

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Philippine Seven Corporation is responsible for all information and representations contained in the consolidated financial statements for the years ended December 31, 2006, 2005 and 2004. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the company's audit committee and 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 or the Executive Committee or the Audit Committee, as authorized by the Board, reviews the financial statements before such statements are approved and submitted to the stockholders of the Company.

Sycip Gorres Velayo and Company, the independent auditors appointed by the Stockholders, has examined the financial statements of the Company in accordance with generally accepted auditing standards in the Philippines and has expressed its opinion on the fairness of presentation upon completion of such examination, in its report to the Board of Directors and/or Executive Committee or Audit Committee and Stockholders.



VICENTE T. PATERNO
Chairman of the Board



JOSE VICTOR P. PATERNO
President



TSUNG-YU LIN
Vice-President for Finance and Administration / Treasurer & CFO

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
Philippine Seven Corporation

We have audited the accompanying financial statements of Philippine Seven Corporation and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2006 and 2005, and the consolidated statements of income, consolidated statements of changes in stockholders' equity and consolidated statements of cash flows for the year ended, and a summary of significant accounting policies and other explanatory notes. The financial statements for the year ended December 31, 2004 were audited by other auditors whose report thereon dated April 6, 2005 expressed an unqualified opinion on those statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Philippine Seven Corporation and Subsidiaries as of December 31, 2006 and 2005, and their financial performance and their cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.



Aldrin M. Cerrado

Partner

CPA Certificate No. 86735

SEC Accreditation No. 0113-AR-1

Tax Identification No. 129-433-783

PTR No. 0266534, January 2, 2007, Makati City

March 6, 2007

PHILIPPINE SEVEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31	
	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	₱329,364,375	₱204,310,766
Receivables - net (Note 5)	47,276,638	73,481,008
Inventories - at cost (Note 6)	331,926,504	336,193,860
Prepayments and other current assets (Note 7)	59,485,387	35,449,833
Total Current Assets	768,052,904	649,435,467
Noncurrent Assets		
Property and equipment - net (Note 8)	800,526,339	714,453,693
Deferred lease expense (Note 22)	17,955,866	18,718,401
Deferred income tax assets - net (Note 24)	54,008,463	77,598,357
Other noncurrent assets - net (Note 9)	197,587,811	199,715,877
Total Noncurrent Assets	1,070,078,479	1,010,486,328
TOTAL ASSETS	₱1,838,131,383	₱1,659,921,795
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Bank loans (Note 10)	₱404,700,000	₱240,000,000
Accounts payable and accrued expenses (Note 11)	610,222,957	556,129,563
Income tax payable	335,684	304,193
Current portion of long-term debt (Note 13)	6,500,000	93,000,000
Other current liabilities (Note 12)	163,181,870	119,649,081
Total Current Liabilities	1,184,940,511	1,009,082,837
Noncurrent Liabilities		
Long-term debt - net of current portion (Note 13)	-	32,500,000
Net pension liabilities (Note 20)	26,888,841	22,700,899
Cumulative redeemable preferred shares (Note 16)	6,000,000	6,000,000
Total Noncurrent Liabilities	32,888,841	61,200,899
Total Liabilities	1,217,829,352	1,070,283,736
Stockholders' Equity		
Capital stock (Notes 14 and 15) - ₱1 par value		
Authorized - 400,000,000 shares		
Issued - 237,938,250 (held by 706 and 713 equity holders		
in 2006 and 2005, respectively)	237,938,250	237,938,250
Additional paid-in capital (Note 14)	293,525,037	293,525,037
Unrealized gain on available-for-sale financial assets	10,519,880	-
Retained earnings	81,242,110	61,098,018
	623,225,277	592,561,305
Cost of 686,250 shares held in treasury (Note 15)	(2,923,246)	(2,923,246)
Total Stockholders' Equity	620,302,031	589,638,059
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	₱1,838,131,383	₱1,659,921,795

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE SEVEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(With Comparative Figures for 2004)

	Capital Stock	Additional Paid-in Capital	Unrealized Gain on Available- for-Sale Financial Assets	Retained Earnings	Treasury Stock	Total
BALANCES AS OF DECEMBER 31, 2003	₱237,938,250	₱293,525,037	₱-	₱49,794,557	(₱2,923,246)	₱578,334,598
Net loss for the year	-	-	-	(2,044,109)	-	(2,044,109)
BALANCES AS OF DECEMBER 31, 2004	237,938,250	293,525,037	-	47,750,448	(2,923,246)	576,290,489
Effect of change in accounting for refundable security deposits (Note 2)	-	-	-	(412,842)	-	(412,842)
BALANCES AS OF JANUARY 1, 2005	237,938,250	293,525,037	-	47,337,606	(2,923,246)	575,877,647
Net income for the year	-	-	-	13,760,412	-	13,760,412
BALANCES AS OF DECEMBER 31, 2005	237,938,250	293,525,037	-	61,098,018	(2,923,246)	589,638,059
Unrealized gain on available-for-sale financial assets during the year	-	-	10,519,880	-	-	10,519,880
Total income recognized directly in equity	-	-	10,519,880	-	-	-
Net income for the year	-	-	-	20,144,092	-	20,144,092
Total income for the year	-	-	10,519,88	20,144,092	-	20,144,092
BALANCES AS OF DECEMBER 31, 2006	₱237,938,250	₱293,525,037	₱10,519,880	₱81,242,110	(₱2,923,246)	₱620,302,031

See accompanying Notes to Financial Statements.

PHILIPPINE SEVEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(With Comparative Figures for 2004)

	2006	2005	2004
REVENUE FROM MERCHANDISE SOLD	₱4,627,880,441	₱4,587,558,113	₱3,941,872,423
COST OF MERCHANDISE SOLD (Note 17)	3,224,082,277	3,186,251,240	2,708,335,765
GROSS PROFIT	1,403,798,164	1,401,306,873	1,233,536,658
Operating expenses (Note 18)	(1,611,425,160)	(1,532,295,682)	(1,328,090,589)
Franchise revenue (Note 26)	147,997,380	58,726,825	22,097,973
Marketing income (Note 26)	82,574,708	96,958,364	77,851,603
Rent income (Note 22)	39,889,745	35,771,211	21,548,725
Interest expense (Note 16)	(35,913,785)	(33,792,023)	(26,861,180)
Commission income (Note 26)	28,635,785	37,848,387	43,575,945
Loss on sale of property and equipment - net	(5,165,280)	(16,717,753)	(14,935,101)
Interest income (Note 9)	2,760,331	3,703,207	3,478,084
Unrealized foreign exchange loss	(1,206,673)	(6,465)	-
Others - net	(4,774,307)	(10,848,566)	(2,247,842)
	(1,356,627,256)	(1,360,652,495)	(1,203,582,382)
INCOME BEFORE INCOME TAX	47,170,908	40,654,378	29,954,276
PROVISION FOR INCOME TAX (Note 24)			
Current	28,819,683	18,646,541	24,883,136
Deferred	(1,792,867)	8,247,425	7,115,249
	27,026,816	26,893,966	31,998,385
NET INCOME (LOSS)	₱20,144,092	₱13,760,412	(₱2,044,109)
BASIC/DILUTED EARNINGS (LOSS) PER SHARE (Note 23)	₱0.08	₱0.06	(₱0.01)

See accompanying Notes to Consolidated Financial Statements.

