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

1. AGENCY BACKGROUND

PITC Pharma, Inc. (PPI) was initially incorporated in the Philippines on July 13, 1981 as Producers Venture Capital Corporation (PVCC). PVCC was 60 per cent owned by Prime Media Holdings, Inc. and 40 per cent owned by the National Development Company (NDC).On October 19, 2005, NDC bought out Prime Media's 60 per cent ownership, which made PVCC 100 per cent 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 PPI from PhP10 million to PhP100 million, divided into One million (1,000,000) common shares at a par value of PhP100 per share. The infusion by Philippine International Trading Corporation (PITC) of PhP 22.5 million in common shares, made PPI 60 per cent owned by PITC. PITC, with the issuance of EO 442, was designated as the lead coordinating agency to make quality medicine available, affordable, and accessible to the greater masses of Filipinos. PPI was created to exclusively take the lead in implementing the government's Half-Priced Medicines Program under EO 442.

Effective November 2008, PPI was designated as the central procurement arm for all government agencies for the importation of drugs and medicines, except for specific programs and instances allowed by the Department of Health (DOH). This is embodied in Section 1 Rule 16 Chapter III of the Implementing Rules and Regulations (IRR) of RA 9502 otherwise known as the Cheaper Medicines Law. Likewise, the IRR's Chapter XI Rule 58 gives authority to PPI to establish a common facility for pooled procurement in compliance with RA 9184.

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

As of December 31, 2012, PPI has a manpower complement of forty three (43) regular and probationary employees.

The principal office address of the Company 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, PPI's functional and presentation currency, and all values are rounded to the nearest peso, except when otherwise indicated.

The accompanying financial statements were prepared with the accounting principles generally accepted in the Philippines as set forth in Generally Accepted Accounting Principles (GAAP) and the National Government Accounting Standards (NGAS).

b. Cash & 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 minus allowance for doubtful accounts.

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

d. Prepaid Expenses

Prepayments are amortized over the period of coverage.

e. Inventories

Merchandise Inventory is valued at acquisition cost plus all incidental expenses incurred in acquiring the goods. Cost is determined using the weighted average method as recommended by the New Government Accounting System (NGAS), in compliance with Philippine Accounting Standards (PAS).

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

	2012	2011
Cash on hand and in banks	2,769,806	6,887,613
Money market placements	1,148,051	11,540,132
	3,917,857	**18,427,745**

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 (LBP) with original maturities of three months or less.

4. ACCOUNTS RECEIVABLE – TRADE

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

	2012	2011
Commercial accounts and territorial distributors	32,148,404	33,370,491
Department of Health (DOH)	16,995,090	29,838,574
Other government accounts	12,338,510	8,812,711
	61,482,004	72,021,776
Less: Allowance for doubtful accounts	37,689,417	37,094,270
	23,792,587	**34,927,506**

5. ACCOUNTS RECEIVABLE – NON TRADE

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

	2012	2011 (as restated)
Due from BIR	1,890,348	992,766
Due from Social Security System (SSS)	128,099	124,949
Due from officers and employees	57,285	290,990
Other receivables	2,980,930	3,064,824
	5,056,662	**4,473,529**

Due from BIR is the excess of input tax over output tax.

6. INVENTORIES - NET

This account is composed of the following:

	2012	2011
Merchandise inventory	514,086	3,920,555
Supplies inventory	456,182	582,421
	970,268	4,502,976
Less: Allowance for inventory loss/ obsolescence	31,116	1,018,346
	939,152	**3,484,630**

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

	2012	2011
Balance, January 1	1,018,346	2,104,253
Adjustment	(987,230)	(1,085,907)
	31,116	**1,018,346**

7. PREPAID EXPENSES

This account consists of the following:

	2012	2011 (as restated)
Prepaid income tax carry over	7,026,110	4,882,632
Prepaid income tax - MCIT	1,593,894	1,352,044
Advances to contractors	657,377	-
Guaranty deposits	8,525	229,501
Prepaid insurance	7,274	160,819
Advances to PITC	-	7,064
Others	6,020	6,020
	9,299,200	**6,638,080**

The prepaid income tax carry over arose from adjustments on creditable withholding tax at source applied to Income Tax Returns from years 2006-2012.

