopted the following policies for accounting for financial assets and liabilities.

Financial assets and financial liabilities are recognized initially at fair value. Transaction costs, if any, are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit and loss.

The Group recognizes a financial asset or a financial liability in the balance sheets when it becomes a party to the contractual provisions of the instrument.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity net of any related income tax benefits. Financial instruments are offset when there is a legally enforceable right to offset and intention to settle either on a net basis or to realize the asset and settle the liability simultaneously.

Financial assets and financial liabilities are further classified into the following categories: Financial asset or financial liability at fair value through profit or loss, loans and receivables, held-to-maturity, available-for-sale financial assets and other financial liabilities. The Group determines the classification at initial recognition and re-evaluates this designation at every reporting date, where appropriate.

(a) Financial asset or financial liability at fair value through profit or loss

A financial asset or financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the near term or upon initial recognition, it is designated by the management at fair value through profit or loss. Assets or liabilities classified under this category are carried at fair value in the balance sheets. Changes in the fair value of such assets and liabilities are accounted for in earnings. Financial instruments held at fair value through profit or loss are classified as current if they are expected to be realized within twelve months of the balance sheet date.

Derivative transactions (including embedded derivatives) are categorized as held at fair value through profit or loss, except those derivatives designated and considered as effective hedging instruments. The Company has not designated derivatives as accounting hedges. The fair value changes of derivatives are reported directly to the statements of income.

Derivatives may be freestanding such as currency forwards or embedded in financial and non-financial contracts. 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. Separated embedded derivatives are accounted for at fair value through profit or loss.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivables. Loans and receivables are carried at cost or amortized cost in the balance sheets. Amortization is determined using the effective interest rate method. Loans and receivables are included in current assets if maturity is within twelve months of the balance sheet date. Otherwise, these are classified as noncurrent assets.

Included under this category are the Group's trade and other receivables.

(c) Held-to-maturity

Held-to-maturity investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities wherein the Group has the positive intention and ability to hold to maturity. Held-to-maturity assets are carried at cost or amortized cost in the balance sheets. Amortization is determined by using the effective interest rate method. Assets under this category are classified as current assets if maturity is within twelve months of the balance sheet date and noncurrent assets if maturity is more than a year.

The Group does not have any held-to-maturity investments at December 31, 2005.

(d) Available-for-sale

Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. Available-for-sale financial assets are measured at fair value with gains or losses being recognized as a separate component of equity, until the investments are derecognized or until the investments are determined to be impaired at which time, the accumulated gains or losses previously reported in equity is included in the statements of income. These financial assets are classified as noncurrent assets unless there is an intention to dispose such assets within twelve months from the balance sheet date.

Included under this category are the Group's investments in listed and non-listed shares of stock of other companies.

Interest-bearing Loans and Borrowings

All loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

Redeemable Preferred Shares

Redeemable preferred shares that exhibit characteristics of a liability is recognized as a financial liability in the consolidated balance sheet, net of transaction costs. The corresponding dividends on those shares are charged as interest expense in the consolidated statement of income.

Derecognition of Financial Assets and Liabilities

Financial Assets

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

- the rights to receive cash flows from the asset have expired;
- 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
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where 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 Liabilities

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

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

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

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 the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually 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.

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

Assets Carried at Cost

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

Available-For-Sale Financial Assets

If an available-for-sale financial asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the statement of income. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

Trade and Other Receivables

Trade and other receivables are recognized and carried at original invoice amount less an allowance for any uncollectible amounts. Provision is made when there is objective evidence that the Group will not be able to collect the debts. Bad debts are written off when identified.

Inventories

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

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

Wheat grains and other raw materials	– purchase cost on a first-in, first-out basis;
Finished goods and work in process	– cost of direct materials and labor and a portion of manufacturing overhead based on normal operating capacity but excluding borrowing costs;
Fuel and lubricants	– first-in, first-out method;
Parts and supplies	– weighted average method

Net realizable value of wheat grains and other raw materials, work in process and finished goods is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. Net realizable value of fuel and lubricants and parts and supplies is the current replacement costs.

Biological Assets

Biological assets are measured on initial recognition and at each balance sheet date at fair value less estimated point-of-sale costs except when, on initial recognition, market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such cases, those biological assets are measured at accumulated costs less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such biological assets becomes reliably measurable, those biological assets are measured at fair value less estimated point-of-sale costs.

Bearer biological assets are stated at cost less accumulated depreciation and any impairment losses. Bearer biological assets are depreciated over 3 years.

Gains or losses arising on initial recognition of a biological asset at fair value less estimated point-of-sale costs and from changes in their fair values less estimated point-of-sale costs are included in profit or loss for the period in which they arise.

Biological assets measured at fair value less estimated point-of-sale cost continue to be measured as such until disposed. Expenditures on biological assets subsequent to initial recognition, excluding the costs of day-to-day servicing, are capitalized.

Property, Plant and Equipment

Property, plant and equipment is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of such property, plant and equipment when that cost is incurred and the recognition criteria are met.

Drydocking costs, consisting mainly of steel plate replacement of the ships' hull and related expenditures, are capitalized as part of "Ships in operation and improvements" and amortized over 30 months or 2 1/2 years. When significant drydocking expenditures occur prior to the expiry of this period, the remaining unamortized balance of the original drydocking cost is expensed in the month of subsequent drydocking.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Except for power plant equipment and flight equipment (included under transportation equipment) of certain subsidiaries, depreciation is calculated on a straight-line basis over the useful life of the assets or the terms of the lease in case of leasehold improvements, whichever is shorter as follows:

Category	Number of Years
Buildings, warehouses and improvements	10 – 30
Transmission and distribution equipment	11 – 20
Distribution transformers and substation equipment	12 – 20
Machinery and equipment	10 – 20
Transportation equipment	3 – 10
Ships in operation and improvements, excluding drydocking costs	10 – 15
Drydocking costs	2 1/2
Containers	5 – 7
Handling equipment	5 – 7
Office furniture, fixtures and equipment	3 – 10
Leasehold improvements	3 – 10
Others	3 – 10

Power plant equipment is depreciated based on a fixed rate and percentage. Flight equipment is depreciated based on estimated number of flying hours. Effective January 1, 2005, the depreciable cost of ships in operation excludes residual value based on the estimated scrap value of the ship's hull.

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

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

The asset's residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each financial year end.

When each major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. Ships under refurbishment include the acquisition cost of the ships, the costs of on-going refurbishments and other direct costs. Construction in progress represents structures under construction and is stated at cost. Borrowing costs that are directly attributable to the refurbishment of ships and construction of other property and equipment are capitalized during the refurbishment and construction period. Ships under refurbishment and construction in progress are not depreciated until such time that the relevant assets are completed and put into operational use.

Tied up vessels, which represent excess vessels identified in the rationalization of Aboitiz Transport System Corporation (ATSC) routing schedules and are offered for sale are carried at cost less accumulated depreciation and any impairment in value at the date when retired from active use.

Investment Properties

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

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

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

For a transfer from investment property to owner-occupied property or inventories, the deemed cost of property for subsequent accounting is its fair value at the date of change in use. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use. For a transfer from inventories to investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognized in profit or loss. When the Group completes the construction or development of a self-constructed investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognized in profit or loss.

Investments in Associates

The Group's investments in associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associates. The consolidated statement of income reflects the share of the results of operations of the associates. Where there has been a change recognized directly in the equity of the associate, the Group recognizes its share of any changes and discloses this, when applicable, in the statement of changes in stockholders' equity.

The reporting dates of the associates and the Group are identical and the associates' accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

Goodwill

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with PAS 14, *Segment Reporting.*

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Software Development Costs

Costs incurred in the development of computer software are capitalized. Software development costs, included under "Other noncurrent assets" account in the consolidated balance sheets, are amortized using the straight-line method over a period of three to four years.

The carrying value of software development costs is reviewed for impairment annually when the asset is not yet in use, and otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

Impairment of Assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognized in the consolidated statement of income in those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of accumulated depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Treasury Shares

Own equity instruments which are reacquired (treasury shares) are deducted from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments.

Revenue Recognition

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

Sales

Revenue from sale of power and electricity is recognized in the period in which actual capacity is generated and earned, and upon distribution of power to customers. Revenue from sale of goods is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer.

Rendering of services

Freight, passage and service revenues are recognized when the related services are rendered, net of rebates and percentage taxes. Customer payments for which service have not yet been rendered are classified as unearned revenue under "Trade and Other Payables" in the consolidated balance sheets.

Rental income

Rental income is accounted for on a straight-line basis over the related lease terms.

Dividend income

Dividend income is recognized when the Group's right to receive payment is established.

Interest income

Interest is recognized as it accrues taking into account the effective yield on the asset.

Borrowing Costs

Borrowing costs generally are expensed as incurred. Borrowing costs, including foreign exchange differences arising from foreign currency borrowings that are regarded as an adjustment of interest costs, are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded.

Pension Benefits

The Group has defined benefit pension plans, which require contributions to be made to separately administered funds. The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plans.

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 pension 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.

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

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as a 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.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating lease. 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 a 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 basis as rental income.

Provisions

Provisions 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. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated statement of income net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a borrowing cost.

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 by the balance sheet date.

Deferred tax

Deferred income tax is provided using the liability method on 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, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

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

Deferred 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 rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income.

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

Sales Tax

Revenues, expenses and assets are recognized net of the amount of sales tax except:

- where the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables that are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated balance sheet.

Contingencies

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

Events After the Balance Sheet Date

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

Earnings Per Common Share

Earnings per common share are computed by dividing net income for the year attributable to common shares by the weighted average number of common shares issued and outstanding during the year, after retroactive adjustments for any stock dividends declared.

Notes to Consolidated Financial Statements

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Business Segments

For management purposes, the Group is organized into four major operating segments (power, food manufacturing, transportation and parent company/others) according to the nature of the products and the services provided, with each segment representing a strategic business unit that offers different products and serves different markets. The entities are the basis upon which the Group reports its primary segment information. Financial information on business segments is presented in Note 34.

3. Explanation of Transition to PFRS

As stated in Note 2, these are the Group's first consolidated financial statements prepared in conformity with PFRS. The Group applied PFRS 1, *First-time Adoption of Philippine Financial Reporting Standards*, in preparing these financial statements, with January 1, 2004 as the date of transition.

The adoption of PFRS resulted in certain changes to the Group's previous accounting policies. The comparative figures for the 2004 consolidated financial statements were restated to reflect the changes in policies except those relating to financial instruments. The Group availed of the exemption under PFRS 1 and applied PAS 32 and PAS 39, the standards on financial instruments, from January 1, 2005.

An explanation of the effects of the adoption of PFRS is set forth in the following notes.

A. Reconciliation of equity

	January 1, 2004 (date of transition)		
	Previous GAAP	Effect of Adoption of PFRS	PFRS
Total Current Assets	₱7,364,447	₱16,873	₱7,381,320
Total Noncurrent Assets	23,452,875	(176,476)	23,276 ,399
Total Current Liabilities	6,226,409	–	6,226,409
Total Noncurrent Liabilities	8,421,781	132,514	8,554,295
Retained Earnings	10,560,362	(312,075)	10,248,287
Minority Interest	995,192	906	996,098

		December 31, 2004 (end of last period presented under the previous GAAP)		
	Notes	Previous GAAP	Effect of Adoption of PFRS	PFRS
ASSETS				
Current Assets				
Cash and cash equivalents		₱4,567,791	₱–	₱4,567,791
Trade and other receivables – net		3,609,651	–	3,609,651
Inventories – net	c	1,468,657	(142,851)	1,325,806
Other current assets	c and h	550,450	168,320	718,770
Total Current Assets		10,196,549	25,469	10,222,018
Noncurrent assets				
Property, plant and equipment – net	c and g	11,484,195	(437,475)	11,046,720
Investment properties	g	–	418,444	418,444
Investments and advances	e, f and g	12,855,108	393,185	13,248,293
Goodwill		784,831	–	784,831
Pension asset	b	56,270	(21,464)	34,806
Deferred income tax assets	b	198,351	46,380	244,731
Other noncurrent assets	c	573,702	19,031	592,733
Total Noncurrent Assts		25,952,457	418,101	26,370,558
TOTAL ASSETS		₱36,149,006	₱443,570	₱36,592,576
LIABILITIES AND EQUITY				
Current liabilities				
Bank loans		₱1,982,710	₱–	₱1,982,710
Trade and other payables		3,925,927	–	3,925,927
Dividends payable		14,228	–	14,228
Income tax payable		215,600	–	215,600
Current portion of long-term debt		1,568,790	–	1,568,790
Current portion of obligations under finance lease		134,273	–	134,273
Total Current Liabilities		7,841,528	–	7,841,528

(Forward)