PHILIPPINE SEVEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005
(With Comparative Figures for 2004)

	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	₱47,170,908	₱40,654,378	₱29,954,276
Adjustments for:			
Depreciation and amortization (Notes 8 and 18)	154,046,259	124,769,238	118,608,597
Interest expense (Note 16)	35,913,785	33,792,023	26,861,180
Accounts written off (Note 18)	9,571,709	-	-
Loss on sale of property and equipment	5,165,280	16,717,753	14,935,101
Gain on write-off of long outstanding liability	(3,232,879)	-	-
Provision for doubtful accounts (Note 18)	2,903,498	-	-
Interest income	(2,760,331)	(3,703,207)	(3,478,084)
Amortization of software (Notes 9 and 18)	1,757,238	2,987,458	2,932,501
Amortization of deferred lease expense (Note 22)	1,660,064	2,107,225	-
Unrealized foreign exchange loss	1,206,673	6,465	-
Loss on refund of deposit	312,000	-	-
Write-off of other noncurrent assets	-	-	9,310
Operating income before working capital changes	253,714,204	217,331,333	189,822,881
Decrease (increase) in:			
Receivables	22,393,731	32,063,346	(48,275,749)
Prepayments and other current assets	5,021,991	(4,129,240)	6,785,934
Inventories	4,267,356	(32,993,915)	(85,335,007)
Increase (decrease) in:			
Accounts payable and accrued expenses	57,175,330	(44,325,854)	130,757,094
Other current liabilities	43,532,789	35,593,858	17,669,390
Net pension liabilities	4,187,942	4,635,376	3,957,023
Cash generated from operations	390,293,343	208,174,904	215,381,566
Interest paid	(35,762,842)	(33,619,530)	(16,635,672)
Income taxes paid	(32,462,976)	(27,558,116)	(19,451,329)
Interest received	1,847,906	2,194,957	3,478,084
Net cash from operating activities	323,915,431	149,192,215	182,772,649
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property and equipment (Note 8)	(248,336,018)	(220,866,173)	(210,197,242)
Refund of security deposit (Note 22)	8,307,564	-	-
Deductions from (additions to) other noncurrent assets	(6,378,528)	3,624,663	(110,570,625)
Proceeds from sale of property and equipment	3,051,833	1,044,776	775,926
Payment of refundable security deposit (Note 22)	-	(20,000,000)	-
Net cash used in investing activities	(243,355,149)	(236,196,734)	(319,991,941)
CASH FLOWS FROM FINANCING ACTIVITIES			
Availments of:			
Bank loans	446,100,000	115,000,000	-
Long-term debt	-	-	220,000,000
Payments of:			
Bank loans	(281,400,000)	(35,000,000)	-
Long-term debt	(119,000,000)	(54,000,000)	(90,531,222)
Net cash from financing activities	45,700,000	26,000,000	129,468,778
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND EQUIVALENTS FOR THE YEAR			
	(1,206,673)	(6,465)	-
NET INCREASE (DECREASE) IN CASH AND CASH AND EQUIVALENTS			
	125,053,609	(61,010,984)	(7,750,514)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR			
	204,310,766	265,321,750	273,072,264
CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 4)			
	₱329,364,375	₱204,310,766	₱265,321,750

See accompanying Notes to Financial Statements.

PHILIPPINE SEVEN CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Corporate Information and Operations

Philippine Seven Corporation (the Company) was incorporated in the Philippines and registered with the Securities and Exchange Commission (SEC) on November 29, 1982. The Company and its subsidiaries (collectively referred to as “the Group”), are primarily engaged in the business of retailing, merchandising, buying, selling, marketing, importing, exporting, franchising, acquiring, holding, distributing, warehousing, trading, exchanging or otherwise dealing in all kinds of grocery items, dry goods, food or foodstuffs, beverages, drinks and all kinds of consumer needs or requirements and in connection therewith, operating or maintaining warehouses, storages, delivery vehicles and similar or incidental facilities. The Group is also engaged in the management, development, sale, exchange, and holding for investment or otherwise of real estate of all kinds, including buildings, houses and apartments and other structures.

The Company is controlled by President Chain Store (Labuan) Holdings, Ltd., an investment holding company incorporated in Malaysia, which owns 56.59% of the Company’s outstanding shares. The remaining 43.41% of the shares are widely held. The ultimate parent of the Group is President Chain Store Corporation (PCSC, incorporated in Taiwan, Republic of China).

The registered office address of the Company is 7th Floor, The Columbia Tower, Ortigas Avenue, Mandaluyong City.

The consolidated financial statements were authorized for issue by the Board of Directors (BOD) on March 6, 2007.

2. Summary of Significant Accounting and Financial Reporting Policies

The principal accounting and financial reporting policies adopted in preparing the financial statements of the Group are as follows:

Basis of Preparation

The consolidated financial statements have been prepared under the historical cost basis, except for available-for-sale financial assets, which are carried at fair value. The consolidated financial statements are presented in Philippine Peso (Peso), which is the Company’s functional currency.

Statement of Compliance

The consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and the following subsidiaries:

	Country of Incorporation	Percentage of Ownership (Common and Preferred)
Convenience Distribution Inc. (CDI)	Philippines	100
Store Sites Holding, Inc. (SSHI)	Philippines	40

Subsidiaries are those entities in which the Company has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies through interlocking directorships such that substantial benefits from the subsidiaries' activities flow to the Company. SSHI is controlled by the Company, as SSHI has common key management personnel with the Company. The remaining 60% of the total shares is owned by Philippine Seven Corporation-Employees Retirement Plan (PSC-ERP) through its trustee, Bank of the Philippines Islands-Asset Management and Trust Group (BPI-AMTG).

The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using uniform accounting policies. Intercompany transactions, balances and unrealized losses are eliminated unless cost cannot be recovered.

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous year, except that the Group has made changes in accounting policies resulting from adoption of the following amendments to existing standards and Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC) interpretation effective beginning January 1, 2006:

- Philippine Accounting Standard (PAS) 19, *Employee Benefits - Actuarial Gains and Losses, Group Plans and Disclosures*, introduced an additional option for actuarial gains and losses arising in post-employment defined benefit plans and prescribed additional disclosures. The Group did not change its accounting for actuarial gains and losses but has included the disclosures required by the amendment.
- PAS 21, *The Effects of Changes in Foreign Exchange Rates*, which amended PAS 21 to recognize all exchange differences arising from a monetary item that forms part of the net investment in a foreign operation in a separate component of equity in the financial statements regardless of the currency in which the monetary item is denominated.
- PAS 39, *Financial Instruments: Recognition and Measurement - Amendment for Financial Guarantee Contracts*, which amended the scope of PAS 39 to include financial guarantee contracts issued. The amendment addresses the treatment of financial guarantee contracts by the issuer. Under PAS 39 as amended, financial guarantee contracts are recognized initially at fair value and generally re-measured at the higher of the amount determined in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with PAS 18, *Revenue*.
- PAS 39, *Financial Instruments: Recognition and Measurement - Amendment for Hedges of Forecast Intragroup Transactions*, which amended PAS 39 to permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in financial statements, provided that the transaction is denominated in a currency other

than the functional currency of the entity entering into the transaction and that the foreign currency risk will affect profit or loss.

- PAS 39, *Financial Instruments: Recognition and Measurement - Amendment for the Fair Value Option*, which restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through profit or loss.
- Philippine Interpretation IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied.

The adoption of the above amendments and interpretation has no material effect on the Group's consolidated financial statements.

Impact of PAS 32, *Financial Instruments: Disclosure and Presentation* and PAS 39, *Financial Instruments: Recognition and Measurement*

The adoption of PAS 32, and PAS 39 on January 1, 2005 resulted to the adjustment of the value of the Group's refundable security deposits to reflect measurement of these amounts at amortized cost using the effective interest rate method. The difference between the nominal amounts and the present values of the refundable security deposits are recognized as deferred lease expense in the consolidated balance sheets. The deferred lease expense is amortized using the straight-line method over the term of the lease in accordance with PAS 17, *Leases*.

Retained earnings as of January 1, 2005 decreased by ₱412,842, which represents the amounts of amortization of deferred lease expense and accretion of interest income from the inception of the lease.

New Accounting Standards, Interpretations and Amendments Effective Subsequent to 2006

The following accounting standards, interpretations and amendments to existing standard are effective subsequent to December 31, 2006:

- PFRS 7, *Financial Instruments: Disclosures*, and the complementary amendment to PAS 1, *Presentation of Financial Statements: Capital Disclosures* (effective for annual periods beginning on or after January 1, 2007), introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. The amendment to PAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group is currently assessing the impact of PFRS 7 and the amendment to PAS 1 and expects that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by PFRS 7 and the amendment to PAS 1. The Group will apply PFRS 7 and the amendment to PAS 1 in 2007.
- PFRS 8, *Operating Segments* (effective for annual periods beginning on or after January 1, 2009), requires a management approach to reporting segment information. PFRS 8 will replace PAS 14, *Segment Reporting*, and is required to be adopted only by entities whose debt or equity instruments are publicly traded, or are in the process of filing with the SEC for purposes of issuing any class of instruments in a public market. The Group expects that the adoption of this interpretation will not have a significant impact on the consolidated financial statements when implemented.