The Prepaid income tax – MCIT pertains to the prepaid income tax consisting of the unexpired portion of Minimum Corporate Income Tax with balances amounting to P516,475, P823,569 and P241,850 for the years 2010, 2011 and 2012 respectively.

The Advances to contractors represent a 30 per cent down payment paid, funded by Apolloplus Distribution, Inc. (Apolloplus), to a supplier of imported medicines. The importation was conducted pursuant to the Memorandum of Agreement (MOA) entered into by PPI, IPVG Corporation (IPVG), and Apolloplus wherein PPI shall import for the account IPVG and Apolloplus quality and affordable drugs and medicines and other pharmaceutical products in accordance with PPI's importation guidelines. PPI and IPVG shall finance all expenses and costs for its requirements on importations using PPI's import facility, through advance payment or opening of a credit line.

Guaranty deposits represent the deposit fee for the photocopying services contract with Ricoh Philippines, Inc.

8. PROPERTY PLANT AND EQUIPMENT

This account consists of the following:

Particulars	Leasehold Improvements	Furniture and fixtures/library books	Communication Equipment	IT Equipment and software	Office Equipment	Other Machineries and Equipment	Total
CY 2012							
Costs							
Balance, January 01	4,478,383	1,644,194	348,956	3,786,200	210,553	-	10,468,286
Additions/Deductions	(2,190,714)	-	-	(688)	-	33,035	(2,158,367)
Balance, December 31	**2,287,669**	**1,644,194**	**348,956**	**3,785,512**	**210,553**	**33,035**	**8,309,919**
Accumulated Depreciation							
Balance, January 01	2,606,703	608,426	126,307	2,899,340	136,670	-	6,377,446
Depreciation	(1,800,688)	147,977	31,490	431,193	33,338	991	(1,155,699)
Balance, December 31	**806,015**	**756,403**	**157,797**	**3,330,533**	**170,008**	**991**	**5,221,747**
Net Book Value December 31, 2012	**1,481,654**	**887,791**	**191,159**	**454,979**	**40,545**	**32,044**	**3,088,172**
CY 2011							
Net Book Value December 31, 2011	1,871,680	1,035,768	222,649	886,860	73,883	-	4,090,840

Leasehold improvements consist of the cost of the renovation of the rented office space at the 2nd floor of the NDC Building. The deduction of P2,190,714 pertains to the cost of improvements on the other leased office space at the adjacent Orient Mansion building which contract was terminated on September 2012.

9. ACCOUNTS PAYABLE

This account consists of:

	2012	2011 (as restated)
Accounts payable – trade	23,418,481	26,087,004
Accounts payable – non-trade	1,360,012	1,200,899
	24,778,493	**27,287,903**

Accounts payable – trade represents amount due to various suppliers for the procurement 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. The reported amount for 2011 of P3,194,405 was restated to reflect the reclassification to Inter-agency payables of Due to COA in the amount of P1,993,506.

10. INTER-AGENCY PAYABLES

This account consists of:

	2012	2011 (as restated)
Due to COA	2,494,506	1,993,506
Due to DOH	1,618,428	1,618,428
Due to BIR	1,002,777	3,076,780
Due to SSS	120,074	118,386
Due to PAG-IBIG	37,385	52,437
Due to PHILHEALTH	20,600	24,188
Due to PCSO	-	4,947,988
	5,293,770	**11,831,713**

The account Due to DOH represents the unliquidated balance of the P50 Million fund transfer intended for the DOH P100 project pursuant to DOH Administrative Order No. 2008-0013, and covered by a Memorandum of Agreement by and between DOH and PPI. The amount is presented at net of receivables of P1,114,994 (Note 5).

The liability to the BIR includes income taxes and withholding taxes for filing and/or remittance in January of the following year.