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

	Notes	December 31, 2004 (end of last period presented under the previous GAAP) Previous GAAP	Effect of Adoption of PFRS	PFRS
Noncurrent liabilities				
Long-term debt – net of current portion		7,106,929		7,106,929
Obligations under finance lease – net of current portion		372,566	–	372,566
Customers' deposits		911,893	–	911,893
Pension liability	b	(67,844)	95,703	27,859
Deferred income tax	b	56,366	20,874	77,240
Total Noncurrent Liabilities		8,379,910	116,577	8,496,487
Equity Attributable to Equity Holders of the Parent				
Capital stock		5,881,300	–	5,881,300
Additional paid-in capital		2,466,792	–	2,466,792
Unrealized losses on noncurrent marketable equity securities		–	(1,024)	(1,024)
Share in cumulative translation adjustments of associates	c	–	639,242	639,242
Share in net unrealized gains (losses) on AFS investments and underwriting accounts of an associate		(383,473)	–	(383,473)
Retained earnings		12,473,291	(269,911)	12,203,380
Treasury stock at cost		(1,710,084)	–	(1,710,084)
		18,727,826	368,307	19,096,133
Minority interests		1,199,742	(41,314)	1,158,428
Total Stockholders' Equity		19,927,568	326,993	20,254,561
TOTAL LIABILITIES AND EQUITY		₱36,149,006	₱443,570	₱36,592,576

a. PFRS 3, *Business Combinations*
The Group applied PFRS to business combinations since January 1, 2004. Adoption of PFRS resulted in the Group closing the balance of the unamortized negative goodwill as of January 1, 2004 of ₱39,887 as a credit to retained earnings and reversing the goodwill amortization in 2004 of ₱152,890.

b. PAS 19, *Employee Benefits*
Under previous GAAP, pension benefits were actuarially determined and past service cost and experience adjustments were amortized over the expected average remaining working lives of the covered employees. Under PFRS, pension benefits are determined using the projected unit credit method. Actuarial gains and losses that exceed a 10% "corridor" are amortized over the expected average remaining working lives of participating employees and vested past service cost, recognized immediately (see Note 2). The change reduced retained earnings at January 1, 2004 by ₱86,134 and increased 2004 net income by ₱36,811.

c. PAS 41, *Agriculture*
The Group's biological assets include breeders, growing stocks and consumables. Under previous GAAP, breeders are carried at accumulated costs, net of any accumulated amortization and any impairment in value. Growing stocks and consumables (included in inventories) are carried at the lower of cost and net realizable value. Under PAS 41, biological assets are measured at fair value less estimated point-of-sale costs, except when market-determined prices or values are not available or is determined to be clearly unreliable, in which case biological assets are measured at accumulated costs less any accumulated depreciation and any accumulated impairment losses.

The change resulted in the following:

- Reclassification of breeders from property, plant and equipment to noncurrent biological assets (under "Other noncurrent assets"), and of growing stocks and consumables from inventories to current biological assets (under "Other current assets");
- Increase in the measurement of consumable biological assets by ₱14,979 and ₱22,022 as of January 1, 2004 and December 31, 2004, respectively, and increase in 2004 income by ₱7,043; and
- Measurement of gains or losses from changes in fair values less estimated point-of-sale costs of consumable biological assets during the year for separate presentation in the consolidated statements of income.

d. *Financial Instruments*
PAS 32, Financial Instruments: Disclosure and Presentation

PAS 32 covers the disclosure and presentation of all financial instruments. The standard requires more comprehensive disclosures about a company's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include terms and conditions of financial instruments used by the entity, types of risks associated with financial instruments (market risk, foreign exchange risk, price risk, credit risk, liquidity risk and cash flow risk), fair value information of financial assets and financial liabilities, and the entity's financial risk management policies and objectives. The standard also requires financial instruments to be classified as debt or equity in accordance with their substance and not their legal form.

The standard also requires presentation of financial assets and financial liabilities on a net basis when, and only when, an entity: (a) currently has a legally enforceable right to set off the recognized amounts; and (b) intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

The change in accounting policy resulted in the reclassification of preferred shares and related additional paid in capital amounting to ₱1,867,000 from stockholders' equity to liability and the related dividends to interest expense.

PAS 39, Financial Instruments: Recognition and Measurement

PAS 39 establishes the accounting and reporting standards for the recognition and measurement of the entity's financial assets and financial liabilities. PAS 39 requires financial instruments at fair value through profit or loss to be recognized initially at fair value, including related transaction costs. Subsequent to initial recognition, an entity should measure financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are measured at amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at amortized cost, except for liabilities classified under fair value through profit and loss and derivatives, which are subsequently measured at fair value.

PAS 39 also establishes the accounting and reporting standards requiring that every derivative instrument (including certain derivatives embedded in other contracts) be recorded in the balance sheets as either an asset or liability measured at its fair value. PAS 39 requires that changes in the derivative's fair value be recognized currently in the statements of income unless specific hedges allow a derivative's gains and losses to offset related results on the hedged item in the statements of income, or deferred in the stockholders' equity as "Cumulative translation adjustments". PAS 39 requires that an entity must formally document, designate and assess the effectiveness of transactions that receive hedge accounting treatment.

Derivatives that are not designated and do not qualify as hedges are adjusted to fair value through income.

As allowed by the Securities and Exchange Commission (SEC), the adoption of PAS 39 did not result in the restatement of prior year consolidated financial statements. The cumulative effect of adopting this accounting standard was charged to the January 1, 2005 retained earnings, including share in effect of adoption of PAS 39 by associates amounting to ₱483,198 (see Note 11). The Company's share in the effect of adoption of PAS 39 of associates pertains, for the most part, to the recognition of impairment losses on the associates' financial assets. The Company's share in the additional impairment recognized amounted to approximately ₱396 million. Other adjustments pertain to the mark-to-market valuation of currency forwards of the associate, implementation of the effective interest method for the associate's loans and receivables, held-to-maturity and available-for-sale investments and the bifurcation of embedded derivatives.

e. PAS 21, *The Effects of Changes in Foreign Exchange Rates*
Under previous GAAP, the financial statements of LHC, WMPC and SPPC, associates, are presented in Philippine peso. Under PAS, LHC, WMPC and SPPC prepare their financial statements using the United States dollars, the functional currency of these associates. For purposes of the recognition of the Group's equity in these associates, their financial statements are translated at the closing rate at balance sheet date for all the asset and liability accounts, and at the average monthly closing rate for the profit and loss accounts. The adoption of PAS 21 resulted in the recognition of the Group's share in the cumulative translation adjustments of these associates amounting to ₱639,242 as of December 31, 2004, a decrease in the Group's accumulated equity of ₱177,572 as of January 1, 2004 and a decrease in the equity share in net earnings in 2004 of ₱65,745.

f. PAS 16, *Property, Plant and Equipment*
Property, plant and equipment under PFRS include the estimated costs of dismantling or removing structures used in operation for which the Group is liable. Under previous GAAP, dismantling or removal costs were recognized when incurred.

In addition, PFRS require that depreciation reflect the useful life of the significant components of the assets. Under previous GAAP, depreciation was based on the useful life determined for each property, plant and equipment. Adoption of PAS reduced the carrying amount of property, plant and equipment and retained earnings as of January 1, 2004 by ₱24,014 and reduced net income in 2004 by ₱53,705.

In 2005, the Group estimated the residual value of ships in operation and improvements to be ₱962,128 and considered such estimate in the computation of depreciable cost as of January 1, 2005. The change in estimated residual value reduced depreciation expense by ₱77,974 in 2005 (see Note 9).

g. PAS 40, *Investment Property*
The Group elected to measure its investment properties at cost. The adoption of PAS requires that where the cost method is used, investment properties, other than land, will be carried at cost less accumulated depreciation. Union Bank of the Philippines (UBP), an associate, measures its investment properties at fair values. The Group's share in the reduction in the carrying values of the associate's investment properties under the cost method is ₱81,115 as of January 1, 2004 and its share in the reduction in 2004 income amounted to ₱36,683.

h. PAS 30, *Disclosures in Financial Statements of Banks and Similar Financial Institutions*
Adoption of PAS 30 resulted in an increase in the Group's retained earnings as of January 1, 2004 amounting to ₱1,894 and income of ₱1,553 in 2004.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

The above adjustments increased (decreased) retained earnings at January 1, 2004 and December 31, 2004 as follows:

	Notes	January 1, 2004	December 31, 2004
Business combination	a	₱39,887	₱192,777
Pension benefits	b	(86,134)	(49,323)
Biological assets	c	14,979	22,022
Functional currency	e	(177,572)	(243,317)
Property, plant and equipment	f	(24,014)	(77,719)
Investment property	g	(81,115)	(117,798)
Disclosure in financial statements of banks	h	1,894	3,447
		(₱312,075)	(₱269,911)

B. Reconciliation of income in 2004

		December 31, 2004 (end of last period presented under the previous GAAP)		
	Notes	Previous GAAP	Effect of Adoption of PFRS	PFRS
Revenues		₱22,410,924	₱–	₱22,410,924
Costs and expenses	b	20,656,967	(56,632)	20,600,335
Gross profit		1,753,957	56,632	1,810,589
Share in net earnings of associates	e, f and g	1,688,264	(156,133)	1,532,131
Interest income		217,041	–	217,041
Interest expense		(1,144,898)	–	(1,144,898)
Others	a, c and h	659,981	161,486	821,467
Income before income tax		3,174,345	61,985	3,236,330
Provision for income tax	b	511,292	19,821	531,113
Net income		2,663,053	42,164	2,705,217
Net income attributable to:				
Equity holders of the parent		2,500,723		2,542,887
Minority interests		162,330		162,330
		2,663,053		2,705,217
Earnings per share				
For income attributable to				
equity holders of the parent		₱0.58	₱–	₱0.527

C. Effect on the cash flow statement in 2004

There are no differences between the cash flow statement prepared under PFRS and the cash flow statement presented under previous GAAP except for the effect of the noncash adjustments as discussed above.

D. Other adopted PFRS

The Group has also adopted the following revised and new standards and comparative presentation and disclosures have been amended as required by the standards. Adoption of these standards has no effect on stockholders' equity as at January 1 and December 31, 2004.

- PAS 1, *Presentation of Financial Statements*;
- PAS 2, *Inventories;*
- PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors;*
- PAS 10, *Events after the Balance Sheet Date;*
- PAS 17, *Leases; and*
- PAS 24, *Related Party Disclosures.*

E. Standards not yet Effective

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

- *Amendments to PAS 19, Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures* – The revised disclosures from the amendments will be included in the Group's consolidated financial statements when the amendments are adopted in 2006.
- PFRS 6, *Exploration for and Evaluation of Mineral Resources,* effective 2006 – This standard does not apply to the activities of the Group.
- PFRS 7, *Financial Instruments – Disclosures* – The revised disclosures on financial instruments provided by this standard will be included in the consolidated financial statements when the standard is adopted in 2007.

Notes to Consolidated Financial Statements

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

4. Cash and Cash Equivalents

	2005	2004
Cash on hand and in banks	**₱1,171,612**	₱1,042,447
Short-term deposits	**3,451,064**	3,525,344
	₱4,622,676	₱4,567,791

Cash in banks earn interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates. The fair value of cash and cash equivalents is ₱4,622,676 and ₱4,567,791 as of December 31, 2005 and 2004, respectively.

For the purpose of the consolidated statements of cash flows, cash and cash equivalents equal the amounts reported as cash and cash equivalents in the consolidated balance sheets.

5. Trade and Other Receivables

	2005	2004
Trade receivables – net of allowance for doubtful accounts of ₱324,071 in 2005 and ₱298,022 in 2004 (see Note 27)	**₱2,567,658**	₱2,586,158
Receivables from insurance and other claims	**35,021**	91,038
Notes receivable	**–**	11,946
Other receivables (see Note 27)	**765,175**	920,509
	₱3,367,854	₱3,609,651

Trade receivables are non-interest bearing and are generally on 10 – 30 days' terms.

For terms and conditions relating to related party receivables, refer to Note 27.

Receivables from insurance and other claims pertain to ATSC's claims for reimbursement of losses against insurance coverage for hull, machinery and cargo damages and personal accidents.

In 2004, notes receivable consist of interest-bearing notes received by ATSC from various customers for the conversion of past due trade accounts. These notes bear interest at rates ranging from 15% to 18% per annum and have maturities of 10 to 12 months.

6. Inventories

	2005	2004
At cost:		
Finished goods	**₱61,903**	₱58,661
Wheat grains and other raw materials	**645,509**	992,203
Fuel and lubricants	**174,519**	106,480
Purchases in transit	**109,351**	95,474
Materials, parts and supplies	**192,799**	29,482
At NRV:		
Materials, parts and supplies	**192,302**	43,506
	₱1,376,383	₱1,325,806

The cost of inventories recognized as part of costs of goods sold in the consolidated statements of income amounted to ₱6,020,658 and ₱5,393,761 in 2005 and 2004, respectively.

