## 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 P100 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 P22.5 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, 2013, PPI has a manpower complement of 48 regular and probationary employees.

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

## 2. REPORT ON OPERATIONS

As of December 31, 2012, PPI incurred a deficit of P349,607,399 due to losses that have accumulated over the past years.

However, with the new leadership that came in November 2012 and a new business model, the company has turned around sales and profit. More importantly, this is the first year that PPI registered a positive bottom line, which is way beyond the net loss of P40.48 million in previous year.

The total sales amounting to P344.64 million is 441 per cent better than last year's performance. This sales performance is driven by strong sales to the Department of Health (DOH) for its influenza and pneumococcal polyvalent vaccines as well as the medicines for breast cancer and leukemia which are two of the Type Z benefit packages of the Philippine Health Insurance Corporation. Year-on-year, all three (3) customer sectors, the DOH account, the government agencies (GA) accounts and the local government units (LGU) accounts posted double-digit growth.

The company also continued to improve its business processes to further accelerate growth in the GA and LGU sectors which are expected to bring in sales for the following year. Management is confident that the measures put in place in 2013 will help sustain the gains it has achieved so far.

*PPI's Sustainable Competitive Advantage: Pooled Procurement Facility*

To achieve its mandate of providing low-priced quality medicines, Management assessed its strengths and weaknesses as well as its opportunities and threats, and has identified its sustainable competitive advantage being the only pharmaceutical government owned and controlled corporation (GOCC) that aggregates all orders for medicines of public health facilities and government agencies in order to achieve competitive prices for quality medicines.

Given this advantage, PPI leverages its strength towards servicing the medicine requirements of the public sector as well as the big private corporations and foundations, particularly their CSR programs on health. It focuses only on the top essential medicines in the Philippine National Formulary System thereby eliminating the "sari-sari" store mentality formerly accorded PPI. To ensure that only quality medicines are made available to its customers and to help stop the proliferation of fake medicines in the market, PPI buys only from the big local and foreign players that have the scale to provide generous credit terms and to guarantee delivery, when necessary, to anywhere in the Philippines, thereby minimizing distribution costs for PPI.

This new business model has proven to have saved the government money which can be used to procure more medicines thereby benefitting more. Proof of this is the vaccines order where, because of the pooled system of procurement, the DOH alone saved P70 million from its original approved budget of the contract of P268 million. Other government agencies, GOCCs, LGUs and foundations also benefited from this aggregation.

As of August 2013, 75 public and private entities have availed of the services of this pooled procurement facility.

Sales to LGUs tripled from P3.036 million in 2012 to P10.766 million in 2013. Majority of the orders came from municipalities in Bicol and Southern Tagalog regions.

The reduction in prices due to pooled procurement brought forth a new revenue stream for PPI in 2013 which was sales to foundations and private corporations, bringing in sales of P5.004 million worth of vaccines and emergency kits.

*Other Programs, Projects and Strategic Activities*

1. Partnership with the DOH on the Various Medicines Access Programs for cancer. In 2009, the DOH launched the Acute Lymphocytic Leukemia Medicines Access Program (ALLMAP) and two years later they expanded the program to cover breast cancer.

   PPI has been identified as the procurement arm for these programs. Under the agreement, PPI supplies the DOH identified sites with the medicines required under the approved treatment protocols. The medicines supplied by the PPI are two to five times cheaper than the innovator counterparts available in the country, but of good quality.

2. Partnership with the Philippine Health Insurance Corporation (PhilHealth) on Selected Type Z Packages. To achieve Universal Health Care or Kalusugan Pangkalahatan, which is the cornerstone of the current administration's health agenda, PhilHealth has launched programs that seek to improve benefits delivery and utilization rate. In 2012, PhilHealth launched the Type Z program wherein PPI is one of the suppliers for Acute Lymphocytic Leukemia and Breast Cancer medicines. Aside from the supplies funded through the National Center for Pharmaceutical Access and Management, some PhilHealth-contracted hospitals ordered their medicine requirement directly from PPI.

3. Restructuring of the P185 million loan payable to NDC. The restructuring of the loan, which matured on December 29, 2009, at lower interest and penalty rates and with longer repayment period, allows PPI to improve or restore liquidity in order to continue its operations.

## 3. 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-per cent 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.