11. OTHER CURRENT LIABILITIES

This account is broken down as follows:

	2012	2011
Loans payable	185,000,000	185,000,000
Interest payable	110,522,603	91,971,918
Performance/bidders bond	4,724,009	3,810,159
Due to other funds	3,122,044	-
Due to officers & employees	1,753,421	1,636,984
Vacation and sick leave	1,697,708	1,880,220
Others	2,203,000	3,482,510
	309,022,785	**287,781,791**

The Loans payable consist of loans availed from NDC under the loan agreement entered into by and between NDC and PPI for organizational and operational expenditures in pursuit of the Half-Priced Medicines Program. The loans bear an interest rate of 10 per cent 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 meantime, the total amount of P185 Million is presented in the financial statements as current.

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 of the end of the year.

Due to other funds represent fund transfers made by IPVG/Apolloplus to finance importations of drugs and medicines using PPI's import facility (Note 7).

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

12. DUE TO AFFILIATES

This account consists of :

	2012	2011
Due to PITC	10,241,575	10,356,770
Due to NDC	8,864,406	6,411,079
	19,105,981	**16,767,849**

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 of the end of the year. It is presented net of receivables for payments made by PPI clients to PITC and other PPI advances for account of PITC of P12,513,036 and P12,413,402 for years 2012 and 2011, respectively.

The Due to NDC account represent liabilities to NDC accruing from the use of NDC's facilities. The account also includes fees charged by NDC for opening a Standby Letter of Credit (SLC) for the account of PPI.

To assist PPI put up the required performance securities for DOH and other government instrumentalities, in July 2012, NDC agreed to open, for the account of PPI, an irrevocable SLC of up to Five Million Pesos in favor of DOH and other government agencies with whom PPI will have a transaction for the supply or procurement of medicines. PPI shall pay NDC a fee of three and a half per cent per annum, based on the face value of the SLC. On July 31, 2012, an SLC in favor of the DOH was opened in the amount of P3,394,019.21.

13. CAPITAL STOCK

PPI has authorized capital stock of PhP100 million, divided into one million (1,000,000) common shares at a par value of PhP100 per share.

The Subscribed and Paid-in Capital of P37, 500,000 consist of:

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

14. DEFICIT

The restatement of this account is detailed as follows:

Balance, January 1, 2011 as previously reported			(262,193,695)
Adjustments:			
	Taxes and licenses	(19,022,407)	
	MCIT 2008	(566,902)	
	MCIT 2009	(663,656)	
	Cost of sales	(656,602)	(20,909,567)
Balance, January 1, 2011 as restated			(283,103,262)
Net Loss for 2011			(19,042,577)
Adjustments:			
	Taxes and licenses	(5,211,354)	
	Cost of sales	(1,769,732)	(6,981,086)
Net Loss for 2011 as restated			(26,023,663)
Balance, December 31, 2011 as restated			**(309,126,925)**

15. SALES

Sales is broken down into the following categories of customers:

	2012	2011
Department of Health	39,521,122	142,367,602
Other government accounts	23,360,146	9,728,954
Commercial accounts	167,876	546,997
BNB Orient Mansion	677,953	1,513,320
Others	-	66,054
	63,727,097	**154,222,927**

16. OPERATING EXPENSES

Operating expenses are broken down as follows:

	2012	2011 (as restated)
Personal Services		
Salaries and wages	12,366,965	14,308,955
Other compensation	6,532,491	7,299,556
Personnel benefits contributions	729,475	840,961
	19,628,931	**22,449,472**
Maintenance and other operating expenses		
Rent expenses	3,388,965	3,681,227
Professional services	3,269,315	4,726,183
Taxes, insurance premiums and other fees	3,086,715	6,229,921
Donation expense	1,072,030	5,254,393
Depreciation expense	1,035,016	998,058
Utility expense	1,008,917	1,096,332
Communication expense	805,264	1,071,209
Bad debt expense	665,700	1,321,918
Loss on inventory	426,915	-
Supplies and materials expense	306,619	275,699
Travelling expense	194,338	1,012,929
Advertising expense	149,715	81,926
Repairs and maintenance expense	48,020	122,694
Representation expense	46,490	128,188
Subscription expense	8,576	-
Membership dues and contributions	2,300	4,600
Training expense	-	106,874
Printing and binding expense	-	1,000
Transportation and delivery expense	-	170
Miscellaneous expense	750,271	1,235,538
	16,265,166	**27,348,859**
	35,894,097	**49,798,331**