- Philippine Interpretation IFRIC 7, *Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies* (effective for annual periods beginning on or after March 1, 2006), provides guidance on how to apply PAS 29 when an economy first becomes hyperinflationary, in particular the accounting for deferred income tax. The Group is not required and will not adopt Philippine Interpretation IFRIC 7.
- Philippine Interpretation IFRIC 8, *Scope of PFRS 2* (effective for annual periods beginning on or after May 1, 2006), requires PFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. The Group expects that the adoption of this interpretation will not have a significant impact on the consolidated financial statements when implemented.
- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives* (for annual periods beginning on or after June 1, 2006), establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Group expects that the adoption of this interpretation will not have a significant impact on the consolidated financial statements when implemented.
- Philippine Interpretation IFRIC 10, *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after November 11, 2006), prohibits the reversal of impairment losses on goodwill and available-for-sale equity investments recognized in the interim financial reports even if impairment is no longer present at the annual balance sheet date. The Group expects that the adoption of this interpretation will not have a significant impact on the consolidated financial statements when implemented.
- Philippine Interpretation IFRIC 11, *PFRS 2 - Group and Treasury Share Transactions* (effective for annual periods beginning on or after March 1, 2007), requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when the subsidiary's employees receive rights to the equity instruments of the parent. The Group currently does not have any stock option plan and therefore, does not expect this interpretation to have a significant impact to its consolidated financial statements when adopted.
- Philippine Interpretation IFRIC 12, *Service Concession Arrangements*, (effective for annual periods beginning on or after January 1, 2008), covers contractual arrangements arising from private entities providing public services. The Group expects that the adoption of this interpretation will not have a significant impact on the consolidated financial statements when implemented.

Cash and Cash Equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from the date of acquisition and that are subject to an insignificant change in value.

Financial Assets and Financial Liabilities

Financial assets and financial liabilities are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit and loss. Fair value is determined by reference to the transaction price or other market prices. If such market prices are not readily determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities.

The Group recognizes a financial asset or a financial liability in the balance sheet when it becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognized on the trade date, i.e., the date that the Group commits to purchase the assets. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place.

Financial Assets

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading and those designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also categorized as held for trading, except those derivatives designated and considered as effective hedging instruments.

Financial assets classified in this category are designated as at fair value through profit or loss by management on initial recognition when the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on them on a different basis, or
- The assets are part of a group of financial assets, or both financial assets and financial liabilities, which are managed and their performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets at fair value through profit or loss are recorded in the consolidated balance sheet at fair value. Changes in fair value are accounted for directly in profit or loss. Interest earned is recorded in interest income, while dividend income is recorded in other income according to the terms of the contract, or when the right of the payment has been established.

The Group has not designated any financial asset as 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. Loans and receivables are carried

either at cost or amortized cost in the consolidated balance sheet. Amortization is determined using the effective interest rate method. Loans and receivables are included in current assets if maturity is within twelve months from the balance sheet date. Otherwise, these are classified as noncurrent assets.

Classified as loans and receivables are the Group's receivable.

(c) Held-to-maturity investments

Held-to-maturity (HTM) 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. HTM assets are carried either at cost or amortized cost in the consolidated balance sheet. 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 from the balance sheet date and noncurrent assets if maturity is more than a year.

The Group has not designated any financial asset as HTM.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. Available-for-sale assets are carried at fair value in the consolidated balance sheet. Changes in the fair value of such assets are accounted for in equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is recognized in the consolidated statement of income. These financial assets are classified as noncurrent assets unless the intention is to dispose such assets within twelve months from the balance sheet date.

The Group has designated its noncurrent investments in marketable securities as available-for-sale financial assets.

Financial Liabilities

(a) Financial liabilities at fair value through profit or loss

Financial liabilities classified under this category are designated by management on initial recognition when the following criteria are met:

- The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognizing gains or losses on them on a different basis, or
- The liabilities are part of a group of financial liabilities, or both financial assets and financial liabilities, which are managed and their performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial liabilities at fair value through profit or loss are recorded in the consolidated balance sheet at fair value. Changes in fair value are accounted for directly in profit or loss. Interest incurred is recorded in interest expense.

(b) Other financial liabilities

This category pertains to financial liabilities that are not held for trading or not designated as fair value through profit or loss upon the inception of the liability. These include liabilities arising from operations (e.g., payables, accruals).

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

The Group determines the classifications of financial assets and financial liabilities at initial recognition and, where allowed and appropriate, reevaluates these classifications at every reporting date.

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 loss is measured as a 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 through the use of an allowance account. The amount of loss is recognized in the consolidated statement of income. The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and 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 the group of financial assets with similar credit risk and 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 continue to be recognized are not included in a collective assessment of impairment.

If, in 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 its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the consolidated 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 recognized in the consolidated statement of income 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.

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

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 the consolidated statement of income.

Inventories

Inventories are stated at the lower of cost or net realizable value (NRV). NRV is the selling price in the ordinary course of business, less the estimated cost of marketing and distribution. The Group is using the retail method in measuring the cost of its store merchandise inventory. Under this method, cost is determined using the average gross profit and is reviewed on a regular basis to ensure that it approximates actual costs. Cost of warehouse merchandise is determined using the first-in, first-out method.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation and amortization, and any impairment in value.

The initial cost of property and equipment consists of its purchase price, including import duties, taxes, and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the assets have been put into operations, such as repairs and maintenance and overhaul costs, are normally charged to operations in the period in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of the assets. When assets are retired or otherwise disposed of, both the cost and the related accumulated depreciation and amortization and any impairment in value are removed from the accounts and any resulting gain or loss is recognized in the statement of income.

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

When assets are sold or otherwise disposed of, its cost and the related accumulated depreciation and amortization, and any impairment in value are removed from the accounts, and any resulting gain or loss is reflected in the consolidated statement of income.

Depreciation is computed on a straight-line method over the estimated useful lives of the assets. Depreciation starts in the following month the property and equipment is received.

	Years
Store furniture and equipment	5 to 10
Buildings and improvements	10 to 12
Office furniture and equipment	3 to 5
Transportation equipment	3 to 5
Computer equipment	3

Leasehold improvements are amortized over the estimated useful lives of the improvements, ranging from 5 to 10 years, or the term of the lease, whichever is shorter.

The assets' residual values, estimated useful lives and depreciation and amortization method are reviewed periodically to ensure that the residual values, period and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property and equipment.

Software and Program Costs

Software and program costs, which are not specifically identifiable and integral to a specific computer hardware, are shown as part of other noncurrent assets in the consolidated balance sheet. These are carried at cost, less accumulated amortization and any impairment in value, which is computed on a straight-line method over their estimated useful life of five years.

Goodwill

Goodwill, included in other noncurrent assets in the consolidated balance sheet, represents the excess of the cost of an acquisition over the fair value of the businesses acquired. 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 carrying value may be impaired.

Impairment of Long-Lived Non-Financial Assets

The Group assesses at each balance sheet 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 risks specific to the asset. Impairment losses, if any, 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 depreciation, had no impairment been recognized for the asset in previous years. Such reversal is recognized in the consolidated statement of income, unless the asset is carried at revalued amount, in which case, the reversal is treated as a revaluation increase. After such 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.

Income Taxes

Current Income Tax

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

Deferred Income Tax

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

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences and carryforward benefits of unused net operating loss carryover (NOLCO) and excess of minimum corporate income tax (MCIT) over regular corporate income tax (RCIT) to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward benefits of unused NOLCO and MCIT can be utilized. Deferred income tax, however, is not recognized when it arises from the initial recognition of an asset or liability in

a transaction that is not a business combination and, at the time of transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred income tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries, associates and interest in joint ventures. With respect to investments in other subsidiaries, associates and interests in joint ventures, deferred income tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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 assets to be utilized.

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

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

Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably.

Revenue from merchandise sold is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer.

Marketing and franchise revenue are recognized when earned.

Commission on services is recognized upon the sale of consigned goods.

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

Interest income is recognized as it accrues based on effective interest rate method.

Pension Costs

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

Past service cost is recognized as an expense in the consolidated statement of income on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested following the introduction of, or changes to the 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 the plan assets out of which 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 refund from the plan or reductions in the future contributions to the plan.