Allowance for inventory obsolescence on materials, parts and supplies amounted to ₱1,643 and ₱1,505 as of December 31, 2005 and 2004, respectively.

7. Other Current Assets

	2005	2004
Prepaid expenses	**₱543,467**	₱413,238
Input value added taxes	**72,579**	75,208
Biological assets (see Note 8)	**159,097**	164,873
Others	**129,524**	65,451
	₱904,667	₱718,770

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

8. Biological Assets

	2005	2004
Consumables		
Market hogs	**₱60,312**	₱80,370
Piglets	**48,009**	45,789
Growing stocks	**50,776**	38,714
	159,097	164,873
Bearers (see Note 14)	**18,406**	19,031
	₱177,503	₱183,904

The Company's biological assets include bearers, growing stocks and consumables.

Bearers and growing stocks are measured at accumulated cost less any accumulated depreciation and accumulated impairment losses. The Group uses this method of measurement because market-determined prices and values are not available and alternative estimates of fair values are determined to be unreliable.

Consumable biological assets are measured at fair value less estimated point-of-sale costs. Fair values are determined based on average market selling prices at year end.

9. Property, Plant and Equipment

	2004	Additions	Disposals	Reclassifications	2005
COST					
Land	₱157,783	₱2,725	₱–	(₱8,347)	**₱152,161**
Building, warehouses and improvements	1,016,974	203,782	(13,432)	4,802	**1,212,126**
Power plant and equipment	1,844,215	18,524	–	–	**1,862,739**
Transmission and distribution equipment	1,723,792	282,820	–	(664)	**2,005,948**
Distribution transformers and substation equipment	943,533	161,891	–	–	**1,105,424**
Machinery and equipment	1,355,610	5,014	(1,271)	(646)	**1,358,707**
Transportation equipment	711,653	204,554	(60,071)	(115,350)	**740,786**
Ships in operation and improvements	8,905,904	425,430	(244,588)	–	**9,086,746**
Containers	1,991,901	843	(16,139)	–	**1,976,605**
Handling equipment	1,086,471	177,732	(26,348)	–	**1,237,855**
Office furniture, fixtures and equipment	603,682	171,556	(23,224)	4,838	**756,852**
Leasehold improvements	200,831	67,383	(4)	37,751	**305,961**
Ships under refurbishment and construction in progress	79,156	47,439	–	(40,939)	**85,656**
Others	23,656	249,879	(46)	151,075	**424,564**
	₱20,645,161	₱2,019,572	(₱385,123)	₱32,520	**₱22,312,130**
ACCUMULATED DEPRECIATION AND AMORTIZATION					
Building, warehouse and improvements	₱409,049	₱126,894	(₱13,329)	(₱81)	**₱522,533**
Power plant and equipment	813,957	6,602	–	–	**820,559**
Transmission and distribution equipment	888,669	196,987	–	–	**1,085,656**
Distribution transformers and substation equipment	520,478	61,360	–	–	**581,838**
Machinery and equipment	536,811	48,724	(1,209)	(762)	**583,564**
Transportation equipment	259,139	77,107	(15,703)	–	**320,543**
Ships in operation and improvements	2,970,922	900,059	(224,815)	–	**3,646,166**
Containers	1,474,777	140,823	(14,774)	–	**1,600,826**
Handling equipment	864,327	114,233	(25,076)	–	**953,484**
Office furniture, fixtures and equipment	467,855	122,686	(21,214)	843	**570,170**
Leasehold improvements	79,436	27,729	(1,972)	–	**105,193**
Others	313,021	5,799	–	(626)	**318,194**
	9,598,441	1,829,003	(318,092)	(626)	**11,108,726**
	₱11,046,720	₱190,569	(₱67,031)	₱33,146	**₱11,203,404**

Containers include units acquired under finance lease arrangements (see Note 19). The related depreciation of the leased containers, amounting to ₱136,614 in 2005 and ₱140,584 in 2004 was computed on the basis of the Group's depreciation policy for owned assets.

Borrowing costs on loans obtained for the ship refurbishment and capitalized to property and equipment amounted to ₱50,434 in 2004, at the average capitalization rate of 9.55% in 2004.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

In 2005, the Group revised the estimated useful lives of ships in operation and improvements from 10-20 years up to 15-30 years from the date of acquisition. The change in estimated useful life reduced depreciation expense by ₱37,297 in 2005. Also, the Group estimated the residual value of ships in operation and improvements amounting to ₱962,128 and considered such estimate in the computation of depreciable cost as of January 1, 2005. The estimated residual value reduced depreciation expense by ₱77,974 in 2005 (see Note 3).

In 2004, ATSC received the proceeds from insurance claim for the loss of MV SuperFerry 14 due to fire which took place on February 27, 2004. ATSC recognized a net gain of ₱208,659 in 2004.

Property, plant and equipment with a carrying amount of ₱5,577,342 and ₱4,734,467 as of December 31, 2005 and 2004, respectively, are used to secure the Group's long-term debt.

10. Investments in Subsidiaries

The consolidated financial statements include the financial statements of Aboitiz Equity Ventures, Inc. and the subsidiaries listed in the following table.

	Nature of Business	Percentage of Ownership 2005 Direct	2005 Indirect	2004 Direct	2004 Indirect
Aboitiz Power Corporation (APC)	Power	**100.00**	**–**	100.00	–
Aboitiz Powersolutions, Inc. (APSI)	Power	**100.00**	**–**	100.00	–
Davao Light and Power Company, Inc. (DLP)	Power	**99.91**	**–**	99.91	–
Cotabato Light and Power Company, Inc. (CLP)	Power	**99.91**	**–**	99.91	–
Subic Enerzone Corporation (SEZC)	Power	**20.00**	**40.00**	20.00	40.00
Northern Mini Hydro Corporation (NMHC)	Power	**–**	**100.00**	–	100.00
Hydro Specialists, Inc.	Power	**–**	**100.00**	–	100.00
Philippine Hydropower Corporation	Power	**–**	**100.00**	–	100.00
Hedcor, Inc. (formerly Benguet Hydropower Corporation, HEDCOR)	Power	**–**	**100.00**	–	100.00
Hydro Electric Development Corporation (HEDC)	Power	**–**	**99.96**	–	99.96
Pilmico Foods Corporation (PILMICO)	Food Manufacturing	**100.00**	**–**	100.00	–
Fil-Am Foods, Inc. (FILAM)	Food Manufacturing	**–**	**100.00**	–	100.00
ATSC	Transportation	**76.11**	**–**	76.11*	–
Cebu Ferries Corporation (CFC)	Transportation	**–**	**100.00**	–	100.00
WG & A Supercommerce, Inc. (WSI)	Transportation	**–**	**100.00**	–	100.00
Aboitiz One, Inc. (AOI) and Subsidiaries	Courier, logistics and forwarding services	**–**	**100.00**	–	100.00*
Aboitiz Jebsen Bulk Transport Corporation (AJBTC) and Subsidiaries	Ship management	**–**	**62.50**	–	62.50*
Jebsen Maritime, Inc. (JMI)	Manpower services	**–**	**62.50**	–	62.50*
Aboitiz Jebsen Manpower Solutions, Inc. (AJMSI)	Manpower services	**–**	**62.50**	–	62.50*
Jebsen Management (BVI) Limited (JMBVI)***	Shipping	**–**	**50.00**	–	50.00*
AEV Aviation, Inc. (AEV Aviation)	Service	**100.00**	**–**	100.00	–
AEV Properties, Inc.**	Real Estate	**100.00**	**–**	100.00	–
Cebu Praedia Development Corporation (CPDC)	Real Estate	**88.27**	**11.72**	88.27	11.72
Cotabato Ice Plant, Inc.	Manufacturing	**–**	**100.00**	–	100.00
Fil-Agri Holdings, Inc.	Holding company	**–**	**100.00**	–	100.00

**As restated arising from the reorganization of the transport group.*
***No commercial operations*
**** Incorporated in the British Virgin Islands. Functional currency is US dollars.*

On June 17, 2005, a "Subscription Agreement and Deed of Assignment (Agreement)" was executed by and between ATSC ("Assignee") and Aboitiz & Company, Inc. (ACO), the Company, and certain individual assignees ("Assignors") as part of the reorganization to integrate under ATSC all businesses related to shipping, transportation and logistics and allow the Group to enhance efficiencies and competitiveness. To effect the reorganization, ATSC issued 414.1 million shares to the Assignors thereby allowing ATSC to own 50% or more interests and acquire control over AOI and Subsidiaries, AJBTC and Subsidiaries, JMI, AJMSI and JMBVI. JMBVI is an offshore company acquired by ACO in 2005. The assignment of the Company's investments in AOI for shares of stock of ATSC is a tax-free transfer on reorganization of companies under common control.

The above transaction was treated as a reorganization of companies under common control and accounted for at historical cost in a manner similar to pooling-of-interests method.Accordingly, all financial data for the period prior to the above transaction as presented have been restated in ATSC to include the results of the new subsidiaries, except JMBVI and Subsidiaries which were acquired by ACO in 2005.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Presented below is the combined statement of income of new subsidiaries accounted for in ATSC at historical cost for the year ended December 31, 2004:

	2004				
	AOI and Subsidiaries	AJBTC and Subsidiaries	JMI	AJMSI	Combined
Revenues	₱1,271,002	₱243,897	₱114,573	₱662	₱1,630,134
Costs and expenses	(1,115,443)	(215,906)	(51,649)	(2,314)	(1,385,312)
Other income (charges)	20,167	5,256	(2,304)	(16)	23,103
Income tax	(36,399)	(12,757)	(19,427)	540	(68,043)
Net income	₱139,327	₱20,490	₱41,193	(₱1,128)	₱199,882

In addition, the consolidation of the above new subsidiaries into ATSC has increased the following accounts in the 2004 consolidated balance sheet:

	2004
Current assets	₱1,058,358
Noncurrent assets	249,452
Current liabilities	1,005,617
Stockholder's equity	350,193

The reorganization of the transport group resulted in a charge to the Company's additional paid-in capital in the amount of ₱414,148, representing the decrease in the Company's equity in the restated consolidated net assets of ATSC following the reorganization. In addition, the said reorganization resulted in a charge to the Company's retained earnings in the amount of ₱130,516 as of January 1, 2004 and ₱51,567 as of January 1, 2005, respectively, representing the decrease in the Company's equity in the restated earnings of ATSC following reorganization.

11. Investments and Advances

	2005	2004
Acquisition cost:		
Balance at beginning of year, as previously reported	**₱8,346,359**	₱8,350,528
Effect of adoption of PFRS 3	**20,478**	20,478
Effect of reorganization of transport group (see Note 10)	**16,725**	16,725
Balance at beginning of year, as restated	**8,383,562**	8,387,731
Additions during the year	**24,789**	5,895
Disposals during the year	**–**	(10,064)
Balance at end of year	**8,408,351**	8,383,562
Accumulated share in net earnings:		
Balance at beginning of year, as previously reported	**4,708,257**	3,837,199
Effect of reorganization of transport group (see Note 10)	**6,589**	13,036
Share in effect of adoption of PAS of associates	**(340,208)**	(320,604)
Balance at beginning of year, as restated	**4,374,638**	3,529,631
Share in effect of adoption of PAS 39 of associates	**(483,198)**	–
Share in net earnings for the year, as restated	**2,155,343**	1,532,131
Cash dividends received	**(733,749)**	(686,942)
Investment sold	**(371)**	(183)
Balance at end of year	**5,312,663**	4,374,637
Share in net unrealized gains (losses) on AFS and underwriting accounts of an associate	**122,290**	(383,473)
Effect of reorganization of transport group	**(1,349)**	(1,077)
Share in cumulative translation adjustments of associates	**452,617**	639,242
	14,294,572	13,012,891
Advances	**239,045**	264,397
Less allowance for impairment losses	**(28,995)**	(28,995)
	₱14,504,622	₱13,248,293

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

The Group's associates and the corresponding equity ownership are as follows:

	Nature of Business	Percentage of Ownership 2005	2004
Visayan Energy Company, Inc. (VECO)	Power	**54.67**	54.58
PILMICO – Mauri Foods Corporation (Pilmico Mauri)	Food manufacturing	**50.00**	50.00
LHC	Power	**50.00**	50.00
Accuria, Inc.	Holding company	**49.54**	49.54
JAIB, Inc.*	Brokerage	**49.00**	49.00
Hijos	Holding company	**46.66**	46.66
San Fernando Electric Light & Power Company (SFELAPCO)	Power	**43.78**	43.78
Pampanga Energy Ventures, Inc. (PEVI)	Holding company	**42.84**	42.84
UBP	Banking	**42.14**	42.02
Cordillera Hydro Corporation *	Power	**35.00**	35.00
City Savings Bank (CSB)	Banking	**34.38**	34.38
WMPC	Power	**20.00**	20.00
Cebu International Container Terminal, Inc. (CICTI)*	Transportation	**20.00**	20.00
SPPC	Power	**20.00**	20.00
South Western Cement Corporation	Cement	**20.00**	20.00
New Zealand Lumber Shippers Ltd**.	Shipping	**50.00**	–
Refrigerated Transport Services, Inc. (RTSI)	Transportation	**50.00**	50.00
Reefer Van Specialist, Inc. (RVSI)	Transportation	**50.00**	50.00
Aboitiz Project TS Corporation (APTSC)	Consulting services	**50.00**	50.00
WG & A Jebsen Ship Management, Inc. (WGA&J)	Ship management	**40.00**	40.00
Hapag-Lloyd Philippines, Inc. (HLP)	Ship management	**15.00**	15.00
Jade Ocean Shipmanagement, Inc. (JOSI)	Ship management	**50.00**	33.33

** No commercial operations.*
*** Incorporated in New Zealand.*

RTSI, RVSI, APTSC, and WGA&J, HLP and JOSI became associates of the Group as a result of the reorganization of the transportation group (see Note 10).