17. OTHER INCOME (EXPENSES)

This account is broken down as follows:

	2012	2011
Financial charges	(147,365)	(158)
Interest income	31,620	283,966
Interest expense	(16,563,112)	(16,517,857)
Miscellaneous income	24,082	84,534
	(16,654,774)	**(16,149,515)**

18. CAPITAL DEFICIENCY/GOING CONCERN

As of December 31, 2011, PPI has a capital deficiency of P 271,626,925 due to the losses that have accumulated over the past years. PPI did not fare any better in 2012. The goals that had been previously identified were not followed through.

However, with a new and stronger leadership, these goals may yet be achieved. It is imperative that PPI improves its financial performance and strengthen its organizational capacity in order to achieve its mission of providing low-priced, quality medicines to the Filipino people.

Reviewing the mandate given by RA No. 9502 and its IRR, PPI has yet to tap and take advantage of its sustainable competitive advantage – that it is the only government pharmaceutical company with the ability to aggregate orders resulting in lowest priced, quality medicines.

Improve Financial Performance

1. Although PPI should earn enough to sustain its operations, PPI is not a profit oriented company. The Governance Commission on Government Owned and Controlled Corporations (GCG) classifies PPI within the Social Services and Housing Sector. We believe therefore that PPI's performance should be judged by what we save our publics.

    - A paradigm shift of sacrificing a higher gross margin percentage to be able to procure at lower costs is necessary. We have now benchmarked a 10 per cent margin on the purchase price of drugs and medicines.
    - The aggregation of orders from government agencies provides volume discounts for PPI plus the lower margin of only 10 per cent ensures prices are the lowest possible.

2. PPI focuses only on the top Essential Medicines in the Philippine National Formulary (PNF) and nothing else.

    - In 2013, PPI released an official Price List with only 117 Products/SKUs based on the PNF.

- This eliminates the ‘sari-sari’ store mentality formerly accorded PPI.

3. PPI buys only from the big local and foreign players

   - These big players have the scale to:
     - Provide generous credit terms (90 days);
     - Guarantee delivery to anywhere in the Philippines, minimizing distribution costs for PPI;
     - Ensure only real, legitimate and high-potency medicines are procured.

Strengthen organizational capacity

The new leadership is determined to accomplish its mission with the support of the whole organization. Thus, management has been working on:

1. Improving Employee Morale through:

   - More open communications with the establishment of the suggestion box, e-newsletter, etc.;
   - More bonding activities;
   - Providing, with better finances, step increments, promotions to deserving employees, and benefits that have previously been withheld. Other benefits within the guidelines established by authorities may also be given;
   - Providing training activities.

2. Running PPI Professionally by:

   - Implementation of good housekeeping practices;
   - Implementation of tried and tested practices and processes: Action Registers, Performance Management System, (goal setting, mid-year appraisals, one on one discussions) etc.;
   - Improved reporting to and engagement with the Board;
   - Timely preparation, submission and approval of the Corporate Operating Budget (COB). The budgeting process will follow prescribed timelines and the COB for following year will be presented to the PPI Board no later than November of the current year.

3. Achievement of Budget via Implementation of Programs through Hands On Management

   - Establish credibility and sustain good working relationships with external publics , especially with big-ticket clients like the DOH, PCSO, PAGCOR, etc.;
   - Finalize the business plan to tap private sector opportunities, the biggest bulk of which are the CSR projects of the different foundations of the conglomerates.

4. Address Balance Sheet Issues through any or a combination of the following options:

   - Restructure matured loan payable to NDC at lower interest rate;

- Recapitalize via conversion of loans payable to NDC and interest payable thereon to equity; and
- Review subsidy option from DBM.

19. RESTATEMENT OF ACCOUNTS

Certain accounts in 2011 were restated to conform with the 2012 financial statements presentation.