Foreign Currency Transactions and Translations

Items included in the consolidated financial statements of the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to the Group. The consolidated financial statements are presented in Peso, which is the functional currency of the Company.

Foreign currency transactions are translated into the functional currency using the applicable exchange rates prevailing at the dates of the transactions. Outstanding foreign currency denominated monetary assets and liabilities are retranslated at the applicable exchange rates prevailing at the balance sheet dates. Foreign exchange gains or losses resulting from the settlement of such transactions and from the translation of outstanding foreign currency denominated monetary assets and liabilities are recognized in the consolidated statement of income.

Cumulative Redeemable Preferred Shares

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

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 arrangements convey a right to use the asset.

Group as Lessee

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

Group as Lessor

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

Provisions and Contingencies

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. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, 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 interest expense. When the Group expects a provision or

loss to be reimbursed, the reimbursement is recognized as a separate asset only when the reimbursement is virtually certain and its amount is estimable. The expense relating to any provision is presented in the consolidated statement of income, net of any reimbursement.

Contingent liabilities are not recognized in the consolidated financial statements. They 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 benefit is probable. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the consolidated financial statements. If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognized in the consolidated financial statements.

Earnings Per Share

Basic earnings per share is calculated by dividing the income or loss for the year attributable to common shareholders by the weighted average number of shares outstanding during the year, excluding treasury shares.

Diluted earnings per share is calculated by dividing the net income or loss for the year attributable to common shareholders by the weighted average number of shares outstanding during the year, excluding treasury shares and adjusted for the effects of all potential dilutive common shares, if any.

In determining both the basic and diluted earnings per share, the effect of stock dividends, if any, is accounted for retroactively.

Treasury Stock

Treasury stock is stated at acquisition cost and is deducted from equity. No gain or loss is recognized in the statement of income on the purchase, sale, issue or cancellation of the Group's own equity instruments.

3. Significant Accounting Judgments and Estimates

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.

Determination of Functional Currency

Based on the economic substance of the underlying circumstances relevant to the Company, the functional currency of the Company has been determined to be the Peso. The Peso is the currency of the primary economic environment in which the Company operates. It is the currency that mainly influences the revenue and costs of the Company.

Determination of Fair Values of Financial Assets and Liabilities

The Group carries certain financial assets and liabilities at fair value, which requires use of accounting estimates and judgment. While significant components of fair value measurement were determined using verifiable and objective evidence (i.e., foreign exchange rates, interest rates), the amount of changes in fair value would differ if the Group utilized a

different valuation methodology. Any changes in fair value of these financial assets and liabilities would affect profit and loss and equity.

As of December 31, 2006 and 2005, financial assets recognized in the consolidated balance sheets amounted to ₱400,778,627 and ₱297,504,284, respectively, while financial liabilities amounted to ₱1,190,604,827 and ₱1,047,278,644, respectively (see Note 25).

Estimation of Allowance for Doubtful Accounts

The Group maintains allowance for doubtful accounts at a level considered adequate to provide for potential uncollectible receivables. The level of this allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts. These factors include, but are not limited to, the length of the Group's relationship with the debtor, the debtor's payment behavior, and known market factors. The Group reviews the age and status of receivables and identifies accounts that are to be provided with allowance on a continuous basis.

Receivables, net of allowance for doubtful accounts, amounted to ₱47,276,638 and ₱73,481,008 as of December 31, 2006 and 2005, respectively (see Note 5). Provision for doubtful accounts, amounted to ₱2,903,498 in 2006 (see Note 18) while reversal of provision for doubtful accounts under "Others - net" in the statement of income amounted to ₱11,900 and ₱1,831,707 in 2005 and 2004, respectively.

Estimation of Useful Lives of Property and Equipment

The Group estimated the useful lives of its property and equipment based on a period over which the assets are expected to be available for use. Property and equipment, net of accumulated depreciation and amortization, amounted to ₱800,526,339 and ₱714,453,693 as of December 31, 2006 and 2005, respectively (see Note 8).

Estimation of Pension Cost

The determination of the obligation and cost of pension is dependent on management's assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 20 and include, among others, discount rates per annum, expected rate of return on plan assets and salary increase rates. Actual results that differ from the Group's assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While the Group believes that the assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect the pension obligations.

The Group's unrecognized net actuarial losses amounted to ₱13,183,698, ₱11,412,574 and ₱1,578,340 as of December 31, 2006, 2005 and 2004, respectively. Net pension liabilities as of December 31, 2006 and 2005 amounted to ₱26,888,841 and ₱22,700,899, respectively (see Note 20).

Classification of Leases- the Group as Lessee

The Group has entered into property leases, where it has determined that the risks and rewards related to those properties are retained with the lessors. As such, these lease agreements are accounted for as operating leases.

The Group's rent expense amounted to ₱265,189,314, ₱259,266,777 and ₱232,113,237 in 2006, 2005 and 2004, respectively (see Note 18). Accrued rent as of December 31, 2006 and 2005 amounted to ₱69,944,073 and ₱72,985,266, respectively (see Note 11).

Classification of Leases - the Group as Lessor

The Group has entered into property subleases on its leased properties. The Group determined that the lessors retain all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

The Group's rent income amounted to ₱39,889,745, ₱35,771,211 and ₱21,548,725 in 2006, 2005 and 2004, respectively (see Note 22). Unearned rent as of December 31, 2006 and 2005 amounted to ₱1,382,354 and ₱462,739, respectively (see Note 12).

Realizability of Deferred Income Taxes

Deferred income tax assets are recognized for all temporary deductible differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized. Management has determined based on business forecast of succeeding years that there is enough taxable profit against which the recognized deferred income tax assets will be realized.

The Group has net deferred income tax assets amounting to ₱54,008,463 and ₱77,598,357 as of December 31, 2006 and 2005, respectively (see Note 24).

Impairment of Assets

The Group determines whether items of its property and equipment and other non-financial long-lived assets such as goodwill are impaired on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the assets are allocated. The preparation of the estimated future cash flows in determining value in use involves significant judgment and estimation. While management believes that the assumptions made are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and may lead to future impairment charges. As of December 31, 2006 and 2005, after due evaluation, the Group concluded that there is no impairment of assets as of those dates.

Property and equipment, net of accumulated depreciation and amortization, amounted to ₱800,526,339 and ₱714,453,693 as of December 31, 2006 and 2005, respectively (see Note 8).

4. Cash and Cash Equivalents

	2006	2005
Cash on hand and in banks	₱328,754,075	₱197,902,121
Short-term placements	610,300	6,408,645
	₱329,364,375	₱204,310,766

Cash in banks earn interest at the respective bank deposit rates. Short-term placements are made for varying periods up to three months depending on the immediate cash requirements of the Group and earn interest at the respective short-term placement rates.

5. Receivables

	2006	2005
Suppliers	₱40,060,216	₱54,745,519
Current portion of notes receivable (Note 9)	4,985,000	4,800,000
Employees	4,429,101	6,982,232
Insurance claims	3,875,542	2,093,321
Receivable from Social Security System	1,023,050	957,012

Subleased spaces	783,260	-
Franchisee - net	-	6,750,663
Others	2,628,408	4,756,702
	57,784,577	81,085,449
Less allowance for doubtful accounts	10,507,939	7,604,441
	₱47,276,638	₱73,481,008

Receivables from suppliers are non interest-bearing and are generally on 30-90 days' terms.