VECO has been excluded in the consolidated financial statement as other shareholders' group exercise the power to govern the financial and operating policies of VECO.

The detailed carrying values of investments in associates (including goodwill) which are accounted for under the equity method follow:

	2005	2004
UBP	**₱8,641,720**	₱7,798,259
LHC	**2,426,532**	2,103,286
VECO/Hijos	**1,720,535**	1,653,648
WMPC	**532,170**	534,895
SPPC	**326,233**	323,821
CICTI	**240,125**	240,125
PEVI/SFELAPCO	**362,832**	347,975
Others	**44,425**	10,882
	₱14,294,572	₱13,012,891

The investments in associates include goodwill of ₱2,070,442.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Following is the summarized financial information of significant associates:

	2005	2004
UBP		
Total current assets	**₱68,272,792**	₱48,404,643
Total noncurrent assets	**32,861,518**	46,664,841
Total current liabilities	**80,771,425**	76,648,125
Total noncurrent liabilities	**7,683,049**	8,596,489
Gross revenue	**5,629,881**	4,974,937
Gross profit	**2,729,070**	3,054,765
Net income	**2,755,107**	2,281,035
LHC		
Total current assets	**₱583,568**	₱850,176
Total noncurrent assets	**7,442,281**	7,616,780
Total current liabilities	**2,807,294**	2,170,079
Total noncurrent liabilities	**861,516**	2,095,859
Gross revenue	**2,455,613**	2,298,904
Gross profit	**2,021,971**	1,774,609
Net income	**1,611,846**	1,259,501
VECO*		
Total current assets	**₱1,764,726**	₱1,814,333
Total noncurrent assets	**3,120,162**	3,179,197
Total current liabilities	**1,115,167**	1,189,549
Total noncurrent liabilities	**1,397,192**	1,496,032
Gross revenue	**8,763,369**	7,542,059
Gross profit (loss)	**256,441**	(171,189)
Net income (loss)	**217,572**	(12,425)

*Amounts are based on appraised values which are adjusted to historical amounts upon equity take-up of the Group.

12. Impairment Testing of Goodwill

Goodwill acquired through business combinations have been attributed to each investee as a single cash-generating unit.

The recoverable amounts of the investments have been determined based on a value in use calculation using cash flow projections based on financial budgets approved by senior management covering a five-year period. The discount rate applied to cash flow projections range from 8.00 % to 13.56% and cash flows beyond the 5-year period are extrapolated using a zero per cent growth rate.

The carrying amount of goodwill follows:

	2005	2004
Subsidiaries		
ATSC	**₱564,655**	₱564,655
NMHC	**220,228**	220,176
	₱784,883	784,831
Associates		
UBP	**₱1,100,148**	₱1,100,148
VECO	**725,563**	725,563
SFELAPCO	**244,731**	244,731
	₱2,070,442	₱2,070,442

Key assumptions used in value in use calculation for December 31, 2005 and 2004

The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill.

Foreign Exchange Rates.

The assumption used to determine foreign exchange rate is a slowing Philippine peso depreciation rate of ₱2.0 every year.

Materials Price Inflation.

The assumption used to determine the value assigned to the materials price inflation is a slowdown in inflation equal to a decrease of 50 basis points every year. The starting point of 2005 is consistent with external information sources.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

13. Pension Benefit Plans

The Group has defined benefit pension plans covering substantially all of its employees, which require contributions to be made to separately administered funds.

The following tables summarize the components of net benefit expense recognized in the consolidated statements of income and the funded status and amounts recognized in the consolidated balance sheets for the respective plans.

Net benefit expense

	2005	2004
Current service cost	**₱30,395**	₱13,720
Interest cost on benefit obligation	**59,073**	33,425
Expected return on plan assets	**(41,443)**	(19,813)
Net actuarial gain recognized in the year	**(847)**	–
Net benefit expense	**₱47,178**	₱27,332

Pension asset – net

	2005	2004
Fair value of plan assets	**₱523,816**	₱460,733
Defined benefit obligation	**(480,633)**	(421,785)
Unrecognized net losses/asset ceiling	**(38,632)**	(32,001)
	₱4,551	₱6,947

Net pension assets above include gross pension asset amounting to ₱45,414 and ₱34,806 as of December 31, 2005 and 2004, respectively, and gross pension liability amounting to ₱40,863 and ₱27,859 as of December 31, 2005 and 2004, respectively.

Changes in the present value of the defined benefit obligation are as follows:

	2005	2004
Opening defined benefit obligation	**₱421,785**	₱402,546
Interest cost	**59,073**	33,425
Current service cost	**30,395**	13,720
Benefits paid	**(10,082)**	(42,050)
Actuarial losses (gains)	**(20,538)**	14,234
Closing defined benefit obligation	**₱480,633**	₱421,875

Changes in the fair value of plan assets are as follows:

	2005	2004
Opening fair value of assets	**₱460,733**	₱341,856
Expected return	**41,443**	19,813
Contributions by employer	**43,389**	117,588
Benefits paid	**(10,082)**	(42,050)
Actuarial gains (losses)	**(11,667)**	23,526
Closing fair value of plan assets	**₱523,816**	₱460,733

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 in determining pension benefit obligations for the Group's plans are shown below:

	2005	2004
Discount rate	**14%**	12%
Expected rate of return on assets	**9%**	9%
Future salary increase	**8%**	8%

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

14. Other Noncurrent Assets

	2005	2004
Software development costs – net of accumulated amortization of ₱141,298 in 2005 and ₱93,431 in 2004	**₱406,779**	₱362,965
Biological assets (see Note 8)	**18,406**	19,031
Others – net	**148,738**	210,737
	₱573,923	₱592,733

Software development costs comprise all expenditures that can be directly attributed to the development and acquisition of several application software related to integrated financial and revenue management system. The additions to software development costs amounted to ₱91,681 and ₱172,524 in 2005 and 2004, respectively. The related amortization amounted to ₱47,867 and ₱27,553 in 2005 and 2004, respectively.

15. Bank Loans

	2005	2004 (As restated)
Peso loans	**₱1,161,250**	₱1,760,163
US dollar loans	**76,981**	222,547
US dollar overdraft facility	**61,122**	–
	₱1,299,353	₱1,982,710

The peso loans are unsecured short-term notes payable obtained from local banks with annual interest rates ranging from 8.41% to 11.2% in 2005 and 8.35% to 9.45% in 2004.

The US dollar loans pertain to unsecured short-term notes payable obtained by AJBTC, JMI and JMBVI from foreign and local banks and have outstanding balances amounting to US$1.2 million and US$4.0 million as of December 31, 2005 and 2004, respectively. These loans bear interest of 6.07% in 2005 and 3.63% to 5.00% in 2004.

The US dollar overdraft facility pertains to loan obtained from a foreign bank by Jebsens Orient Shipping AS, a wholly owned subsidiary of JMBVI based in Norway, with interest at the aggregate of LIBOR plus a margin of 1.50% per annum. This loan is secured by an assignment of earnings and a guarantee by a JMBVI shareholder.

16. Trade and Other Payables

	2005	2004
Trade payables (see Note 27)	**₱2,441,754**	₱1,892,469
Accrued expenses (see Note 27)	**1,324,283**	1,248,180
Nontrade payables and others (see Note 27)	**829,379**	785,278
	₱4,595,416	₱3,925,927

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

17. Long-term Debt

	Effective Interest Rate	2005	2004 (As restated, see Note 9)
Company:			
Financial institutions - unsecured peso denominated loans	various	**₱3,255,000**	₱3,856,000
Non-financial institutions	11% - 12%	**25,500**	932,027
		3,280,500	4,788,027
Subsidiaries:			
ATSC			
Financial institutions - secured:			
Peso loans due until 2010	8.41% to 10.70%	**₱2,529,231**	₱2,169,318
Australian (AU) dollar loan due until 2009	LIBOR + 1.75%	**37,627**	–
		2,566,858	2,169,318
Installments payable	8.27%	**–**	25,823
		2,566,858	2,195,141
DLP			
Financial institutions - secured	10.89% - 11.2%	**412,308**	654,615
PILMICO			
Financial institutions - secured	various	**381,846**	357,436
HEDCOR			
Financial institution - secured	2.25% over the applicable three-month Treasury Securities rate	**650,000**	450,000
FILAM			
Financial institution - secured	9.41% - 10.04%	**162,500**	200,000
CLP			
Financial institution - secured	8.78%	**25,808**	30,500
SEZC			
Financial institution - secured	9.9%	**87,212**	–
		4,286,532	3,887,692
Total		**7,567,032**	8,675,719
Less current portion		**1,756,246**	1,568,790
		₱5,810,786	₱7,106,929

Company

The loans availed by the Company from financial institutions include:

a. Unsecured loans totaling ₱1,800,000 payable in five years up to 2007, with two years grace period, on a quarterly basis to commence at the end of the eighth quarter with 4% of the principal due on the 8th to 12th quarters, 7.5% due on the 13th to 16th quarters and 12.5% due on the 17th to 20th quarters, with effective interest rates ranging from 8.37% to 10.37% and 8.27% to 10.20% in 2005 and 2004, respectively.

b. An unsecured loan amounting to ₱1,000,000 payable in 12 equal consecutive quarterly installments up to 2008 to commence at the end of the eighth quarter with interest rates ranging from 8.37% to 10.37% and 8.32% to 10.20% in 2005 and 2004, respectively.

c. An unsecured loan amounting to ₱1,000,000 obtained in 2004 payable on the last day of the 60th month from the date of the first drawdown with interest rate of 10.49% in 2005 and 9.77% in 2004, to be repriced on a quarterly basis.

d. An unsecured loan amounting to ₱200,000 obtained in 2003 and payable in five years up to 2008 to commence at the end of the third year with 25% of the principal due on the third and fourth years, and a bullet payment of the remaining principal balance upon maturity, with interest rates ranging from 8.12% to 10.12% and 8.21% to 9.94% in 2005 and 2004, respectively.

e. US dollar denominated loans amounting to $4,857 (₱270,000) which are unsecured and bear interest rates ranging from 7.50% to 9.42% in 2004. The ₱150,000 and ₱120,000 loans were paid in lump sum amounts on March 26, 2004 and May 7, 2004, respectively.

The loans availed by the Company from non-financial institutions include loans from the Carlos Gothong Group, Chiongbian Group and Aboitiz Foundation, Inc. amounting to ₱25,500 and ₱937,027 as of December 31, 2005 and 2004, respectively.

In 2004, the BOD unanimously approved the acceleration of the payment of the loans to the Carlos Gothong Group and Chiongbian Group. Accordingly, principal payments were accelerated and the loans were fully paid in June 2005.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

ATSC

Bank loans availed by ATSC from financial institutions and denominated in Philippine pesos are collateralized by certain parcels of land and vessels of ATSC with carrying value of ₱4,937,342 as of December 31, 2005 and ₱4,557,732 as of December 31, 2004. The pledged assets have an aggregate appraised value of ₱7,566,513 and ₱8,488,650 as of December 31, 2005 and 2004, respectively.

Some agreements covering bank loans provide for certain restrictions and requirements that include, among others, maintenance of favorable financial ratios such as current ratio, debt to tangible net worth ratio and debt service coverage ratio. As of December 31, 2005 and 2004, ATSC was not able to meet the required current ratio of 1:1 and debt service coverage ratio of 1.5:1. However, ATSC has obtained waivers from the creditor banks.

The AU dollar-denominated loan pertains to a 5-year term loan obtained by International Marketing and Logistics PTY Ltd (IML), a subsidiary of JMBVI based in Australia. This loan requires IML to ensure that during the term of the loan dividend payments will be restricted to ensure that cash and cash equivalents reduced by the dividend payments exceed the debt service of the following half year.