## 4. CASH AND CASH EQUIVALENTS

The account is composed of the following:

| | **2013** | 2012 |
|---|---|---|
| Cash on hand and in banks | **28,346,904** | 2,769,806 |
| Money market placements | **15,127,660** | 1,148,051 |
| Total | **43,474,564** | 3,917,857 |

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.

## 5. ACCOUNTS RECEIVABLE – TRADE

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

| | **2013** | 2012 |
|---|---|---|
| Department of Health | **79,584,710** | 16,995,090 |
| Private accounts | **32,522,590** | 32,148,404 |
| Other government accounts | **14,137,131** | 12,338,510 |
| | **126,244,431** | 61,482,004 |
| Less: Allowance for doubtful accounts | **36,626,174** | 37,689,417 |
| Balance | **89,618,257** | 23,792,587 |

## 6. ACCOUNTS RECEIVABLE – NON TRADE

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

| | **2013** | 2012 |
|---|---|---|
| Due from BIR | - | 1,890,348 |
| Due from Social Security System (SSS) | **193,094** | 128,099 |
| Due from officers and employees | **59,121** | 57,285 |
| Other receivables | **2,987,885** | 2,980,930 |
| Total | **3,240,100** | 5,056,662 |

## 7. INVENTORIES - NET

This account is composed of the following:

| | **2013** | 2012 |
|---|---|---|
| Merchandise inventory | **28,469,147** | 514,086 |
| Supplies inventory | **152,675** | 456,182 |
| | **28,621,822** | 970,268 |
| Less: Allowance for inventory loss/ obsolescence | **73,398** | 31,116 |
| Balance | **28,548,424** | 939,152 |

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

| | **2013** | 2012 |
|---|---|---|
| Balance, January 1 | **31,116** | 1,018,346 |
| Adjustment | **42,282** | (987,230) |
| Balance, December 31 | **73,398** | 31,116 |

## 8. PREPAID EXPENSES

This account consists of the following:

| | **2013** | 2012 |
|---|---|---|
| Prepaid input tax carry over | **10,836,475** | 7,026,110 |
| Prepaid income tax | **4,593,414** | 1,593,894 |
| Advances to contractors | **217,650** | 657,377 |
| Guaranty deposits | **110,790** | 8,525 |
| Prepaid insurance | **88,378** | 7,274 |
| Others | **8,890** | 6,020 |
| Total | **15,855,597** | 9,299,200 |

The prepaid input tax carry-over arose from excess of input tax over output tax and the prepaid income tax carry-over is the excess payments of income tax due to creditable withholding tax at source applied to income tax payable from years 2006-2013.

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. and with NDC for the rental of additional space at the 12th floor, NDC building.

## 9. 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 2013 | | | | | | | |
| Costs | | | | | | | |
| Balance, January 01 | **2,287,669** | **1,644,194** | **348,956** | **3,785,512** | **210,553** | **33,035** | **8,309,919** |
| Additions(Deductions) | (7,768) | (114,264) | (12,482) | 231,058 | 26,151 | 16,461 | 139,156 |
| **Balance, December 31** | **2,279,901** | **1,529,930** | **336,474** | **4,016,570** | **236,704** | **49,496** | **8,449,075** |
| Accumulated Depreciation | | | | | | | |
| Balance, January 01 | **806,015** | **756,403** | **157,797** | **3,330,533** | **170,008** | **991** | **5,221,747** |
| Depreciation | 822,471 | 85,467 | 23,899 | 59,407 | 15,241 | 6,934 | 1,013,419 |
| **Balance, December 31** | **1,628,486** | **841,870** | **181,696** | **3,389,940** | **185,249** | **7,925** | **6,235,166** |
| **Net Book Value December 31, 2013** | **651,415** | **688,060** | **154,778** | **626,630** | **51,455** | **41,571** | **2,213,909** |
| CY 2012 | | | | | | | |
| Net Book Value December 31, 2012 | **1,481,654** | **887,791** | **191,159** | **454,979** | **40,545** | **32,044** | **3,088,172** |

Leasehold improvements consist of the cost of the renovation of the rented office space at the 2nd floor of the NDC Building.

## 10. ACCOUNTS PAYABLE

This account consists of:

| | **2013** | 2012 |
|---|---|---|
| Accounts payable – trade | **151,752,569** | 23,418,481 |
| Accounts payable – non-trade | **2,437,555** | 1,360,012 |
| Total | **154,190,124** | 24,778,493 |

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.

