PITC PHARMA, INC.
(A Subsidiary of the Philippine International Trading Corporation)
NOTES TO FINANCIAL STATEMENTS
(All amounts in Philippine Peso unless otherwise stated)

1. AGENCY BACKGROUND

PITC Pharma, Inc. (the Corporation) was initially incorporated in the Philippines on July 13, 1981 as Producers Venture Capital Corporation (PVCC). PVCC was 60 percent owned by Prime Media Holdings, Inc. and 40 percent owned by the National Development Company (NDC). On October 19, 2005, NDC bought out Prime Media's 60 percent ownership, which made PVCC 100 percent owned by NDC.

On November 9, 2005, the Securities and Exchange Commission (SEC) approved the change in PVCC's corporate name from Producers Venture Capital Corporation to PITC Pharma, Inc., and its primary purpose from that of a financing company to a pharmaceutical firm engaged in the business of research, development, production, manufacture, packaging, sale and/or distribution of pharmaceutical products and/or investment and/or management of investments in pharmaceuticals and related commercial ventures.

On September 12, 2006, the SEC approved the increase in the Authorized Capital Stock of the Corporation from P10 million to P100 million, divided into one million (1,000,000) common shares at a par value of P100 per share. The infusion by Philippine International Trading Corporation (PITC) of P22.5 million in common shares, made the Corporation 60 percent owned by PITC. With the issuance of Executive Order (EO) 442, PITC was designated as the lead coordinating agency to make quality medicine available, affordable, and accessible to the greater masses of Filipinos. The Corporation was created to exclusively take the lead in implementing the government's Half-Priced Medicines Program under EO 442.

Pursuant to Section 1 Rule 16 Chapter III of the Implementing Rules and Regulations of Republic Act 9502, otherwise known as the Cheaper Medicines Bill Law, PITC Pharma Inc. was mandated to undertake the centralized importation of pharmaceutical products for the government except for specific programs and instances allowed by the Department of Health.

The License to Operate as a Drug Distributor/ Importer/ Wholesaler was granted to the Corporation on October 16, 2006.

The principal office address of the Corporation is at 2nd floor, NDC Building, 116 Tordesillas Street, Salcedo Village, Makati City.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Financial Statements Preparation and Statement of Compliance

The financial statements are presented in Philippine peso, the Corporation's functional and presentation currency, and all values are rounded to the nearest peso, except when otherwise indicated.

The accompanying financial statements are prepared and presented in accordance with State accounting principles.

b. 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 maturity dates of three months or less from the date of acquisition.

c. Accounts receivable - trade

Trade receivables are recognized at their face value less allowance for doubtful accounts.

Allowance for doubtful accounts is provided for potentially uncollectible receivables specifically identified, principally based on the following criteria: accounts with pending legal investigation, clients who have issued bouncing checks and uncollectible accounts aged three years and above (100 percent), uncollectible accounts aged two years (50 percent), and DOH accounts and other uncollectible accounts aged one year (25 percent).

d. Prepaid expenses

Prepayments are amortized over the period of coverage.

e. Inventories

Merchandise Inventory is stated at the lower of cost or net realizable value. Cost includes acquisition cost plus all incidental expenses incurred in acquiring the goods and in bringing them to their present location and condition. Costs are assigned to inventories using the weighted average method.

The provision for allowance of inventory loss is based on the expiration dates of stocks counted during the year-end physical count. Stocks expiring on or before the end of the current year are considered an outright expense, and therefore charged against the inventory account. A 50 percent allowance is provided for medicines that will expire from January to June of the succeeding year and 25 percent for medicines that expire at the end of the same year.

Accountable Forms and Other Supplies Inventory are valued at cost.

f. **Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets in accordance with COA Circular No. 2003-007. In the case of leasehold improvements, the assets are depreciated over the period of the lease or service life of the improvement, whichever comes first.

g. **Income and expenses**

Income and expenses are recorded on accrual basis.

3. CASH AND CASH EQUIVALENTS

The account is composed of the following:

Particulars	2011	2010
Cash on hand and in banks	6,887,613	2,218,707
Money market placements	11,540,132	21,603,034
Total Cash and cash equivalents	**18,427,745**	**23,821,741**

Cash on hand includes cash with the Cash collecting officer.

Money market placements are short-term, highly liquid peso investments with Land Bank of the Philippines with original maturities of three months or less.