In 2004, the installments payable, which are denominated in US dollars, have outstanding balances amounting to US$458 as of December 31, 2004 and have been restated to Philippine pesos at the rates prevailing as of that date of ₱56.341 to US$1.

DLP

Loans availed by DLP from financial institutions include:

				Principal	
Creditor	Effective Interest Rate	Payment Schedule	Collateral	**2005**	2004
China Banking Corporation (CBC)	11.20% per annum	12 quarterly payments of 26.7 million starting January 2007	Mortage trust indenture on DLP's power plant equipment	**₱320,000**	₱320,000
UBP	1% over the Land Bank of the Philippines pass-on rate to UBP, repriced on a quarterly basis	13 quarterly payments of ₱23.08 million	–	**92,308**	184,615
Security Bank and Trust Company, Inc. (SBTC)	10.89% per annum	Quarterly payments of ₱25 million in the first three quarters and ₱50 million in the fourth quarter of 2003, ₱50 million in 2004 and 2005	Mortgage trust indenture on DLP's power plant equipment	**–**	150,000
				412,308	654,615
Less current portion				**92,308**	242,307
				₱320,000	₱412,308

The carrying amount of power plant equipment used as collateral for the loans from CBC and SBTC amounted to ₱640,000 as of December 31, 2005.

The loan agreements with UBP and CBC prohibit DLP among others, to make or permit any material change in the character of its business and in the ownership or control of its capital stock, permit the ratio of its total liabilities to total stockholder's equity to exceed 2:1, permit the current ratio to be less than 1:1, participate into any merger or consolidation without written consent of the lender. The agreements also prohibit DLP to sell, lease, mortgage or dispose substantially all of its assets; voluntarily suspend its business operations or dissolve its affairs; amend its Articles of Incorporation and By-laws which would cause a material adverse change in its financial ability and, to declare and pay dividends to its stockholders or retain, retire, purchase or otherwise acquire any class of capital stock, or make any other capital or other asset distribution.

PILMICO

The loans availed by PILMICO include:

				Principal	
Creditor	Interest Rate	Payment Schedule	Collateral	**2005**	2004
Union Bank of the Philippines (UBP) (see Note 11)	1% over the prevailing fixed LBP passed-on rate	13 equal quarterly payments of ₱19.2 million starting October 2003	Secured by a mortgage trust indenture (MTI)	**₱153,846**	₱230,769
UBP (see Note 11)	1% over the prevailing fixed LBP passed-on rate	12 quarterly installments of ₱8.3 million	Secured by MTI	**100,000**	100,000

(Forward)

Notes to Consolidated Financial Statements

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

				Principal	
Creditor	Interest Rate	Payment Schedule	Collateral	**2005**	2004
Citibank, N.A. (Citibank)	9.2% in 2005 and 11.68% in 2004	15 equal quarterly payments of ₱6.7 million up to December 2005	Secured by MTI	**–**	26,667
Metrobank (MBTC)	1.5% over the prevailing DBP passed-on rate	20 equal quarterly payments of ₱4.4 million starting January 2008	Secured by MTI	**88,000**	–
MBTC	1.5% over the prevailing MART 1 rate	20 equal quarterly payments of ₱2.0 million starting October 2007	Secured by MTI	**40,000**	–
				381,846	357,436
Less current portion				**110,256**	103,590
				₱271,590	₱253,846

The MTI with UBP requires PILMICO among others, to maintain and preserve the collateral values as well as seek prior approval for any merger, consolidation, change in ownership, suspension of business operations, disposal of assets, maintenance of financial ratios and others.

The MTI with Citibank prohibits PILMICO to incur major capital expenditures and/or investments, and to pay out dividends or make any distributions to its stockholders, purchase, redeem, retire or otherwise acquire for value any of its capital stock now or hereafter outstanding (other than as a result of conversion of any shares of capital stock into shares of any other class of capital stock), return any capital to its stockholders (other than distributions payable in shares of its capital stock), or make any capital asset distribution to its stockholders without prior approval from Citibank. Citibank may waive and/or reconsider the prohibition on the payment of dividends by PILMICO commencing in the year 2003.

The MTIs with MBTC require PILMICO among others, to seek prior approval for any merger, consolidation, change in ownership, suspension of business operations, disposal of assets, and maintenance of financial ratios. They also prohibit PILMICO to purchase, redeem, retire or otherwise acquire for value any of its capital stock now or hereafter outstanding (other than as a result of the conversion of any share of capital stock into any other class of capital stock), return any capital to the stockholders (other than distributions payable in shares of its capital stock), declare or pay dividends to its stockholders if payment of any sum due to MBTC is in arrears, and declare or pay management bonus or profit sharing over and above existing employee benefits.

HEDCOR

The loan availed by HEDCOR is a five year loan payable on December 9, 2009, and bears interest rates at two and one-fourth percent (2.25%) over the applicable three-month treasury securities as displayed on MART 1 page of Bloomberg of the rate setting day plus gross receipts tax, reviewable and payable quarterly. The loan is secured by a chattel mortgage over the machineries and improvements of the Benguet and Davao hydropower plants of HEDCOR and a suretyship of Aboitiz Power Corporation (APC).

Loan covenant includes, among others, maintenance of current ratio of at least 1:1 and debt-equity ratio of 15:1 and restrictions such as not to incur any debt with a maturity of more than one (1) year without bank notification, no substantial change in present majority ownership or management, not to enter into any merger or consolidation, sell, lease, mortgage, hypothecate, pledge or otherwise transfer 51% or more of its assets.

FILAM

Long-term debt consists of the following peso-denominated loans obtained from Equitable PCI Bank to finance the construction of a second feedmill plant and working capital requirements:

			Principal	
Interest Rate	Payment Schedule	Collateral	**2005**	2004
Annual interest at 9.41%	12 quarterly installments of ₱12.5 million starting May 2, 2005	Mortgage trust indenture covering the Company's property, plant and equipment	**₱112,500**	₱150,000
Annual interest at agreed rate of 7.84% plus a spread of 2.2%	12 quarterly installments of ₱4.2 million starting March 10, 2006	Mortgage trust indenture covering the Company's property, plant and equipment	**50,000**	50,000
			162,500	200,000
Less current portion			**66,800**	37,500
			₱95,700	₱162,500

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

CLP

The loan availed by CLP pertains to a term loan to partially finance capital and regular expenditures for the rehabilitation and modernization of its distribution system. The loan is payable in five years (inclusive of a two year grace period) in 13 quarterly installments of ₱2,300 starting September 26, 2005 and bears interest at a fixed rate of 8.78%. The loan is secured by a mortgage trust indenture in favor of the designated trustee, for the pari-passu and pro rata benefit of the creditor banks, covering CLP's land and building improvements and transmission and distribution equipment with a carrying value of ₱176,735 as of December 31, 2005.

SEZC

The loan availed of by SEZC pertains to a term loan for assistance in the financing of the Phase 1 rehabilitation of the Subic Bay Metropolitan Authority Power Distribution System (PDS) up to a total amount of ₱185,000. The loan is payable in 10 years inclusive of 3 1/2 years grace period in 26 equal quarterly installments commencing at the 15th quarter from initial drawdown. As of December 31, 2005, SEZC has drawn ₱89,000 from the facility.

The loan is secured by surety of the stockholders and assignment of rights and benefits of SEZC related to the revenue receivable and new equipment and assets to be purchased and used in the PDS. The term loan agreement prohibits SEZC to make or permit a material change in the character, ownership or control of its business, to secure any indebtedness, to sell, lease, transfer or dispose of all or substantially all of its properties, assets and investments. The agreement also does not permit SEZC to exceed the allowed debt to equity ratio or go below the allowed current ratio.

18. Customers' Deposits

Customers' deposits consist of bill deposits, transformer deposits and lines and poles deposits.

Bill deposits are obtained from customers and maintained at approximately equivalent to one (1) month consumption principally as guarantee for any uncollected bills upon termination of the service contract. Under the Magna Carta for Residential Electricity Consumers (Magna Carta) which took effect on July 19, 2004, bill deposits shall earn interest equivalent to the interest incorporated in the calculation of the Distribution Utilities' Weighted Average Cost of Capital; otherwise, the prevailing interest rate for savings deposit as approved by the Bangko Sentral ng Pilipinas shall apply and the same shall be credited yearly to the bills of the registered customer. The Magna Carta also provides that bill deposits, together with accrued interests, shall be refunded within one month from the termination of the services if all bills have been paid. In addition to this, the customer who has paid his electric bills on or before its due date for three consecutive years, may demand for the full refund of the deposit even prior to the termination of the service.

Transformer and lines and poles deposits are obtained from certain customers principally as guarantee for their proper maintenance of the said facilities while under their exclusive use and responsibility. These deposits are contractually to be applied against any costs of restoring the transformers and lines and poles to their appropriate condition anytime upon the termination of the respective service contracts.

19. Finance Leases

ATSC acquired certain containers under finance lease arrangements denominated in US dollars. Containers as of December 31, 2005 and 2004, shown under "Property, plant and equipment" account in the consolidated balance sheets, include the following amounts:

	2005	2004
Cost	**₱1,113,424**	₱1,137,613
Less accumulated depreciation	**743,709**	630,019
	₱369,715	₱507,594

The aggregate future minimum payments under the leases are as follows:

	2005	2004
2005	**₱–**	₱178,739
2006	**165,636**	182,523
2007 to 2009	**237,336**	252,003
Total minimum lease obligation	**402,972**	613,265
Less amount representing interest	**52,089**	106,426
Present value of minimum lease payments	**350,883**	506,839
Less current portion	**140,393**	134,273
	₱210,490	₱372,566

The outstanding balance of the US dollar denominated finance lease obligation of US$6,821 as of December 31, 2005 and US$8,996 as of December 31, 2004 have been restated at the rates prevailing as of those dates of ₱53.062 to US$1 and ₱56.341 to US$1, respectively.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

20. Capital Stock/Redeemable Preferred Shares

Information on the Company's capital stock follows:

	Number of Shares	
	2005	2004
Authorized capital stock:		
Common shares, ₱1 par value	**9,600,000,000**	9,600,000,000
Preferred shares, ₱1 par value	**400,000,000**	400,000,000

Movements in the outstanding capital stock are as follows:

	Number of Shares	
	2005	2004
Common shares issued:		
Balance at beginning of year	**5,694,599,621**	5,694,599,621
Less treasury shares	**788,230,923**	873,261,437
Balance at end of year	**4,906,368,698**	4,821,338,184
Preferred shares issued:		
Balance at beginning of year	**186,700,000**	100,000,000
Issued during the year	**–**	86,700,000
Balance at end of year	**186,700,000**	186,700,000

The preferred shares are non-voting, non-participating, non-convertible, cumulative reissuable and redeemable and may be issued from time to time by the BOD in one or more series and fixed before issuance thereof, the number of shares in each series, and all designations, relative rights, preferences and limitations of the shares in each series. Preferred shares that are redeemed by the Company may be re-issued.

The Company's preferred shares consist of (1) Series "A" with floating dividend rate determined quarterly equivalent to the Applicable Base Rate for Series "A" or the Alternative Base Rate for Series "A" plus a spread of 1.25% per annum; and (2) Series "B" with fixed dividend rate based on Applicable Base Rate for Series "B" plus a spread of 0.125% per annum.

The Company shall redeem all the preferred shares at the end of the fifth (5th) year from the Issue Date ("Final Redemption Date") regardless of the existence of unrestricted retained earnings or other amounts legally available for the payment of dividends in such period, provided that the Issuer has, after redemption, sufficient assets in the books to cover debts and liabilities inclusive of capital stock, and subject to the Issuer's compliance with the applicable laws, rules and regulations, including the requirements of the Securities and Exchange Commission (SEC). Final redemption is substantially in December 2009.

The preferred shares shall be redeemed by payment in cash of 100% of the Issue Price plus all accrued and unpaid cash dividends on the Final Redemption Date.

As discussed in Note 3 (d), the Company's preferred shares were reclassified to liability in 2005 as a result of adopting PAS 32/PAS 39.

21. Retained Earnings

The portion of the Company's retained earnings corresponding to the equity in the undistributed net earnings of subsidiaries and associates amounting to ₱5,312,663 and ₱4,374,637 as of December 31, 2005 and 2004 respectively, is not currently available for dividend distribution unless declared by the subsidiaries and associates.