## 11. INTER-AGENCY PAYABLES

This account consists of:

| | 2013 | 2012 |
|---|---|---|
| Due to COA | **3,553,093** | 2,494,506 |
| Due to DOH | **1,618,428** | 1,618,428 |
| Due to BIR | **1,103,232** | 1,002,777 |
| Due to SSS | **95,872** | 120,074 |
| Due to PAG-IBIG | **51,036** | 37,385 |
| Due to PHILHEALTH | **24,225** | 20,600 |
| Total | **6,445,886** | 5,293,770 |

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 for cost of stickers and packaging materials advanced by PPI for the project.

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

## 12. OTHER CURRENT LIABILITIES

This account is broken down as follows:

| | 2013 | 2012 |
|---|---|---|
| Current portion of loan payable | **16,472,632** | 185,000,000 |
| Performance/bidders bond | **9,847,629** | 4,724,009 |
| Vacation and sick leave | **1,617,008** | 1,697,708 |
| Due to officers & employees | **1,605,069** | 1,753,421 |
| Due to other funds | **1,539,932** | 3,122,044 |
| Interest payable | **-** | 110,522,603 |
| Others | **1,429,437** | 2,203,000 |
| Total | **32,511,707** | 309,022,785 |

The current portion of loan payable pertains to the principal amortizations due on September 30, 2014 and December 31, 2014 of the loan payable as disclosed in Note 13.

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 8).

Other payables include trust liabilities arising from proceeds of the sale of bid documents and a fund entrusted by a supplier for the advance payment of advocacy expenses.

## 13. LOAN PAYABLE

| | **2013** | 2012 |
|---|---|---|
| Loan from NDC | **275,322,623** | - |

NDC and PPI entered into a Loan Restructuring Agreement effective June 30, 2013 with a new loan amount of P291,795,254.40 consisting of the outstanding principal of P185,000,000 (Note 12) and accrued interest thereon. The new loan is payable every quarter for a period of eight years with a one-year grace period and bears an interest rate of 7 per cent per annum, also payable every quarter.

## 14. DUE TO AFFILIATES

This account consists of :

| | **2013** | 2012 |
|---|---|---|
| Due to PITC | **9,641,575** | 10,241,575 |
| Due to NDC | **8,170,962** | 8,864,406 |
| Total | **17,812,537** | 19,105,981 |

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 payments made by PPI clients to PITC and other PPI advances for account of PITC.

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, NDC, in July 2012, agreed to open, for the account of PPI, an irrevocable SLC in favor of DOH and other government agencies with whom PPI will have a transaction for the supply or procurement of medicines. PPI pays NDC a fee of three and a half per cent per annum, based on the face value of the SLC. As of December 31, 2013, the outstanding SLCs amount to P17.7 million representing performance securities for the influenza and pneumococcal vaccines and the oncology projects of the DOH.

## 15. CAPITAL STOCK

PPI has authorized capital stock of P100 million, divided into one million (1,000,000) common shares at a par value of P100 per share.

The subscribed and paid-in capital of P37, 500,000 consists of:

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

## 16. SALES

Sales is broken down into the following categories of customers:

| | 2013 | 2012 |
|---|---|---|
| Department of Health | **311,848,841** | 39,521,122 |
| Other government accounts | **27,530,794** | 23,360,146 |
| Private accounts | **5,181,014** | 167,876 |
| BNB Orient Mansion | **82,708** | 677,953 |
| Total | **344,643,357** | 63,727,097 |

## 17. OTHER INCOME (EXPENSES)

This account is broken down as follows:

| | 2013 | 2012 |
|---|---|---|
| Financial charges | **(1,030,322)** | ( 147,365) |
| Interest income | **86,567** | 31,620 |
| Interest expense | **(17,309,648)** | (16,563,112) |
| Gain on loan restructuring | **11,918,395** | - |
| Adjustment of allowance for doubtful accounts | **1,063,243** | - |
| Other income | **15,384** | 24,082 |
| Total | **(5,256,381)** | (16,654,774) |