6. Inventories

	2006	2005
At cost:		
Store merchandise	₱151,108,238	₱164,096,138
Warehouse merchandise and others	180,818,266	172,097,722
	₱331,926,504	₱336,193,860

7. Prepayments and Other Current Assets

	2006	2005
Input value-added tax (VAT) (Note 24)	₱31,337,732	₱11,585,940
Creditable withholding taxes	16,259,015	12,993,605
Advances for expenses	4,224,340	3,555,751
Rent	1,358,613	650,212
Prepaid taxes and licenses	1,276,440	875,815
Prepaid uniform	1,173,479	1,331,083
Supplies	957,770	2,653,954
Others	2,897,998	1,803,473
	₱59,485,387	₱35,449,833

8. Property and Equipment

	2006								
		Store			Office				
	Land	Leasehold Improvements	Furniture and Equipment	Buildings and Improvements	Furniture and Equipment	Transportation Equipment	Computer Equipment	Construction In-Progress	Total
Cost									
Beginning balances	₱39,866,864	₱390,085,977	₱411,932,449	₱104,305,299	₱180,143,089	₱15,491,722	₱123,497,773	₱117,674	₱1,265,440,847
Additions	-	75,987,421	75,745,563	17,411	41,608,928	5,751,071	38,225,638	10,999,986	248,336,018
Disposals	-	(16,277,953)	(473,131)	-	(2,017,106)	(2,100,000)	(42,857)	-	(20,911,047)
Reclassifications	-	(83,555)	33,476	62,828	(2,458)	-	(10,291)	-	-
Ending balances	39,866,864	449,711,890	487,238,357	104,385,538	219,732,453	19,142,793	161,670,263	11,117,660	1,492,865,818
Accumulated Depreciation and Amortization									
Beginning balances	-	139,757,818	224,534,360	36,971,748	93,297,421	10,311,052	46,114,755	-	550,987,154
Depreciation and amortization (Note 18)	-	63,245,099	44,957,653	3,715,544	17,066,436	1,585,326	23,476,201	-	154,046,259
Disposals	-	(11,197,468)	(43,299)	-	(1,428,799)	-	(24,368)	-	(12,693,934)
Reclassifications	-	(75,729)	42,908	1,599	(1,794)	-	33,016	-	-
Ending balances	-	191,729,720	269,491,622	40,688,891	108,933,264	11,896,378	69,599,604	-	692,339,479
Net Book Values	₱39,866,864	₱257,982,170	₱217,746,735	₱63,696,647	₱110,799,189	₱7,246,415	₱92,070,659	₱11,117,660	₱800,526,339

	2005								
		Store			Office				
	Land	Leasehold Improvements	Furniture and Equipment	Buildings and Improvements	Furniture and Equipment	Transportation Equipment	Computer Equipment	Construction In-Progress	Total
Cost									
Beginning balances	₱39,866,864	₱374,702,787	₱348,873,835	₱110,413,634	₱142,944,090	₱11,511,516	₱58,486,830	₱1,020,000	₱1,087,819,556
Additions	-	39,211,639	67,610,217	-	43,024,203	3,980,206	66,815,534	224,374	220,866,173
Disposals	-	(29,732,205)	(5,531,064)	-	(5,734,992)	-	(988,103)	-	(41,986,364)
Reclassifications	-	5,903,756	979,461	(6,108,335)	(90,212)	-	(816,488)	(1,126,700)	(1,258,518)
Ending balances	39,866,864	390,085,977	411,932,449	104,305,299	180,143,089	15,491,722	123,497,773	117,674	1,265,440,847
Accumulated Depreciation and Amortization									
Beginning balances	-	101,815,343	189,719,325	35,140,876	83,107,736	9,366,307	31,292,164	-	450,441,751

Depreciation and amortization (Note 18)	-	49,908,285	38,628,254	4,649,016	14,943,671	944,745	15,695,267	-	124,769,238
Disposals	-	(14,748,697)	(3,833,096)	-	(4,757,182)	-	(884,860)	-	(24,223,835)
Reclassifications	-	2,782,887	19,877	(2,818,144)	3,196	-	12,184	-	-
Ending balances	-	139,757,818	224,534,360	36,971,748	93,297,421	10,311,052	46,114,755	-	550,987,154
Net Book Values	₱39,866,864	₱250,328,159	₱187,398,089	₱67,333,551	₱86,845,668	₱5,180,670	₱77,383,018	₱117,674	₱714,453,693

9. Other Noncurrent Assets

	2006	2005
Deposits:		
Rent (Note 22)	₱81,446,679	₱84,083,646
Utilities	21,901,249	19,473,665
Suppliers	3,284,738	9,741,722
Others	752,710	493,996
	107,385,376	113,793,029
Goodwill	70,178,892	70,178,892
Available-for-sale financial assets	12,834,455	6,319,880
Software and programs - net of accumulated amortization of ₱280,000 in 2006 and ₱15,302,798 in 2005 (Note 18)	3,920,000	1,477,239
Notes receivable - net of current portion	-	6,265,190
Others	3,269,088	1,681,647
	₱197,587,811	₱199,715,877

The amortized cost of refundable security deposits included under Rent of Deposits as of December 31, 2006 and 2005 amounted to ₱9,189,188 and ₱7,127,440, respectively. Interest income on accretion of the value of the refundable security deposits amounted to ₱912,425 and ₱1,508,250 in 2006 and 2005, respectively.

On March 22, 2004, the Group purchased the leasehold rights and store assets of Jollimart Philippines Corporation for a total consideration of ₱130,000,000. The excess of the acquisition cost over the fair value of the assets acquired was recorded as goodwill. The recoverable amount for the goodwill was estimated based on the value in use and was determined at the cash generating unit level. In determining value in use, the cash flows (pre-tax) were discounted at a pre-tax rate of 9%. There was no impairment loss recognized in 2006 and 2005.

The Group's old inventory management software, ES1/Super Logistics, with acquisition cost of ₱16,780,037, became fully depreciated in 2006 and was written off during the same year. A new software was acquired with acquisition cost amounting to ₱4,200,000. Amortization of ₱280,000 was recognized in 2006.

Notes receivable pertains to the long-term portion of a secured, receivable from an armored car service provider for stolen collections bearing interest at 8%. Outstanding balance of the notes receivable amounts to ₱4,985,000, which pertains to the estimated fair value of mortgaged armored vehicles in favor of the Group. The remaining balance was written off in 2006 (see Note 18).

10. Bank Loans

Bank loans represent unsecured peso-denominated short-term borrowings from various local banks, payable in lump-sum in 2007 and 2006 with annual interest rates ranging from 8.13% to 11.67%, which are monthly repriced based on market conditions.

11. Accounts Payable and Accrued Expenses

	2006	2005
Trade payable	₱493,694,257	₱432,922,697
Rent	69,944,073	72,985,266
Utilities	11,729,488	7,098,028
Employee benefits	10,351,365	9,070,264
Advertising and promotion	10,121,125	20,809,697
Bank charges	2,760,120	1,838,320
Security services	1,978,886	2,143,476
Interest	1,616,110	1,465,167
Others	8,027,533	7,796,648
	₱610,222,957	₱556,129,563

12. Other Current Liabilities

	2006	2005
Non-trade accounts payable	₱62,534,858	₱31,060,963
Deposits from sublessees	55,747,867	53,247,068
Payable to franchisee	11,729,699	-
Withholding taxes	10,458,897	12,898,655
Output VAT (Note 24)	9,163,433	6,885,322
Retention payable	6,720,669	1,276,290
Unearned rent (Note 22)	1,382,354	462,739
Interest payable	546,660	691,320
Royalty (Note 21)	175,447	6,282,112
Payable to contractors	-	1,549,221
Others	4,721,986	5,295,391
	₱163,181,870	₱119,649,081

13. Long-term Debt

	2006	2005
Unsecured long-term promissory notes with local banks: Interest is at a fixed rate of 11.67% for the first 24 months, the rate thereafter shall be at the prevailing lender rate. The principal is payable in equal monthly installments starting on the sixth month, until March 2007.	₱6,500,000	₱32,500,000
Unsecured long-term promissory notes with various third parties under escrow agency agreement with a local bank: Interest rates range from 10.50% to 11.00%, payable in lump-sum on May 2006.	₱-	₱65,000,000
Secured long-term promissory notes with a local bank: Interest is at a fixed rate of 10.50% for three years, payable in equal monthly installments starting on the sixth month, until December 2006. The loan is guaranteed by PCSC.	-	28,000,000
	6,500,000	125,500,000
Less current portion of long-term debt	6,500,000	93,000,000
	₱-	₱32,500,000

14. Common Stock and Additional Paid-in Capital

On January 9, 1998, the SEC approved the registration of the following:

- a. The 237,938,250 common shares consist of:

Outstanding common shares (including underlying shares for the 122,882 warrant units)	166,556,250
Initial public offering	47,000,000
Private placement	24,382,000
	<hr/>
	237,938,250

On February 4, 1998, the Group offered for sale 71,382,000 common shares, consisting of 47,000,000 shares for public offering and 24,382,000 shares for private placement both at an offer price of ₱4.40 per share. Net proceeds generated from the offering amounted to ₱288,300,000. The excess of the net proceeds over the cost of common shares amounting to ₱216,900,000 was credited to "Additional paid-in capital".