22. Revenue

The Uniform Rate Filing Requirements (UFR) on the rate unbundling released by the ERC on October 30, 2001, specified that the billing for sale and distribution of power and electricity will have the following components: Generation Charge, Transmission Charge, System Loss Charge, Distribution Charge, Supply Charge, Metering Charge, the CERA and Interclass and Lifeline Subsidies. National and local franchise taxes, the Power Act Reduction (for residential customers) and the Universal Charge are also separately indicated in the customer's billing statements.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

23. Costs and Expenses

Operating expenses consist of:

	2005	2004 (As restated, see Notes 2 and 3)
Fuel and lubricants	**₱3,277,603**	₱2,682,172
Charter hire	**1,890,139**	–
Personnel (see Notes 12 and 24)	**950,970**	946,420
Depreciation	**817,865**	736,874
Outside services	**782,046**	675,710
Repairs and maintenance	**472,236**	693,379
Insurance	**314,036**	377,339
Management fees (see Note 27)	**313,831**	109,348
Commissions	**209,432**	203,704
Taxes and licenses	**184,317**	157,806
Freight and handling	**79,978**	56,613
Transportation and travel	**65,286**	70,408
Rent	**49,086**	17,228
Advertising	**31,358**	25,696
Utilities	**20,781**	49,142
Training and development	**17,530**	10,271
Others	**470,438**	896,637
	₱9,946,932	₱7,708,747

Cost of goods sold consists of:

	2005	2004 (As restated, see Notes 2 and 3)
Raw materials used	**₱3,655,387**	₱3,691,747
Direct labor	**24,041**	23,969
Manufacturing overhead		
Purchases and changes in biological assets and inventories	**1,969,669**	1,355,744
Depreciation	**77,873**	74,635
Power	**61,217**	52,241
Utilities and supplies	**49,064**	32,960
Repairs and maintenance	**36,847**	38,934
Insurance	**26,016**	27,378
Taxes and licenses	**20,491**	13,818
Indirect labor	**16,322**	13,025
Freight and handling	**4,093**	3,821
Fuel and lubricants	**4,881**	3,516
Employees' benefits	**2,337**	2,679
Pest control	**2,593**	2,220
Others	**73,069**	67,994
	2,344,472	1,688,965
Cost of goods manufactured	**6,023,900**	5,404,681
Finished goods inventory (see Note 6)		
Beginning of year	**58,661**	47,741
End of year	**(61,903)**	(58,661)
	₱6,020,658	₱5,393,761

Notes to Consolidated Financial Statements

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Overhead expenses consist of:

	2005	2004 (As restated, see Notes 2 and 3)
Personnel (see Notes 12 and 24)	**₱504,509**	₱516,060
Depreciation and amortization	**167,528**	128,208
Outside services	**120,339**	150,683
Advertising	**111,396**	119,117
Communication, light and water	**100,874**	120,029
Rent	**83,874**	65,780
Provision for doubtful accounts	**71,796**	112,928
Entertainment, amusement and recreation	**29,296**	33,637
Others	**356,402**	189,567
	₱1,546,014	₱1,436,009

Terminal expenses consist of:

	2005	2004 (As restated, see Notes 2 and 3)
Outside services	**₱460,654**	₱462,746
Depreciation	**254,994**	237,144
Transportation and delivery	**173,067**	109,801
Repairs and maintenance	**112,667**	124,028
Personnel (see Notes 12 and 24)	**61,098**	36,356
Rent	**48,957**	34,217
Fuel and lubricants	**47,112**	27,866
Others	**67,203**	76,196
	₱1,225,752	₱1,108,354

24. Personnel Expenses

	2005	2004 (As restated, see Notes 2 and 3)
Salaries and wages	**₱1,522,920**	₱1,507,404
Employee benefits	**36,357**	31,105
	₱1,559,277	₱1,538,509

25. Other Income (Charges)

	2005	2004 (As restated, see Notes 2 and 3)
Service and other fees	**₱118,139**	₱–
Gain on sale of:		
Property and equipment	**99,662**	211,994
Investments in shares of stock	**–**	15,696
Dividend income	**5,144**	11,811
Write-off of project costs and others	**(6,600)**	–
Foreign exchange gains (losses) – net	**(109,879)**	12,305
Gain from insurance claims	**–**	208,659
Unrealized gain on recovery in value of marketable equity securities	**–**	11,661
Rent income	**–**	11,260
Others – net	**294,197**	338,081
	₱400,663	₱821,467

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

26. Income Taxes

The provisions for income tax consist of:

	2005	2004 (As restated, see Notes 2 and 3)
Current		
Corporate income tax	**₱609,266**	₱578,086
Final tax	**11,219**	9,287
	620,485	587,373
Deferred	**(151,916)**	(56,260)
	₱468,569	₱531,113

A reconciliation between the statutory income tax rate and the Group's effective income tax rates follows:

	2005	2004 (As restated, see Notes 2 and 3)
Statutory income tax rate	**32.50%**	32.00%
Tax effects of:		
Nontaxable equity in net earnings of associates	**(19.00)**	(16.86)
Interest income subjected to final tax at lower rates – net	**(2.16)**	(1.00)
Others	**1.37**	2.27
	12.71%	16.41%

Deferred income tax at December 31 relates to the following:

	2005	2004 (As restated, see Notes 2 and 3)
Deferred income tax assets:		
NOLCO	**₱92,626**	₱30,081
Allowances for:		
Doubtful accounts and probable losses	**86,085**	56,857
Inventory obsolescence	**40,786**	40,264
MCIT	**50,964**	51,298
Accrued retirement benefits	**17,503**	22,999
Unrealized foreign exchange losses	**9,958**	19,732
Unamortized preoperating expenses and software and project development costs	**9,662**	15,437
Pension cost liability	**4,704**	4,066
Unamortized past service cost	**4,214**	3,769
Others	**683**	228
Deferred income tax assets	**₱317,185**	₱244,731

	2005	2004 (As restated, see Notes 2 and 3)
Deferred income tax liabilities:		
Unamortized customs duties and taxes capitalized	**10,503**	8,175
Pension cost	**6,017**	7,060
Unamortized streetlight donations capitalized	**–**	1,749
Rental income based on straight line	**1,047**	–
Unrealized foreign exchange gains	**6,893**	60,574
Others	**(3,207)**	(318)
Net deferred income tax liabilities	**₱21,253**	₱77,240

In computing for deferred tax assets and liabilities, the rate used was 35%, which is the rate expected to apply to taxable income in the years in which the deferred tax assets and liabilities are expected to be recovered or settled. In addition, the effect of ATSC's availment of income tax holiday incentive for its registration with the Board of Investments (BOI) (see Note 29) on certain temporary differences has likewise been considered in the above computation.

As of December 31, 2005, the Group has carryover NOLCO and MCIT (incurred in 2003 to 2005 and expires in 2006 to 2008) that can be claimed as deductions from future taxable income or used as deductions against income tax liabilities as follows:

Year incurred	Expiry date	NOLCO	MCIT
2003	2006	₱554,451	₱32,353
2004	2007	558,902	3,210
2005	2008	260,606	22,188
		₱1,373,959	₱57,751

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

At December 31, 2005 and 2004, deferred income tax liabilities have not been recognized on the undistributed earnings of subsidiaries and associates since such amounts are not taxable. Such undistributed earnings amounted to ₱5,312,663 and ₱4,374,637 in 2005 and 2004, respectively (see Note 11).

There are no income tax consequences to the Group attaching to the payment of dividends to its shareholders.

27. Related Party Disclosures

ACO, the holding company of the Group, owns 49.80% of the Company's common shares.

In the normal course of business, the Group enters into transactions with related parties, principally consisting of the following:

a. Management and other service contracts of certain subsidiaries and associates with ACO at fees based on agreed rates. Management and other service fees paid by the Group to ACO amounted to 221,429 and 199,943 in 2005 and 2004, respectively.

b. Temporary cash advances from and to ACO for working capital requirements. The advances are interest bearing at an average rate of 6.60% in 2005 and 3.26% in 2004. Net interest expense (income) on temporary cash advances from (to) ACO amounted to 3,606, and (1,904) in 2005 and 2004 respectively.

c. Aviation services rendered by AEV Aviation to associates. Total aviation services income from such associates amounted to 4,433 and 2,586 in 2005 and 2004, respectively.

d. Lease of commercial office units by ACO and certain associates from CPDC for a period of three years. Rental income amounted to 7,609 and 6,453 in 2005, and 2004, respectively.

e. Freight revenues from associates amounted to ₱14,619 and ₱49,074 in 2005 and 2004, respectively. Expenses incurred relating to such revenues amounted to ₱427,880 and ₱265,066 in 2005 and 2004, respectively.

Significant outstanding account balances with related parties as of December 31, 2005 and 2004 are as follows:

		Amounts Owed By Related Parties	Amounts Owed to Related Parties
ACO	**2005**	**₱–**	**₱5,998**
	2004	22,990	–
Accuria	**2005**	**219,413**	**–**
	2004	243,552	–

The compensation of key management personnel of the Company follows:

	2005	2004
Short-term employee benefits	**₱39,560**	₱43,999
Post-employment benefits	**1,880**	2,567
	₱41,440	₱46,566

28. Rate Regulation, Power Supply and Other Agreements

a. Certain subsidiaries are subject to the ratemaking regulations and regulatory policies by the ERC.

b. Certain subsidiaries have contracts for the purchase of electricity from National Power Corporation (NPC). Under the contracts, the parties have agreed, among others, on the contract demand (1,560 kilowatts, 216 kilowatts and 28 kilowatts for DLP, CLP and SEZC, respectively) and contract energy (504,367 kilowatt hours, 104,400 kilowatt hours and 13,286 kilowatt hours for DLP, CLP and SEZC, respectively per year at varying monthly rates per kilowatt hour), allocated by NPC to the subsidiaries for each year during the effectivity of the agreements.

c. HEDCOR has an Electric Power Supply Agreement with various corporations to supply or sell power and energy produced by the mini hydro electric power plants. The maturity of these agreements vary from one off-taker to another with the nearest to mature in calendar year 2007 and the farthest in 2018. All agreements provide for renewals or extensions subject to mutually agreed terms and conditions by both parties. HEDCOR is committed to supply 130,000 kilowatt hours per year based on 88% of the Luzon grid rate per kilowatt hour.

d. HEDCOR signed an Operating and Maintenance Agreement with LHC to provide administration services and operate the 70 MW hydro electric power plant of LHC located in Alilem, Ilocos Sur starting on October 27, 2000 until December 31, 2006 unless extended by mutual written agreement by the parties.

e. AJBTC, JMI and AJMSI (Agents) have outstanding agreements with foreign shipping principals, wherein the Agents render manning and crew management services consisting primarily of the employment of crew for the principals' vessels. As such, the principals have authorized the Agents to act on their behalf with respect to all matters relating to the manning of the vessels. Total service fees recognized in the consolidated statements of income amounted to ₱279,808 in 2005 and ₱222,230 in 2004.

f. JMBVI and Subsidiaries have outstanding Charter Party Agreements with the vessels' owners for the use of the vessels or for sublease to third parties within the specified periods of 1 to 3 years under the terms and conditions covered in the agreements. In consideration thereof, JMBVI recognized charter hire expense amounted to ₱1,890,139 in 2005.

29. Registration with the Department of Energy and Board of Investments

a. HEDCOR and NMHC are registered as mini hydro electric power developers with the Department of Energy under Republic Act (RA) 7156, entitled "Mini Hydro Electric Power Incentive Act". By virtue of such registration, these companies were entitled to certain incentives, among which are the special privilege tax at the rate of 2% on power sales, tax and duty free importation of machinery, equipment and materials; tax credit on domestic capital equipment, and income tax holiday. Such incentives expired in 2000, except for the four (4) power plants located in Davao City, acquired from the Power Sector Assets and Liabilities Management Corporation which started commercial operations on January 19, 2005. Income tax holiday of the four plants started on September 28, 2005.

With the effectivity of RA 9136 known as "Electric Power Industry Reform Act of 2001", sales of generated power by generation companies became value added tax zero-rated. HEDCOR and NMHC have updated their registration with the BIR from VAT Exempt to VAT Zero Rated effective April 10, 2003.

b. ATSC is registered with the BOI under the Omnibus Investment Code of 1987 as a new operator of inter-island shipping through its SuperFerry 15, 16, 17 and 18 vessels on a pioneer status starting February 13, 2003 and SuperFerry 19 starting December 29, 2004, and Superferry 12 starting May 4, 2005. Such registration entitles ATSC to income holiday for a period of three to six years from the date of registration. Income tax holiday incentive availed amounted to ₱55,789 and ₱40,640 in 2005 and 2004, respectively.

30. Financial Risk Management Objectives and Policies

The Group's principal financial instruments comprise of cash and cash equivalents, AFS investments, trade and other receivables, trade and other payables, non-convertible, cumulative, redeemable preferred shares, and interest-bearing loans. The main purpose of these financial instruments is to raise finances for the Group's operations and its investments in existing associates and in new projects.

The main risks arising from the Group's financial instruments are interest rate risk resulting from movements in interest rates that may have an impact on outstanding long-term loans; credit risk involving possible exposure to counter-party default on its cash investments; liquidity risk in terms of the proper matching of the type of financing required for specific investments; and foreign exchange risk in terms of foreign exchange fluctuations that may significantly affect its foreign currency denominated placements.