## 18. OPERATING EXPENSES

Operating expenses are broken down as follows:

| | Selling and distribution expenses | | Administrative expenses | |
|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 |
| **Personal Services** | | | | |
| Salaries and wages | **4,805,863** | 3,650,466 | **7,505,889** | 8,716,499 |
| Other compensation | **1,993,834** | 1,297,850 | **5,038,305** | 5,234,641 |
| Personnel benefits contributions | **333,600** | 243,810 | **400,713** | 485,665 |
| Sub-total | **7,133,297** | 5,192,126 | **12,944,907** | 14,436,805 |
| **Maintenance and other operating expenses** | | | | |
| Travel expense | **307,823** | 156,215 | **36,988** | 38,123 |
| Transportation and delivery expenses | **1,761,930** | - | **-** | - |
| Training expense | **27,383** | - | **72,404** | - |
| Communication expense | **227,939** | 202,490 | **539,116** | 602,773 |
| Supplies and materials expense | **621,773** | 38,218 | **480,086** | 268,401 |
| Rent expenses | **15,522** | 6,890 | **2,403,597** | 3,382,075 |
| Professional services | **-** | - | **3,173,837** | 3,269,315 |
| Taxes, insurance premiums and other fees | **37,147** | 64,218 | **2,409,360** | 3,022,497 |
| Representation expense | **74,695** | 12,101 | **108,760** | 34,389 |
| Repairs and maintenance expense | **-** | - | **130,030** | 48,020 |
| Utility expenses | **-** | - | **790,642** | 1,008,917 |
| Subscription expense | **3,898** | 3,636 | **8,985** | 4,940 |
| Advertising expense | **-** | 58,700 | **279,461** | 91,015 |
| Membership dues and contributions | **-** | - | **4,400** | 2,300 |
| Gender and development expenses | **3,819** | - | **148,834** | - |
| Printing and binding expenses | **-** | - | **8,504** | - |
| Donation expense | **-** | - | **-** | 1,072,030 |
| Depreciation expense | **-** | - | **1,147,933** | 1,035,017 |
| Loss on inventory | **113,550** | 426,915 | **-** | - |
| Bad debt expense | **-** | - | **-** | 665,700 |
| Miscellaneous expense | **2,266** | 137,275 | **405,110** | 612,995 |
| Provision for income tax | **-** | - | **3,760,874** | - |
| Sub-total | **3,197,745** | 1,106,659 | **15,908,921** | 15,158,507 |
| Total | **10,331,042** | 6,298,785 | **28,853,828** | 29,595,312 |

## 19. TAX DISCLOSURES

A. Value-Added Tax

PPI is a VAT-registered company with VAT output tax declaration during the year of P40,847,517 based on sales and other income totaling P340,395,979. VAT-exempt sales amounted to P4,262,763.

The amount of VAT Input taxes claimed are broken down as follows:

| | | |
|---|---|---|
| Beginning balance | | 1,890,348 |
| Add: Purchases during the year: | | |
| 1. On goods for resale | 36,876,127 | |
| 2. On goods other than for resale | 64,333 | |
| 3. On capital goods | 24,739 | |
| 4. On services recorded as operating expenses | 1,904,757 | 38,869,956 |
| Sub-total | | 40,760,304 |
| Less: Input VAT charged to expense | | 9,789,603 |
| Ending balance | | 30,970,701 |

B. Other taxes and licenses paid during the year:

| | |
|---|---|
| Local | |
| 1. Mayor's permit | 301,948 |
| 2. Barangay clearance / CTC | 11,150 |
| 3. Other business taxes | 2,080 |
| National | |
| 1. BIR annual registration | 500 |
| 2. PDEA license | 6,650 |
| 3. Others | 7,433 |

C. Taxes withheld and remitted during the year

| | |
|---|---|
| 1. On compensation | 1,906,673 |
| 2. Expanded withholding taxes | 2,515,962 |
| 3. Final withholding taxes | 10,598,087 |

D. Letters of Authority

PPI has a pending Final Decision on Disputed Assessment (FDDA) from Revenue District Office No. 50 amounting to P7,897,294 inclusive of interest as of December 31, 2012 for income tax deficiency covering the taxable year 2007. A Protest-Letter was filed in October 2012 disputing the amended assessment. The protest is still under investigation.

The Letter of Authority for taxable year 2008 was settled in August 2013 with the remittance of P1,997,256 for deficiency VAT, expanded withholding tax, withholding tax on compensation and donor's tax.

## 20. RECLASSIFICATION OF ACCOUNTS

The operating expenses in 2012 were reclassified as to selling and administrative expenses to conform to the 2013 financial statements presentation.