- b. The 122,882 5-year warrants with attached 4% perpetual income bonds.

On June 13, 2000, the BOD approved a resolution authorizing the issuance of the Group's shares ("Optional Shares") for the exercise of the 122,882 warrants with attached 4% perpetual income bonds consisting of 18,432,300 common shares to be taken from unissued portion of the authorized capital stock and 12,288,200 treasury shares or a total of 30,720,500 shares pursuant to their registration with the SEC. Moreover, upon the actual exercise of the warrants and purchase of the Optional Shares, the Group was authorized to list the 30,720,500 shares with the Philippine Stock Exchange (PSE).

During the period September 15 to 25, 2000, all of the Group's warrants were exercised and the corresponding shares of 30,720,500 were issued at a price of ₱1.732 per share resulting in an additional paid-in capital of ₱13,492,444. The excess of cost over re-issue price of treasury shares amounting to ₱27,902,091 is presented as deduction against additional paid-in capital in the consolidated statements of changes in stockholders' equity. Consequently, on September 28, 2000, the Group listed the 30,720,500 with the PSE and delisted the corresponding 122,882 warrants.

15. Employee Stock Purchase Plan

The Group has an Employee Stock Purchase Plan (ESPP) which allows all full-time and regular employees, who have rendered at least two years of service to the Group as of December 31, 1996, to purchase the Group's shares in the offering at a purchase price of ₱4.40 per share. Each eligible employee can purchase a minimum of 1,000 shares and a maximum number of shares with a purchase price equivalent to 1 ½ months basic salary or, in the case of a manager, up to 3 months basic salary.

On the stock purchase date, the Group has the right to vote the pledged shares until full payment of the loan, and the participants have the right to receive all cash dividends, but stock dividends shall be held in escrow until full payment of loan.

In 1998, 997,000 shares were subscribed by the employees under the ESPP and the unsold shares were taken by the lead underwriter as part of the offering to the public.

In 2001, 686,250 shares were withdrawn by the employees and returned to the Group and accounted for as treasury shares.

16. Cumulative Redeemable Preferred Shares

Cumulative redeemable preferred shares represent the share of PSC - ERP through its trustee, BPI-AMTG, in SSHI's net assets pertaining to preferred shares. PSC - ERP is entitled to an annual "Guaranteed Preferred Dividend" in the earnings of SSHI starting April 5, 2002, the date when the 25% of the subscription on preferred shares have been paid, in accordance with the Corporation Code.

The guaranteed annual dividends shall be calculated and paid in accordance with the Shareholder's Agreement dated November 16, 2000 which provides that the dividend shall be determined by the BOD of SSHI using the prevailing market conditions and other relevant factors.

17. Cost of Merchandise Sold

	2006	2005	2004
Merchandise inventory, beginning	₱336,193,860	₱303,199,945	₱217,864,938
Net purchases	3,219,814,921	3,219,245,155	2,793,670,772
	3,556,008,781	3,522,445,100	3,011,535,710
Less merchandise inventory, ending	331,926,504	336,193,860	303,199,945
	₱3,224,082,277	₱3,186,251,240	₱2,708,335,765

18. Operating Expenses

	2006	2005	2004
Personnel costs (Note19)	₱336,901,558	₱336,406,816	₱315,383,011
Communication, light and water	315,827,699	318,194,940	227,979,403
Rent (Notes 21 and 22)	265,189,314	259,266,777	232,113,237
Depreciation and amortization	154,046,259	124,769,238	118,608,597
Management fee (Note 26)	82,307,663	63,632,738	29,591,124
Outside services	61,441,165	58,312,084	65,706,940
Taxes and licenses	57,897,515	50,439,534	42,418,352
Supplies	51,387,785	50,621,852	49,620,514
Trucking services	51,000,456	44,077,388	33,441,900
Advertising and promotion	42,419,622	31,426,121	24,313,117
Warehousing services	39,175,543	32,264,919	24,937,771
Repairs and maintenance	36,587,772	32,438,344	31,041,100
Royalties (Note 21)	24,634,225	47,138,470	40,136,325
Provision for inventory losses	21,867,776	33,391,052	46,257,278
Transportation and travel	14,341,622	14,469,528	8,267,891
Entertainment, amusement and recreation	14,182,789	5,960,260	3,801,443
Accounts written off	9,571,709	-	-
Dues and subscription	3,581,679	2,837,951	2,240,629
Provision for doubtful accounts	2,903,498	-	-
Insurance	2,825,865	3,925,247	4,858,338
Amortization of software	1,757,239	2,987,458	2,932,501
Others	21,576,407	19,734,965	24,441,118

₱1,611,425,160	₱1,532,295,682	₱1,328,090,589
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19. Personnel Costs

	2006	2005	2004
Salaries and wages	₱210,336,816	₱210,254,837	₱204,906,138
Employee benefits	120,085,026	121,516,603	106,519,850
Pension cost (Note 20)	6,479,716	4,635,376	3,957,023
	₱336,901,558	₱336,406,816	₱315,383,011

20. Pension Plan

The Group maintains a trustee, non-contributory pension plan covering qualified employees. Normal retirement benefits are equal to the employee's retirement pay as defined in Republic Act (RA) No. 7641 multiplied by his years of service. Normal retirement date is the attainment of age 60 and completion of at least 5 years of service.

The following tables summarize the components of net pension costs recognized in the consolidated statements of income and the funding status and amounts recognized in the consolidated balance sheets:

- a. Net pension costs for the year are as follows:

	2006	2005	2004
Current service cost	₱2,042,880	₱1,337,215	₱1,770,112
Interest cost	4,814,791	4,346,025	3,717,610
Expected return on plan assets	(643,797)	(1,047,864)	(1,530,699)
Net actuarial loss recognized this year	265,842	-	-
Net pension costs for the year	₱6,479,716	₱4,635,376	₱3,957,023

- b. Net pension liabilities recognized by the Group are as follows:

	2006	2005
Present value of pension liabilities	₱46,674,326	₱40,551,447
Less fair value of plan assets	6,601,787	6,437,974
Unfunded obligation	40,072,539	34,113,473
Less unrecognized net actuarial losses	13,183,698	11,412,574
Net pension liabilities	₱26,888,841	₱22,700,899

- c. Changes in present value of the pension liabilities are as follows:

	2006	2005
Beginning of year	₱40,551,447	₱30,122,500
Interest cost	4,814,791	4,346,025
Current service cost	2,042,880	1,337,215
Benefits paid	(2,839,768)	(4,838,968)
Actuarial loss	2,104,976	9,584,675
End of year	₱46,674,326	₱40,551,447

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

	2006	2005
Beginning of year	₱6,437,974	₱10,478,637

Expected return on plan assets	643,797	1,047,864
Contribution	2,291,774	-
Benefits paid	(2,839,768)	(4,838,968)
Actuarial loss (gain)	68,010	(249,559)
End of year	₱6,601,787	₱6,437,974

The fair value of the Group's net plan assets are as follows:

	2006	2005
Cash in bank	₱263	₱243
Investments in equity securities and trust and mutual funds	6,612,401	6,450,251
Liabilities	(10,877)	(12,520)
Fund Balance	₱6,601,787	₱6,437,974

Actual return on plan assets amounted to ₱711,807 and ₱744,165 in 2006 and 2005, respectively.

The overall expected return on the plan assets is determined based on the market prices prevailing on the date applicable to the period over which the obligation is to be settled. There has been no change in the expected rate of return on plan assets.

The Group expects to contribute ₱4,000,000 to its defined benefit plan in 2007.

The principal assumptions used in determining net pension costs for the Group's plan are as follows:

	2006	2005	2004
Number of employees	848	1,028	986
Discount rate per annum	8.00%	11.74%	14.24%
Expected annual rate of return on plan assets	10.00%	10.00%	10.00%
Increase in salary	5.00%	5.00%	5.00%

Amounts for the current and prior periods are as follows:

	2006	2005	2004
Present value of pension liabilities	(₱46,674,326)	(₱40,551,447)	(₱30,122,500)
Fair value of plan assets	6,601,787	6,437,974	10,478,637
Deficit	(40,072,539)	(34,113,473)	(19,643,863)
Experience adjustments on pension liabilities	(2,104,976)	(9,584,675)	(344,909)
Experience adjustments on plan assets	-	-	-

21. Related Party Transactions

Significant transactions with related parties consist of:

- Licensing agreement of the Group with Seven Eleven, Inc. (SEI), a related company organized in Texas, U.S.A. This grants the Group the exclusive right to use the 7-Eleven System in the Philippines. In accordance with the agreement, the Group pays, among others, royalty fee to SEI based on a certain percentage of monthly gross sales net of gross receipts tax.