Interest rate risk. The Group's exposure to market risk for changes in interest rates relates primarily to its long-term debt obligations. To manage this risk, the Group determines the mix of its debt portfolio as a function of the level of current interest rates, the required tenor of the loan, and the general use of the proceeds of its various fund raising activities.

Credit risk. For its cash investments, the Group's credit risk is generally concentrated on possible default of the counter-party, with a maximum exposure equal to the carrying amount of these investments. The risk is mitigated by the short-term and or liquid nature of its cash investments mainly in bank deposits and placements, which are placed with financial institutions of high credit standing.

Credit risk, or the risk of counterparties defaulting, is controlled by the application of credit approval, limit and monitoring procedures. It is the Group's policy to enter into transactions with a diversity of credit-worthy parties to mitigate any significant concentration of credit risk. The Group ensures that sales of are made to customers with appropriate credit history and has internal mechanism to monitor the granting of credit and managements of credit exposures.

Liquidity risk. The Group maintains sufficient cash and cash equivalents to finance its operations. Any excess cash is invested in short-term money market placements. These placements are maintained to meet maturing obligations and pay dividend declarations. The Group, in general, matches the appropriate long-term funding instruments with the general nature of its equity investments.

Foreign Exchange. The foreign exchange risk of the Group is mainly with respect to its foreign currency denominated cash investments. To mitigate the risk of incurring foreign exchange losses, foreign currency holdings are matched against the potential need for foreign currency in financing equity investments and new projects.

31. Financial Instruments

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements at other than fair values (amounts in millions).

	Carrying Amount	Fair Value
Financial assets		
Cash	₱4,623	₱4,623
Trade and other receivables	3,368	3,368
Available-for-sale financial assets	150	150
	₱8,141	₱8,141
Financial liabilities		
Bank loans	₱1,299	₱1,299
Trade and other payables	4,595	4,595
Customers' deposits	1,016	1,016
Obligations under finance leases	351	404
Floating rate borrowings	3,238	3,238
Fixed rate borrowings	4,329	4,608
Redeemable preferred shares	1,887	1,887
	₱16,715	₱17,047

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

Fair Value of Financial Instruments

Fair value is defined as the amount at which the financial instrument could be exchanged in a current transaction between knowledgeable willing parties in an arm's length transaction, other than in a forced liquidation or sale. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models, as appropriate.

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents and trade and other receivables. The carrying amounts of cash and cash equivalents and trade and other receivables approximate fair value due to the relatively short-term maturity of these financial instruments.

Fixed-rate borrowings. The fair value of fixed rate interest bearing loans is based on the discounted value of future cash flows using the applicable rates for similar types of loans.

Variable-rate borrowings. Where the repricing of the variable-rate interest bearing loan is frequent (i.e., three-month repricing), the carrying value approximates the fair value. Otherwise, the fair value is determined by discounting the principal plus the known interest payment using current market rates. The carrying value of the variable-rate borrowings approximate the fair value.

Redeemable preferred shares and available-for-sale financial assets. The fair value of the redeemable preferred shares is based on the discounted value of future cash flows using the applicable rates for similar types of borrowings. The fair value of available-for-sale financial assets is based on quoted market prices.

Obligations under finance lease. The fair values of obligations under finance lease are based on the discounted net present value of cash flows using prevailing market rates.

Interest rate risk

The following table sets out the carrying amount, by maturity, of the Group's financial instruments that are exposed to interest rate risk as of December 31, 2005:

	< 1 year	1-5years	> 5 years	Total
Floating rate - long-term debt	₱1,187,850	₱3,060,268	₱80,452	₱4,328,570
Fixed rate - long-term debt	568,396	2,228,616	441,450	3,238,462
Redeemable preferred shares	–	1,886,940	–	1,886,940
Obligations under finance lease	140,393	210,490	–	350,883
	₱1,896,639	₱7,386,314	₱521,902	₱9,804,855

Interest on financial instruments classified as floating rate is repriced at intervals of less than one year. 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 above tables are non-interest bearing and are therefore not subject to interest rate risk.

32. Other Commitments

a. Operating Lease Commitments

Certain subsidiaries lease their office space for a period of one to three years. Total rent charged to operations amounted to ₱133,181, ₱96,828, ₱1,700 in 2005, 2004 and 2003, respectively.

Future minimum rentals payable under non-cancelable operating leases is as follows as of December 31, 2005:

Within one year	₱28,744
After one year but not more than five years	87,317
	₱116,061

b. Memorandum of Agreement

In 2002, ATSC entered into a Memorandum of Agreement (Agreement) with Asian Terminals, Inc. (ATI) for the use of the latter's facilities and services at the South Harbor for the embarkation and disembarkation of ATSC's domestic passengers, as well as loading, unloading and storage of the cargoes. The Agreement shall be for a period of five years, which term commenced effective May 1, 2003, the first scheduled service of ATSC at the South Harbor. The Agreement is renewable for another five years under such terms as may be mutually agreed by the parties in writing. If the total term of the Agreement is less than ten years, then ATSC shall pay the penalty equivalent to unamortized reimbursement of capital expenditures and other related costs incurred by ATI in the development of South Harbor.

Under the terms and conditions of the Agreement, ATSC shall avail of the terminal services of ATI, which include among others, stevedoring, arrastre, storage, warehousing and passenger terminal. Domestic tariff for such services shall be subject to an escalation of 5% every year. Total service fees charged to operations amounted to ₱279,808 in 2005 and ₱222,230 in 2004.

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

c. Agreement with SBMA

On May 15, 2003, the SBMA, AEV and DLPC entered into a DMSA for the privatization of the SBMA PDS on a rehabilitate-operate-and-transfer arrangement. Under the terms of the DMSA, SEZC was created to undertake the administration, rehabilitation, operation and maintenance of the PDS including the provision of electric power service to the customers within the Subic Bay Freeport Secured Areas of the Subic Bay Freeport Zone as well as the collection of the relevant fees from them for its services and the payment by SBMA of the service fees throughout the service period pursuant to the terms of the DMSA.

The DMSA shall be effective for a 25-year period commencing on the turnover date and consisting of two phases: (a) the 5-year rehabilitation period and (b) the 20-year operation, management and maintenance period. Total estimated rehabilitation costs committed by SEZC under the DMSA amounted to ₱368,600.

For and in consideration of the services and expenditures of SEZC for it to undertake the rehabilitation, operation, management and maintenance of the PDS, it shall be paid by the SBMA the service fees in such amount equivalent to all the earnings of the PDS, provided, however, that SEZC shall remit the amount of ₱40,000 to the SBMA at the start of every 12-month period throughout the service period regardless of the total amount of all earnings of the PDS. The said remittance may be reduced by the outstanding power receivables from the SBMA, including streetlights power consumption and maintenance, for the immediately preceding year.

The unamortized portion of the remittance to the SBMA as of December 31, 2005 and 2004 amounting to ₱60,000 and ₱33,300 million, respectively, are presented as part of the “Prepayments and other current assets” account in the balance sheets.

33. Earnings Per Common Share and Dividends Per Preferred Share

Earnings per common share amounts were computed as follows:

		2005	2004 (As restated, see Notes 2 and 3)
a.	Net income attributable to equity holders of the parent	**₱3,159,132**	₱2,542,887
b.	Weighted average number of common shares issued and outstanding	**4,849,546,525**	4,821,494,988
c.	Earnings per common share (a/b)	**₱0.651**	₱0.527

(Amounts in Thousands, Except Par Value, Per Share Amounts, Kilowatt Hour Rates
Number of Shares, Percentages, Useful Lives and Exchange Rates)

34. Business Segment Information

The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

The power segment is engaged in power generation and sale of electricity.
The food manufacturing segment is engaged in the production of flour and feeds and swine breeding.
The transportation segment provides domestic sea transportation services.

Financial information on the operations of the various business segments are summarized as follows:

	Power		Food Manufacturing		Transport Services		Parent Company and Others		Eliminations		Consolidated	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004	**2005**	2004	**2005**	2004
REVENUE	**₱8,106,300**	₱6,583,131	**₱7,037,184**	₱6,168,828	**₱11,656,756**	₱9,681,849	**₱397,568**	₱67,580	**(₱274,984)**	(₱90,464)	**₱26,922,824**	₱22,410,924
RESULTS												
Segment results	**1,380,475**	1,096,626	**422,287**	389,227	**184,225**	522,898	**139,088**	(198,162)	**15,975**	–	**2,142,050**	1,810,589
Unallocated corporate income (expenses)	**493,182**	205,584	**135,516**	66,671	**180,096**	471,370	**(75,576)**	77,842	**(332,555)**	–	**400,663**	821,467
INCOME FROM OPERATIONS											**2,542,713**	2,632,056
Interest expense	**(232,381)**	(231,628)	**(50,724)**	(64,126)	**(383,406)**	(369,177)	**(590,227)**	(479,967)	**–**	–	**(1,256,738)**	(1,144,898)
Interest income	**25,638**	31,361	**6,652**	4,806	**26,166**	20,999	**186,288**	159,875	**–**	–	**244,744**	217,041
Share in net earnings of associates	**1,031,436**	821,372	**2,965**	3,668	**22,527**	(454)	**3,480,142**	3,005,065	**(2,381,727)**	(2,297,520)	**2,155,343**	1,532,131
Provision for Income tax	**(402,726)**	(323,037)	**(135,134)**	(63,236)	**36,082**	(133,123)	**33,209**	(11,717)	**–**	–	**(468,569)**	(531,113)
NET INCOME											**3,217,493**	2,705,217
OTHER INFORMATION												
Segment assets	**2,100,909**	1,752,301	**1,839,103**	1,823,477	**3,622,033**	3,348,995	**2,986,736**	3,895,318	**(277,201)**	(598,073)	**10,271,580**	10,222,018
Investments and advances	**3,383,353**	3,860,305	**54,292**	51,306	**46,915**	22,238	**22,422,708**	20,201,264	**(11,402,646)**	(10,886,820)	**14,504,622**	13,248,293
Unallocated corporate assets	**3,189,293**	3,027,893	**1,464,018**	1,385,355	**7,684,663**	7,867,417	**1,167,594**	1,010,385	**(39,064)**	(168,785)	**13,466,504**	13,122,265
Consolidated total assets											**38,242,706**	36,592,576
Segment liabilities	**933,333**	1,122,245	**351,525**	239,169	**3,322,429**	3,011,543	**83,486**	85,067	**(62,893)**	(302,269)	**4,627,880**	4,155,755
Unallocated corporate liabilities	**3,993,387**	2,821,064	**1,265,036**	1,470,950	**3,599,579**	3,696,982	**4,199,394**	5,702,627	**(749,033)**	(1,509,363)	**12,308,363**	12,182,260
Consolidated total liabilities											**16,936,243**	16,338,015
Capital Expenditure	**809,694**	489,449	**173,034**	23,681	**1,002,947**	2,424,812	**33,897**	21,516	**–**	–	**2,019,572**	2,959,458
Depreciation and amortization	**403,166**	356,355	**96,133**	90,027	**1,288,269**	1,257,180	**41,435**	57,072	**–**	–	**1,829,003**	1,760,634
Non-cash expenses other than depreciation	**8,439**	11,296	**591**	180	**493,420**	508,050	**125,385**	14,832	**–**	–	**627,835**	534,358

35. Contingencies

There are legal cases filed against certain subsidiaries in the normal course of business. Management and its legal counsel believe that the subsidiaries have substantial legal and factual bases for their position and are of the opinion that losses arising from these cases, if any, will not have a material adverse impact on the consolidated financial statements.

36. Other Matters

a. Impact of the Generation Rate Adjustment Mechanism (GRAM) Case of the Manila Electric Company, Inc. (Meralco)

The ERC promulgated an Order dated February 24, 2003 in ERC Case No. 2003-44 adopting the Implementing Rules for the Recovery of Fuel and Independent Power Producer Costs or the GRAM. The GRAM Implementing Rules provide, among others, that before any generation cost is passed on to consumers by the distribution utilities, a petition must be filed at the ERC for approval. Meralco filed its application docketed as ERC Case No. 2004-112 for approval of actual generation costs for the period November 2003 to January 2004. In the Order dated June 2, 2004, the ERC approved the adjustment of Meralco's Generation Charge in accordance with the GRAM Implementing Rules.

The National Association of Electricity Consumers for Reforms (NASECORE) filed a Petition with the Supreme Court (SC) questioning the approval. In a Decision promulgated on February 2, 2006, the SC declared as void the ERC Order dated June 2, 2004 on the ground that the application and the GRAM Implementing Rules failed to satisfy the requirements on publication. Both the ERC and Meralco filed their respective motions for reconsideration of the SC decision.