4. ACCOUNTS RECEIVABLE - TRADE - NET

The Accounts receivable - trade account is categorized into the following:

Particulars	2011	2010 (As restated)
Commercial Accounts including Territorial Wholesalers	33,370,491	34,031,032
Department of Health (DOH)	29,838,574	22,282,812
Other Government Accounts	8,812,711	8,871,846
	72,021,776	65,185,690
Less: Allowance for doubtful accounts	37,094,270	35,772,352
Accounts receivable - trade - net	**34,927,506**	**29,413,338**

5. ACCOUNTS RECEIVABLE - NON-TRADE

The Accounts receivable - non-trade account is composed of the following:

Particulars	2011	2010
Due from BIR	31,565,033	28,758,202
Due from affiliates - PITC	12,413,402	12,340,049
Due from DOH	1,114,994	38,486
Due from officers and employees	290,990	549,295
Due from SSS	124,949	124,949
Other receivables	3,064,824	2,112,903
Total Accounts receivable - non-trade	**48,574,192**	**43,923,884**

The Due from BIR Input tax is net of recorded Output tax as of year-end.

Due from affiliates - PITC represents payments made by PITC Pharma, Inc. clients to PITC and other PPI advances for account of PITC.

Due from DOH represents cost of stickers and packaging materials for P100 project charged to DOH.

6. INVENTORIES - NET

This account is composed of the following:

Particulars	2011	2010 (As restated)
Merchandise Inventory	3,920,555	33,854,845
Accountable Forms	582,421	540,558
	4,502,976	34,395,403
Less: Allowance for Inventory Loss/Obsolescence	1,018,346	2,104,253
Inventories - net	**3,484,630**	**32,291,150**

Changes in allowance for inventory losses for the years ended December 31 are as follows:

	2011	2010
January 1	2,104,253	5,485,731
Provision	(1,085,907)	(3,381,478)
December 31	**1,018,346**	**2,104,253**

7. PREPAID EXPENSES

This account consists of the following:

Particulars	2011	2010
Guaranty deposits	229,501	-
Prepaid insurance	160,819	274,462
Advances to PITC	7,064	-
Prepaid rent	-	220,976
Deferred charges	-	680
Others	6,020	25,137
Total Prepaid expenses	**403,404**	**521,255**

Guaranty deposits represents the two months security deposit to Dexter Go Co for the pharmacy and office space at the Orient Mansion in the amount of P220,976 and deposit for the photocopying service contract with Ricoh Philippines Inc. in the amount of P8,525.

Advances to PITC represent the GSIS comprehensive and TPL insurance for PPI assigned vehicles for the year 2011.

8. PROPERTY PLANT AND EQUIPMENT - NET

This account consists of the following:

Particulars	Leasehold improvements	Furniture and fixtures/ library books	Communication equipment and other machineries	IT Equipment and software	Office equipment	Total
CY 2011						
Costs						
January 01	4,478,383	1,644,194	348,956	3,786,200	210,553	10,468,286
Additions	-	-	-	-	-	-
December 31	**4,478,383**	**1,644,194**	**348,956**	**3,786,200**	**210,553**	**10,468,286**
Accumulated Depreciation						
January 01	2,503,758	460,449	94,817	2,221,594	98,770	5,379,388
Depreciation	102,945	147,977	31,490	677,746	37,900	998,058
December 31	**2,606,703**	**608,426**	**126,307**	**2,899,340**	**136,670**	**6,377,446**
Net Book Value						
December 31	**1,871,680**	**1,035,768**	**222,649**	**886,860**	**73,883**	**4,090,840**
CY 2010						
Net Book Value						
December 31	**1,974,625**	**1,183,745**	**254,139**	**1,564,606**	**111,783**	**5,088,898**

Leasehold improvements represent the cost of the renovation of the Corporation's leased office space and Corporation-operated Botika ng Bayan at the ground floor of the Orient Mansion and the renovation of the Corporation's main office at the 2nd floor of the NDC building.

9. ACCOUNTS PAYABLE

This account consists of:

Particulars	2011	2010 (As restated)
Accounts payable - trade	23,369,510	52,973,106
Accounts payable - non-trade	3,194,405	2,197,997
Total Accounts payable	**26,563,915**	**55,171,103**

Accounts payable - trade represents amount due to various suppliers for the purchase of merchandise for sale.

Accounts payable - non-trade are liabilities arising from various services such as security, janitorial, expenses for utility, communications and expenses other than purchase of merchandise for sale.

10. INTER-AGENCY PAYABLES

This account consists of:

Particulars	2011	2010
Due to PCSO	4,947,988	4,947,988
Due to DOH	2,733,422	1,775,965
Due to BIR	2,241,211	1,655,478
Due to SSS	118,386	111,358
Due to Pag-IBIG	52,437	48,131
Due to Philhealth	24,188	29,050
Total Inter-agency payables	**10,117,632**	**8,567,970**

The account Due to DOH represents the unliquidated balance of the P50 million fund transfers intended for the DOH P100 project pursuant to DOH Administrative Order No. 2008-0013, covered by a Memorandum of Agreement by and between DOH and PPI.