In 2006, the Group and SEI entered into a Store Renovation Agreement (Agreement), wherein SEI will waive a maximum amount of USD 10,000 royalty fee per 7-Eleven Store renovated from February 1, 2006 until January 31, 2007.

Royalty fees recorded by the Group amounted to ₱24,634,225, ₱47,138,470 and ₱40,136,325 in 2006, 2005 and 2004, respectively.

Royalty payable amounted to ₱175,447 and ₱6,282,112 as of December 31, 2006 and 2005, respectively.

- b. Rental of post-mix machines from PCSC for three years until June 30, 2005. The Group pays the latter 5% of sales from the said machines. Payments shall be made quarterly before the 20th day of January, April, July and October. Expense recognized on rental of post-mix machines amounted to ₱3,971,343 and ₱8,603,475 in 2005 and 2004, respectively.
- c. Compensation of key management personnel are as follows:

	2006	2005	2004
Short-term employee benefits	₱18,288,784	₱14,479,587	₱13,843,834
Post-employment benefits	356,304	2,164,572	204,484
Other long-term benefits	507,563	447,192	2,026,602
	₱19,152,651	₱17,091,351	₱16,074,920

22. Leases

- a. The Group has various lease agreements with third parties relating to its store operations. Certain agreements provide for the payment of rentals based on various schemes such as an agreed percentage of net sales for the month and fixed monthly rate.

Rental expense related to these lease agreements amounted to ₱236,887,280, ₱237,616,908 and ₱213,127,332 in 2006, 2005 and 2004, respectively. Amortization of deferred lease expense amounted to ₱569,564 in 2006 and ₱534,436 in 2005.

The approximate annual minimum rental payments of the Group under its existing lease agreements as of December 31, 2006 are as follows:

Year	Amount
2007	₱106,762,689
2008	96,868,743
2009	79,649,977
2010	61,574,642
2011	47,542,366
2012 and onwards	71,317,345

- b. The Group has various sublease agreements with third parties which provide for lease rentals based on an agreed fixed monthly rate or as agreed upon by the parties. Rental income related to these sublease agreements amounted to ₱39,889,745 in 2006, ₱35,771,211 in 2005 and ₱21,548,725 in 2004.

The approximate annual minimum sublease payments expected to be received under its existing sublease agreements as of December 31, 2006 are as follows:

Year	Amount
2007	₱19,016,236
2008	13,130,654
2009	6,134,855
2010 and onwards	6,313,586

- c. CDI entered into a 15-year operating lease contract for the lease of its warehouse starting November 1, 2005, after the expiration of its previous five-year lease contract on November 30, 2005. The lease is subject to an escalation rate of 7% every after two years starting on the third year of the lease.

The Group paid security deposits amounting to ₱20,000,000 related to the lease contract in 2005. The security deposit related to the previous lease contract amounting to ₱5,640,000 as of December 31, 2005 was refunded to the Group in January 2006.

Rent expenses related to these lease agreements amounted to ₱22,925,240 in 2006, ₱13,213,153 in 2005 and ₱8,278,362 in 2004. Amortization of deferred lease expense amounted to ₱1,090,500 and ₱1,572,789 in 2006 and 2005, respectively.

The approximate annual minimum rental payments of the Group under its existing lease contract as of December 31, 2006 are as follows:

Year	Amount
2007	₱18,393,452
2008	19,454,030
2009	19,680,994
2010	20,815,812
2011	21,058,664
2012 and onwards	223,264,084

CDI also has other various short-term operating leases. Related rent expense amounts to ₱3,716,730, ₱2,358,148 and ₱2,104,068 in 2006, 2005 and 2004, respectively.

23. Basic/Diluted Earnings (Loss) Per Share

	2006	2005	2004
Net income (loss) attributable to equity holders of the Parent	₱20,144,092	₱13,760,412	(₱2,044,109)
b. Weighted average number of shares issued	237,938,250	237,938,250	237,938,250
c. Less weighted average number of shares held in the treasury	686,250	686,250	686,250
d. Weighted average number of shares outstanding (b-c)	237,252,000	237,252,000	237,252,000
e. Basic/diluted earnings (loss) per share (a/d)	₱0.08	₱0.06	(₱0.01)

The Group does not have potentially dilutive common shares as of December 31, 2006, 2005 and 2004. Thus, the basic earnings (loss) per share is equal to the diluted earnings (loss) per share as of those dates.

24. Income Tax

- a. The components of the Group's current income tax are as follows:

	2006	2005	2004
RCIT	₱28,453,281	₱17,944,535	₱109,783
MCIT	-	263,015	24,114,157
Final tax on interest income	366,402	438,991	659,196
	₱28,819,683	₱18,646,541	₱24,883,136

- b. The components of the Group's net deferred income tax assets are as follows:

	2006	2005
Excess of MCIT over RCIT	₱17,283,785	₱42,666,546
Tax effects of:		
Accrued rent	24,464,954	25,544,843
Net pension liabilities	9,411,094	7,945,314
Unamortized capitalized interest	(2,667,513)	(2,625,895)
Allowance for doubtful accounts	3,677,779	2,661,554
Unamortized past service cost	932,205	1,241,773
Unearned rent	483,823	161,959
Unrealized foreign exchange loss - net	422,336	2,263
	₱54,008,463	₱77,598,357

- c. The Group's NOLCO amounting to ₱37,676,181, ₱314,887 and ₱173,301 incurred in 2002, 2003 and 2004, respectively, were applied against taxable income in 2005.

- d. As of December 31, 2006, the Group's MCIT available for deduction from future RCIT payable are as follows:

Year incurred	MCIT	Applied	Balance	Available Until
2003	₱18,416,000	₱18,416,000	₱-	2006
2004	24,114,157	6,830,372	17,283,785	2007
2005	136,389	136,389	-	2008
	₱42,666,546	₱25,382,761	₱17,283,785	

- e. The reconciliation of the provision for income tax computed at the statutory income tax rate to provision for income tax shown in the consolidated statements of income follows:

	2006	2005	2004
Provision for income tax computed at statutory income tax rate	₱16,509,818	₱13,212,673	₱9,585,368
Adjustments for:			
Nondeductible expenses:			
Inventory losses	7,653,722	11,807,192	-
Interest expense and others	2,915,948	5,542,188	744,425
Nontaxable income:			
Interest income on accretion	(319,349)	(490,181)	-
Bank interest income	(274,801)	(274,369)	(395,516)
Effect of change in tax rate in 2005	-	(3,335,599)	-
Expired MCIT	-	432,062	17,785,656
Expired NOLCO	-	-	4,487,887
Others	541,478	-	(209,435)
	₱27,026,816	₱26,893,966	₱31,998,385

- f. On May 24, 2005, the new Expanded Value-Added Tax (E-VAT) law was signed into law as R.A. No. 9337 or the E-VAT Law of 2005. The E-VAT law took effect on November 1, 2005 following the approval on October 19, 2005 of Revenue Regulations (RR) 16-2005, which provides for the implementation of the rules of the new E-VAT law. Among the relevant provisions of the new E-VAT law are:
- i. change in RCIT rate from 32% to 35% for the next three years effective on November 1, 2005, and 30% starting on January 1, 2009 and thereafter;
 - ii. change in the nondeductible interest expense rate from 38% to 42% of interest income subjected to final tax for the next three years effective on November 1, 2005, and 33% starting January 1, 2009 and thereafter;
 - iii. input VAT on capital goods should be spread evenly over the useful life or 60 months, whichever is shorter, if the acquisition cost, excluding the VAT component thereof, exceeds ₱1 million;
 - iv. a 70% cap on the input VAT that can be claimed against output VAT; and
 - v. increase in the VAT rate imposed on goods and services from 10% to 12% effective January 1, 2006 provided that the VAT collection as a percentage of Gross Domestic Product (GDP) of the previous year exceeds 2.8% or the National Government deficit as a percentage of GDP of the previous year exceeds 1.5%.