An adverse decision by the SC on this case may affect the power industry. As of December 31, 2005, the ERC has approved the GRAM application of DLP. DLP, however, believes that the decision should not have a material impact to DLP since the above SC decision did not order the refund of the collections under the GRAM. In addition, generation costs for the period covered by the GRAM have all been confirmed for recovery from customers. If recovery is not allowed through the GRAM, it will be through some other methods that the ERC may allow.

b. Electric Power Industry Reform Act of 2001 (EPIRA)

RA No. 9136 was signed into law on June 8, 2001 and took effect on June 26, 2001. RA No. 9136 provides for the privatization of NPC and the restructuring of the electric power industry. The Implementing Rules and Regulations (IRR) were approved by the Joint Congressional Power Commission on February 27, 2002.

RA No. 9136 and the IRR impact the power industry as a whole. Other provisions of RA No. 9136 and the IRR are: (a) distribution utilities will provide open and nondiscriminatory access to its distribution systems within three years from the effectivity of the EPIRA, subject to certain conditions precedent; (b) distributors shall be allowed to recover stranded contract costs, subject to review and verification by the ERC for fairness and reasonableness; (c) NPC and distributors shall have filed their proposed unbundled charges within six months from the EPIRA's effectivity; (d) distributors shall file a Business Separation Unbundling Plan (BSUP) with the ERC by December 26, 2002; (e) residential users shall get a ₱0.30 per kwh reduction in power rates to be provided by NPC and passed on by distributors starting August 2001; (f) the power to grant electric distribution franchises shall be vested solely in Congress, thereby repealing or amending Section 43 of Presidential Decree 269 (The National Electrification Decree); (g) NPC shall segregate its subtransmission assets for disposal to qualified distributors within two years from the effectivity of the EPIRA; (h) NPC shall file with the ERC within six months from the effectivity of the EPIRA the Transition Supply Contracts negotiated with distributors; and (i) distribution companies may engage in related business, provided up to 50% of the income from the related business shall be used to lower wheeling charges. The law also empowers the ERC to enforce rules to encourage competition and penalize anti-competitive behavior.

Following the enactment of EPIRA in June 2001, the implementation of its various provisions continued in 2005.

Distribution Wheeling Rate Guidelines

In accordance with the authority given to the ERC by Sec. 43 of EPIRA to "adopt alternative forms of internationally-accepted rate-setting methodology", the ERC approved the Distribution Wheeling Rate Guidelines (DWRG) on December 20, 2004. The DWRG took effect on January 29, 2005.

DWRG embodies a new rate-fixing scheme more commonly known as performance-based ratemaking (PBR). Under the current RORB methodology, utility tariffs are based on historical costs plus a reasonable rate of return. On the other hand, the PBR scheme sets tariffs according to forecasts of performance and capital and operating expenditures. The DWRG also employs a penalty/reward mechanism depending on a utility's actual performance.

The DWRG stipulates that the ERC must publish a Regulatory Reset Issues Paper for the regulatory reset process, which the ERC released for public comments last September 30, 2005. Also, participating utilities shall submit to the ERC information on historical network and customer service performance by March 31, 2006 and file a rate application by August 31, 2006. After hearings and regulatory evaluation, the new PBR-based tariffs should be implemented by July 2007.

Wholesale Electricity Spot Market

The year 2005 also saw the Philippine Electricity Market Corporation, or PEMCO, finalizing its preparations for the commercial operations of the wholesale electricity spot market, or WESM, as envisioned by Sec. 30 of EPIRA.

To test the WESM's hardware and software systems, the PEMCO began a Trial Operations Program last April 2005, in which the power distribution utilities participated. The WESM system was also certified by PA Consulting as being "substantially compliant" with the WESM rules and the associated market manuals and system operations procedures. For its governance structure, the PEMCO Board is selecting members to the committees that will assist it in overseeing the operation of the WESM. These committees include the Market Surveillance Committee, Dispute Resolution Administrator, Rules Change Committee, Technical Committee, and the PEM Auditor.

Presently, the PEMCO and the DOE is seeking regulatory approval of key market rules, particularly the market's price determination methodology (PDM), the setting of market fees, and the administered price.

Preparations for retail competition

The ERC has been laying down the framework for the eventual introduction of retail competition and open access, in accordance with Sec. 31 of EPIRA. The framework, known as the "seven pillars", is a set of regulations that are intended to encourage and govern competition in the retail supply market.

Of the seven, three have been promulgated, the Business Separation Guidelines (September 2003), the Retail Electricity Supplier Licensing Guidelines (July 2005), and the Distribution Service and Open Access Rules (February 2006). Currently, the ERC is soliciting comments on a draft Code of Conduct for Retail Market Participants and the proposed Supplier of Last Resort, or SoLR, Guidelines, the draft Manual of Uniform Business Practices, and a revised Competition Rules and Complaints Procedures.

The ERC has yet to release a draft of its Manual of Uniform Business Practices.

The ERC also announced that it would be conducting public consultations on a possible revision of its timeline for implementing retail competition.
In an earlier Resolution (dated September 2004), the ERC set the commencement of retail competition in the Luzon Grid on July 1, 2006.

Removal of cross-subsidies

The ERC ordered the schedule of the inter-class subsidy. The gradual removal of cross-subsidies is mandated by Sec. 74 of the EPIRA.

c. DLP's Case

On December 7, 1990, certain customers of DLP filed a letter-petition for recovery before the Energy Regulatory Board (ERB), ERC's predecessor agency, claiming that with the SC's decision reducing the sound appraisal value of DLP's properties, that DLP exceeded the 12% return on rate base. ERB's order dated June 4, 1998, limited the computation coverage of the refund from January 19, 1984 to December 14, 1984. No amount was indicated in the ERB order as this has yet to be recomputed.

The Court of Appeals (CA), in Court of Appeals General Register (CAGR) No. Special Proceeding (SP) No. 50771, promulgated a decision dated February 23, 2001 which reversed the order of the ERB, expanding the computation coverage period from January 19, 1984 to September 18, 1989.

DLP strongly disputes the decision. However, whatever is the outcome of the final decision, management is confident that there are no excess profits for the period 1984-1989 and therefore, there will be no refund.

d. VECO Dispute

On March 17, 2004, the Parent Company and Vivant, of which the Garcia family is the majority owner, signed a Memorandum of Agreement (MOA) for the purpose of amicably settling all existing litigation among the parties and to cooperate with respect to the management and preservation of VECO's assets, franchise and business for the benefit of all stakeholders.

The dispute arose when Hijos de F. Escaño (Hijos), a holding company owning 51% of the outstanding shares in VECO swapped 30% of its controlling block of shares in exchange for shares in the Garcia's publicly listed company, Vivant. VECO is the second largest private electric distribution utility in the county with a franchise in Cebu. Hijos is owned 46.7% by the Parent Company and 50.9% by the Garcia family. The Parent Company beneficially owns a total of 54.58% of the outstanding shares of VECO.

The MOA also aims to restore Hijos' VECO shares transfred under the share swap transaction and redistribute prorata the excess of Hijos' 25% shareholdings in VECO to its shareholders to comply with the Electric Power Industry Reform Act of 2001. The agreed redistribution under the MOA will result in the increase of the Aboitizes' direct ownership of VECO to 43%. Under the MOA, the Garcias and the Aboitizes will share in the management of VECO. The Garcias will retain control of the VECO Board. The chairmanship and the vice-chairmanship will be rotated every year. Initially, the Garcias will nominate the chairman, while the Aboitizes will nominate the vice-chairman. The Garcias will also nominate the President. On the other hand, the Aboitizes will nominate the Executive Vice-President/Chief Operating Officer who will be responsible for the operations and performance of VECO. Moreover, the BOD shall create an Executive Committee that will be composed of five members. Such committee will have two co-chairmen, with the Garcias and the Aboitizes nominating their co-chairmen.

Effectivity of the MOA is subject to compliance on or before April 2, 2004 of specific conditions, which include the finalization of Shareholders Cooperation Agreements and the setting up of an escrow account that will serve to enforce certain conditions of the MOA and mutual settlement of the cases at the CA.

On April 2, 2004, after complying with the specific conditions, the MOA was completed and related closing documents were signed.

On July 7, 2004, the Court of Appeals upheld the MOA in its Notice of Judgment with respect to the appeals filed by the Garcia and Aboitiz groups on the Decision dated January 8, 2004 in civil case No. SRC-045-CEB of the Regional Trial Branch 12, Cebu City.

e. LHC Arbitration

LHC is a party to a dispute with a contractor regarding the delay in the completion of LHC's Power Station. Under the Turnkey Contract, the contractor shall pay liquidated damages for each day of delay on the following day without the need of demand from LHC. LHC may, without prejudice to any other method of recovery, deduct the amount of such damages from any monies due or to become due to the contractor and/or by drawing on the irrevocable and confirmed standby letters of credit amounting to US$18 million (the Security).

In 2001, due to the delay in the completion of the Power Station, LHC withdrew the irrevocable and confirmed standby letters of credit amounting to US$18 million which the contractor has constituted as security to LHC as contained in the Turnkey Contract.

In November 2000, the contractor and LHC elevated their claims and counterclaims to an Arbitration Tribunal operating under the Rules of International Chamber of Commerce sitting in Australia (ICC International Australian Case No. 11264/TE/MW).

The Arbitration Tribunal delivered the final award on August 9, 2005.

LHC was successful in certain claims concerning the design and construction of the lined and unlined tunnel. However, the Arbitration Tribunal also found that the contractor is entitled to certain money claims and refund of the liquidating damages that LHC has drawn from the contractor's letters of credit.

LHC has recognized provisions for arbitration for the full financial effects of the final award delivered by the Arbitration Tribunal for the claims and counterclaims filed by the contractor and LHC for the construction of the Power Station.

LHC believes that the accounting entries made for the full financial effects of the final award do not reflect its admission of any obligation under the award and that the ultimate amounts of liabilities to be paid or settled, if any, depend upon the final outcome of other court cases that would affect enforcement of said final award.

f. Use of Tax Credit Certificates (TCC)

PILMICO, Pilmico-Mauri and VECO were ordered by the Bureau of Internal Revenue (BIR) to pay the total amount of ₱57,618, including fines and penalties for value added taxes (VAT) for the first quarter of 2003 and April 2003. The order arises from the use of alleged invalid TCCs purchased by the companies and subsequently applied to taxes due. Management has been advised by its legal counsel that the order of payment was not preceded by a letter of authority to investigate, an actual investigation, nor by a deficiency assessment for VAT. The companies' legal counsel believes that the assessment is void for lack of due process and has contested the same at the Court of Tax Appeals. The case is now undergoing trial on the merits of the BIR order of payment. Management and legal counsel believe that the order of payment has no legal basis because aside from the above stated reasons, the VAT sought to be paid has in fact already been paid in the form of Tax Debit Memo validly issued by the BIR.

aboitiz
Equity Ventures

Investor Information

Head Office: Aboitiz Corporate Center,
Gov. Manuel A. Cuenco Avenue,
Kasambagan, Cebu City 6000, Philippines
Tel. No. (63-32) 231-2580 • Fax (63-32) 231-4031

Metro Manila Office: 6th Floor, Legazpi Street,
Legaspi Village, Makati City, Manila, Philippines
Tel. No. (63-2) 816-2881 • Fax (63-2) 817-3560

Common Stock
The Company's common stock is listed and traded on the Philippine Stock Exchange.

Citibank N.A. serves as depository bank.

Stockholders' Meeting
The Company's regular stockholders' meeting is held on the third Monday of May of every year.

Stockholders' Services and Assistance
The UnionBank of the Philippines' Stock Transfer Department serves as the Company's stock transfer agent registrar. For inquiries regarding dividend payments, change of address and account status, lost or damaged stock certificates, please write or call:

UBP Stock Transfer Department
UBP Plaza
23/F Meralco Avenue
Corner Onyx Street,
Ortigas Center, Pasig City
Trunk lines: (63-2) 638-0280 / 638-0299
Fax number: (63-2) 638-0234

Institutional Investor Inquiries
AEV welcomes inquiries from institutional investors, analysts, and the financial community.

Please write or call:

Investor Relations
Aboitiz Equity Ventures, Inc.
Tel: (63-32) 231-1874
Fax: (63-32) 231-4031
e-mail: aev@aboitiz.com
www.aboitiz.com

Prepared by AEV Corporate Communications Group
Design by Henson Design
Photos by Jimmy Henson [Corporate], Ben Chan [Portraits]

Cebu: Aboitiz Corporate Center
Gov. Manuel A. Cuenco Avenue
Cebu City, Philippines
Tel. No. (63-32) 231-2580
Fax (63-32) 231-4031

Manila: 6th Floor, 110 Legazpi Street
Legaspi Village, Makati City, Philippines
Tel. No. (63-2) 816-2881
Fax (63-2) 817-3560

www.aboitiz.com
email: aev@aboitiz.com

aboitiz
Equity Ventures