The liability to the BIR includes withholding taxes for remittance in January of the following year. Due to SSS represents social security benefits, likewise for remittance in January of the following year.

11. OTHER CURRENT LIABILITIES

This account is broken down as follows:

Particulars	2011	2010
Current portion of long-term loan	185,000,000	185,000,000
Interest payable	91,971,918	73,471,918
Performance/bidders bond	3,810,159	5,066,662
Vacation and sick leave	1,880,220	1,655,860
Due to officers and employees	1,636,984	1,275,904
Others	3,482,510	2,801,139
Total Other current liabilities	**287,781,791**	**269,271,483**

Other current liabilities include the current portion of the four-year loans payable to NDC which expired on December 26, 2009. Interest payable represents accrued interest on the loans availed from NDC as disclosed in Note 12.

Vacation and sick leave payable is recognized corresponding to the monetary value of the unused accumulated vacation and sick leave credit balances as at December 31, 2011.

Other payables include overpayments made by various clients and a fund entrusted by a supplier for the payment of advocacy expenses.

12. LOANS PAYABLE

This account consists of loans availed from NDC under the Loan Agreement entered into by and between NDC and the Company for organizational and operational expenditures in pursuit of the Half-Priced Medicines Program. The loans bear an interest rate of 10 percent per annum. The principal and interest are payable every quarter reckoned from each drawdown date for a period of four years, with a one year grace period on the principal, but in no case shall the repayment period extend beyond December 26, 2009. However, due to failure to pay, PPI has requested NDC a restructuring of the matured loan with a possible reduction of interest rate.

In the absence of a restructuring agreement, the total amount of P185 million is presented in the financial statements as current (Note 11).

13. DUE TO AFFILIATES

The breakdown of this account is as follows:

Particulars	2011	2010 (As restated)
Due to PITC	22,770,172	22,770,172
Due to NDC	6,411,079	3,973,233
Total Due to affiliates	**29,181,251**	**26,743,405**

The liability to PITC includes portion of cost of stocks transferred from PITC, trade returns accepted from previous PITC sales, and other direct expenses unpaid as at December 31, 2011.

14. CAPITAL STOCK

With the Securities and Exchange Commission's approval of the increase in capitalization, the Corporation presently has an authorized capital stock of P100 million, divided into one million (1,000,000) common shares at a par value of P100 per share.

As at December 31, 2011, the Corporation has Subscribed and Paid-in Capital of P37,500,000, consisting of:

Investors	Percentage	Amount
Philippine International Trading Corporation	60%	22,500,000
National Development Company	40%	15,000,000
Total	**100%**	**37,500,000**

15. SALES

Sales is broken down into the following categories of customers:

Particulars	2011	2010
Department of Health	142,367,602	101,314,165
BnB Orient Mansion	1,513,320	4,217,345
Commercial Accounts	546,997	7,423,120
Other Government Accounts	9,728,954	7,469,812
Others	66,054	1,143,184
Total Sales	**154,222,927**	**121,567,626**

16. OPERATING EXPENSES

Operating Expenses are broken down as follows:

Particulars	Notes	2011	2010 (As restated)
Personal Services			
Salaries and wages		14,308,955	17,025,607
Other compensation		7,299,556	9,663,773
Personnel benefits		840,961	1,047,590
		22,449,472	**27,736,970**
Maintenance and other operating expenses			
Donation expense	18	5,254,393	21,250,774
Professional services		4,726,183	3,913,380
Rent expense		3,681,227	3,851,323
Bad debt expense		1,321,918	5,099,331
Utility expense	18	1,096,332	1,240,179
Communication expense		1,071,209	1,449,754
Taxes, insurance premiums and other fees		1,018,567	1,363,462
Travelling expense		1,012,929	1,528,258
Depreciation expense		998,058	1,113,292
Supplies and materials expense		275,699	536,797
Representation expense		128,188	259,522
Repairs and maintenance expense		122,694	130,198
Training expense		106,874	60,763
Advertising expense		81,925	514,631
Membership dues and contributions to organization		4,600	5,000
Printing and binding expense		1,000	3,288
Transportation and delivery expense		170	-
Subscription expense		-	9,184
Miscellaneous expense		1,235,538	512,504
		22,137,504	**42,841,640**
Total Operating expenses		**44,586,976**	**70,578,610**

17. OTHER INCOME (EXPENSES)

This account is broken down as follows:

Particulars	2011	2010
Other Income (expenses)		
Financial charges	(158)	(6,514)
Interest income	283,966	562,536
Interest expense	(16,517,857)	(16,517,857)
Other service income	-	238,039
Miscellaneous Income	84,534	253,456
Total Other Income (expenses)	**(16,149,515)**	**(15,470,340)**

18. DEFICIT

Certain accounts in 2010 were restated to reflect the adjustments of prior year expenses and related accounts in accordance with the Philippine Accounting Standards (PAS).