On January 31, 2006, the President upon recommendation of the Secretary of Finance approved the 2% increase in VAT rates effective February 1, 2006.

- g. On November 21, 2006, the President signed into law RA No. 9361 which amends Section 110 (B) of the Tax Code. This law, which became effective on December 13, 2006, provides that if the input tax, inclusive of the input tax carried over from the previous quarter exceeds the output tax, the excess input tax shall be carried over to the succeeding quarter or quarters. The Department of Finance through the Bureau of Internal Revenue issued RR No. 2-2007 to implement the provisions of the said law. Based on this regulation, the amendment shall apply to the quarterly VAT returns to be filed after the effectivity of RA No. 9361 except VAT returns covering taxable quarters ending earlier than December 2006.

25. Financial Instruments and Risk Management Objectives and Policies

The Group's principal financial instruments comprise of bank loans, and cash and cash equivalents. The main purpose of these financial instruments is to finance the Group's operations. The Group has various other financial assets and liabilities such as receivables, available-for-sale financial assets, refundable security deposits and other assets, accounts payable and accrued expenses, and other current liabilities, which arise directly from its operations.

It is, and has been throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

Financial Risk Management Objectives and Policies

The main risks arising from the Group's financial instruments are liquidity risk, interest rate risk, and credit risk. The BOD reviews and approves policies for managing each of these risks and they are summarized below.

Liquidity Risk

The Group seeks to manage its liquidity profile to be able to finance its capital expenditures and service its maturing debts. To cover for its financing requirements, the Group intends to use internally generated funds and sales of certain assets.

As part of its liquidity risk management program, the Group regularly evaluates projected and actual cash flow information and continuously assesses conditions in the financial markets for opportunities to pursue fund raising initiatives. These initiatives may include drawing of loans from the approved credit line intended for working capital and capital expenditures purposes and equity market issues.

Interest Rate Risk

The Group is expecting to substantially reduce the level of bank loans within the next three years. Internally generated funds coming from its cash generating units and from its franchising business will be used to pay off outstanding debts and consequently reduce the interest rate exposure.

The maturity profiles of financial instruments that are exposed to interest rate risk are as follows:

Year ended December 31, 2006

	Rate	<1 year	>1-<2 years	>2-<3 years	>3-<4 years	>4-<5 years	>5 years	Total
Bank loans:								
Fixed rate	8.60%-8.80%	₱30,000,000	₱-	₱-	₱-	₱-	₱-	₱30,000,000
Floating rate	8.60%-8.80%	374,000,000	-	-	-	-	-	374,000,000
Long-term debt:								
Fixed rate	11.67%	6,500,000	-	-	-	-	-	6,500,000

Year ended December 31, 2005

	Rate	<1 year	>1-<2 years	>2-<3 years	>3-<4 years	>4-<5 years	>5 years	Total
Bank loans:								
Fixed rate	8.70%	₱5,000,000	₱-	₱-	₱-	₱-	₱-	₱5,000,000
Floating rate	8.40%-9.50%	235,000,000	-	-	-	-	-	235,000,000
Long-term debt:								
Fixed rate	10.50%-11.67%	54,000,000	6,500,000	-	-	-	-	60,500,000
Floating rate	360 days PHIBOR + 1.25%	65,000,000	-	-	-	-	-	65,000,000

Interest of financial instruments classified as floating rate is repriced at intervals of 30 days. 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.

Credit Risk

The receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. With respect to credit risk arising from the other financial assets, the Group's exposure to credit risk arises from default of the counterparty,

with a maximum exposure equal to the carrying amount of these instruments. The Group deals only with counterparty duly approved by the BOD.

The Group has no significant concentration of credit risk.

Fair Value Information

The following table summarizes the carrying and fair value of the financial assets and financial liabilities as of December 31, 2006 and 2005:

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Current:				
Cash and cash equivalents	₱329,364,375	₱329,364,375	₱204,310,766	₱204,310,766
Receivables	47,276,638	47,276,638	73,481,008	73,481,008
Noncurrent:				
Available-for-sale financial assets	12,834,455	12,834,455	6,319,880	6,319,880
Refundable security deposits	9,189,188	13,632,022	7,127,440	9,586,101
Other assets	2,113,971	2,113,971	-	-
Notes receivable	-	-	6,265,190	6,265,190
	₱400,778,627	₱405,221,461	₱297,504,284	₱300,913,342

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Liabilities				
Current:				
Bank loans	₱404,700,000	₱404,700,000	₱240,000,000	₱240,000,000
Accounts payable and accrued expenses	610,222,957	610,222,957	556,129,563	556,129,563
Current portion of long-term debt	6,500,000	6,500,000	93,000,000	93,000,000
Other current liabilities	163,181,870	163,181,870	119,649,081	119,649,081
Noncurrent:				
Long-term debt - net of current portion	-	-	32,500,000	32,500,000
Cumulative redeemable preferred shares	6,000,000	6,000,000	6,000,000	6,000,000
	₱1,190,604,827	₱1,190,604,827	₱1,047,278,644	₱1,047,278,644

Current financial assets and liabilities

Due to the short-term nature of the transactions, the fair value of cash and cash equivalents, receivables, bank loans, accounts payable and accrued liabilities, current portion of long-term debt and other current liabilities approximates carrying amount as of balance sheet date.

Refundable security deposits

The fair value of security deposit is determined by discounting the sum of future cash flows using the prevailing market rates for instruments with similar maturities ranging from 4.98% to 6.69%.

Available-for-sale financial assets

The fair value of available-for-sale financial assets is based on quoted price as of December 31, 2006 and 2005.

Long-term debt

The carrying value approximates fair value because of recent and regular repricing based on market conditions.

Cumulative redeemable preferred shares

The carrying value approximates fair value because corresponding dividends on these shares that are charged as interest expense in the statements of income are based on recent treasury bill rates.

26. Significant Agreements

- a. The Group has various store franchise agreements with third parties for the operation of certain stores. The agreement includes a one-time franchise fee payment and an annual 7-Eleven charge for the franchisee, which is equal to a certain percentage of the franchised store's gross profit. Franchise fee amounted to ₱65,278,976, ₱26,931,394 and ₱12,487,682 in 2006, 2005, and 2004, respectively, and franchise revenue for the 7-Eleven charge amounted to ₱82,718,404, ₱31,795,431 and ₱9,610,291 in 2006, 2005 and 2004, respectively.
- b. The Group has service management agreements with third parties for the management and operation of certain stores. In consideration thereof, the store operator is entitled to a management fee based on a certain percentage of the store's gross profit and operating expenses as stipulated in the service management agreement. Management fee amounted to ₱82,307,663, ₱63,632,738 and ₱29,591,124 in 2006, 2005 and 2004, respectively.
- c. The Group has an agreement with its phone card supplier effective January 1, 2000. Under the arrangement, the Group earns commission on the sale of phone cards based on a certain percentage of net sales for the month and a fixed monthly rate. Commission income amounted to ₱28,635,785 in 2006, ₱37,848,387 in 2005 and ₱43,575,945 in 2004.
- d. The Group entered into a Marketing Support and Exclusivity Agreement (the Agreement) with San Miguel Pure Foods Group, Inc. (SMPFC) on June 23, 2005. Under the agreement, the Group is appointed as SMPFC's exclusive distributor for the covered products, for a period of 5 years starting retroactively on January 24, 2005. During the term of the agreement, the Group is required to purchase a minimum volume of 19,564 metric tons of the covered products. The agreement further stipulates that SMPFC shall grant the Group marketing support funds aggregating ₱19,989,000 to support the sale of the covered products. The Group received marketing support funds amounting to ₱19,989,000 in June 2005.

27. Contingencies

The Group is a party to various litigations involving, among others, price tag law issues before the Department of Trade and Industry, employees suing for illegal dismissal, back wages and damage claims, claims arising from store operations and as co-respondents with manufacturers on complaints with the Bureau of Food and Drugs, specific performance and other civil claims. All such cases are in the normal course of business and are not deemed to be considered as material legal proceedings. Further, these cases are either pending in courts

or under protest, the outcome of which are not presently determinable. Management and its legal counsel believe that the liability, if any, that may result from the outcome of these litigations and claims will not materially affect their financial position or results of operations.