Deficit, January 1, 2010, as previously reported		**(203,586,306)**
Net Loss for 2010		(61,540,150)
Adjustments:		
Cost of Sales	2,109,293	
Donation Expenses	845,693	
Utility Expenses	(22,225)	2,932,761
Net Loss for 2010 as adjusted		(58,607,389)
Deficit, December 31, 2010, as restated		**(262,193,695)**

19. CAPITAL DEFICIENCY

As at December 31, 2011, PPI has a capital deficiency of P243,736,272 due to the losses that have accumulated over the past years.

Nonetheless, opportunities are still coming in especially for government accounts. Moreover, notwithstanding the imposition of the maximum retail prices (MRP) on identified branded medicines as a result of the enactment of RA 9502 and its implementing rules and regulations, the prices of most medicines in the country are still generally pricier compared to other Asian countries. Hence, the mandate given to the Corporation is still relevant with still more room to further affect the pricing policies for drugs and medicines in the local pharmaceutical industry.

Aware of the foregoing and keeping in mind the social factor that PPI can impact on the majority of the country's population, the PPI Board of Directors, with the recent changes in its organization, has expressed its full support for the "rehabilitation" of PPI and has directed management to design a Business Plan that shall address the Corporation's capital deficiency over a period of time while aligning its strategies and activities towards the attainment of PPI's vision and mission.

The Corporation has identified the following three main goals which would help PPI eradicate its capital deficiency over the next few years:

a) Improved financial performance;
b) Quality and cheaper healthcare products and services made available and accessible on a timely manner; and
c) Strengthened organizational capacity.

These goals are interconnected as products cannot be made available without access to working capital, while delivery cannot be made on time without an efficient organization. The timely delivery of available products would ensure a shorter receivable turnover rate thereby increasing working capital available for stock replenishment and organizational development.

<u>Improved Financial Performance</u>

a) The Corporation shall arrest the losses that it has been experiencing since its inception. Realistically, the Corporation intends to achieve at least break-even by the end of 2014. This objective would require dramatic increases in sales while reducing administrative expenses.

b) However, the eradication of PPI's capital deficiency would come not only from the over-all improvement of its operations, but would also need capital reorganization. Capital reorganization for PPI entails a debt to equity conversion, and the restructuring of the remaining debt with a lower interest rate and longer repayment period. The decrease in the debt balance as well as a reduced interest rate will result in a smaller interest expense that would help improve the Corporation's bottom line. PPI shall submit this Business Plan to the National Development Company (NDC), creditor, to support the request for capital and loan restructuring.

c) Another strategic objective is to boost working capital:

   i. PPI shall lobby with the national government for subsidy since PPI is operating for public interest. Sales to government entities do not give the Corporation a gross margin percentage sufficient to finance its operating expenses;

   ii. PPI has requested NDC for an initial bridge financing arrangement for the posting of a performance security for a P68 million project for DOH. PPI shall continue to employ this financing arrangement for DOH and such other big projects from institutional accounts like the Philippine Charity Sweepstakes Office (PCSO);

   iii. PPI shall explore other short-term financing schemes such as a) fund transfer arrangements for institutional accounts, e.g. Philippine Army, Philippine Coast Guard, the Bureau of Corrections and such other institutions willing and allowed to participate in such an arrangement and b) IRA-intercept arrangement for local government accounts, in coordination with the Department of Budget and Management (DBM).

Quality and Cheaper Healthcare Products and Services

The availability of quality and cheaper healthcare products and their timely delivery are the mandate by which the Corporation exists.

a) Continue to partner with private companies for the supply of pharmaceutical products. Exploratory discussions for possible joint venture arrangements in the areas of supply and/or toll manufacturing of medicines are ongoing. These partnerships shall ensure a steady supply of medicines procured at lower prices;

b) The Corporation is already in the process of preparing the terms of reference for the public bidding for territorial distributors, as a tool to distribute products to the regions, alongside institutional wholesalers, who operate as distributors to their own networks;

c) Access to remote areas shall be made possible through:

    i. continued coordination with the DOH; and

    ii. a more aggressive sales and marketing approach towards local government units (LGUs). PPI would endeavor to work with the Leagues of LGUs and the DBM to establish a pooled procurement system for LGUs.

Strengthened Organizational Capacity

a) Institute concrete improvements in the different stages of operations, from procurement to delivery, by systemizing processes;

b) Establish an organizational development program aimed to increase professional effectiveness;

c) Develop a fully integrated and automated system that will link PPI with its service providers, and hopefully with clients, to improve monitoring and to generate on-time reports and data necessary for informed decision-making.