



**KEMWATER PHIL. CORP.**

Financial Statements  
December 31, 2004 and 2003

and

Report of Independent Auditors

\*SGVMC304610\*

## **Report of Independent Auditors**

The Stockholders and the Board of Directors  
Kemwater Phil. Corp.

We have audited the accompanying balance sheets of Kemwater Phil. Corp. as of December 31, 2004 and 2003, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kemwater Phil. Corp. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the Philippines.

Aldrin M. Cerrado  
Partner  
CPA Certificate No. 86735  
SEC Accreditation No. 0113-A  
Tax Identification No. 129-433-783  
PTR No. 1195836, January 3, 2005, Makati City

March 29, 2005

**\* SGVMC304610 \***

## Report of Independent Auditors

The Stockholders and the Board of Directors  
Kemwater Phil. Corp.  
Chemphil Building, 851 A. Arnaiz Avenue  
Legaspi Village, Makati City

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**KEMWATER PHIL. CORP.****BALANCE SHEETS**

	<b>December 31</b>	
	<b>2004</b>	2003 (As restated - Note 2)
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents (Note 3)	<b>₱3,178,352</b>	₱5,001,173
Receivables (Note 4)	<b>26,287,452</b>	17,064,336
Due from related parties (Note 9)	<b>16,619,452</b>	184,334
Inventories (Note 5)	<b>16,557,631</b>	10,719,873
Prepaid expenses and other current assets (Note 6)	<b>1,446,456</b>	2,788,945
<b>Total Current Assets</b>	<b>64,089,343</b>	35,758,661
<b>Noncurrent Assets</b>		
Property, plant and equipment (Note 7)		
At cost - net	<b>15,946,425</b>	14,751,931
At appraised value	<b>32,069,000</b>	32,069,000
Deferred income tax assets (Note 14)	<b>519,153</b>	531,054
Other noncurrent assets - net (Note 15)	<b>8,634,516</b>	10,729,445
<b>Total Noncurrent Assets</b>	<b>57,169,094</b>	58,081,430
<b>TOTAL ASSETS</b>	<b>₱121,258,437</b>	₱93,840,091
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued expenses (Note 8)	<b>₱7,971,728</b>	₱4,382,996
Liabilities under letters of credit and trust receipts (Note 5)	<b>8,892,070</b>	6,840,811
Due to related parties (Note 9)	<b>4,776,310</b>	5,823,391
<b>Total Current Liabilities</b>	<b>21,640,108</b>	17,047,198
<b>Noncurrent Liability</b>		
Deferred income tax liability (Notes 2 and 14)	<b>1,263,236</b>	1,263,236
<b>Total Liabilities</b>	<b>22,903,344</b>	18,310,434
<b>Stockholders' Equity</b>		
Capital stock - ₱1 par value		
Authorized - 200,000,000 shares		
Issued and outstanding - 115,000,000 shares in 2004	<b>115,000,000</b>	115,000,000
Revaluation increment in land (Notes 2 and 7)	<b>2,684,376</b>	2,684,376
Deficit	<b>(19,329,283)</b>	(42,154,719)
<b>Total Stockholders' Equity</b>	<b>98,355,093</b>	75,529,657
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>₱121,258,437</b>	₱93,840,091

See accompanying Notes to Financial Statements.

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**KEMWATER PHIL. CORP.**  
**STATEMENTS OF INCOME**

	Years Ended December 31	
	2004	2003
<b>NET SALES</b>	<b>₱138,079,901</b>	₱82,932,851
<b>COST OF GOODS SOLD</b> (Note 10)	<b>101,689,202</b>	76,637,753
<b>GROSS INCOME</b>	<b>36,390,699</b>	6,295,098
<b>OPERATING EXPENSES</b> (Note 11)	<b>12,296,568</b>	10,310,587
<b>INCOME (LOSS) FROM OPERATIONS</b>	<b>24,094,131</b>	(4,015,489)
<b>OTHER INCOME (EXPENSES)</b>		
Interest income	746,885	355,325
Interest expense	(193,157)	(863,778)
Others - net	(83,131)	293,926
	<b>470,597</b>	(214,527)
<b>INCOME (LOSS) BEFORE INCOME TAX</b>	<b>24,564,728</b>	(4,230,016)
<b>PROVISION FOR INCOME TAX</b> (Note 14)		
Current	1,727,391	163,664
Deferred	11,901	(59,372)
	<b>1,739,292</b>	104,292
<b>NET INCOME (LOSS)</b>	<b>₱22,825,436</b>	(₱4,334,308)

*See accompanying Notes to Financial Statements.*

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**KEMWATER PHIL. CORP.****STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003**

	Capital Stock	Revaluation Increment in Land (Notes 2 and 7)	Deficit	Total
<b>BALANCES AT DECEMBER 31, 2002 AS PREVIOUSLY STATED</b>	<b>₱103,144,553</b>	<b>₱3,947,612</b>	<b>(₱37,820,411)</b>	<b>₱69,271,754</b>
Effect of change in accounting for income taxes (Note 2)	–	(1,263,236)	–	(1,263,236)
<b>BALANCES AT DECEMBER 31, 2002, AS RESTATED</b>	<b>103,144,553</b>	<b>2,684,376</b>	<b>(37,820,411)</b>	<b>68,008,518</b>
Issuance of common stock	11,855,447	–	–	11,855,447
Net loss for the year	–	–	(4,334,308)	(4,334,308)
<b>BALANCES AT DECEMBER 31, 2003</b>	<b>115,000,000</b>	<b>2,684,376</b>	<b>(42,154,719)</b>	<b>75,529,657</b>
Net income for the year	–	–	22,825,436	22,825,436
<b>BALANCES AT DECEMBER 31, 2004</b>	<b>₱115,000,000</b>	<b>₱2,684,376</b>	<b>(₱19,329,283)</b>	<b>₱98,355,093</b>

*See accompanying Notes to Financial Statements.*

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**KEMWATER PHIL. CORP.**  
**STATEMENTS OF CASH FLOWS**

	<b>Years Ended December 31</b>	
	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income (loss) before income tax	<b>₱24,564,728</b>	(₱4,230,016)
Adjustments for:		
Depreciation (Note 7)	<b>2,886,884</b>	4,183,814
Amortization of deferred costs (Note 11)	<b>2,549,475</b>	1,133,100
Interest income	<b>(746,885)</b>	(355,325)
Interest expense	<b>193,157</b>	863,778
Provision for probable inventory losses	<b>152,083</b>	–
Provision for doubtful accounts	<b>74,931</b>	38,868
Unrealized foreign exchange (gains) losses - net	<b>719</b>	124,920
Gain on sale of property, plant and equipment	<b>–</b>	(205,675)
Operating income before working capital changes	<b>29,675,092</b>	1,553,464
Decrease (increase) in:		
Receivables	<b>(9,137,136)</b>	(1,827,983)
Due from related parties	<b>(16,435,118)</b>	131,198
Inventories	<b>(5,989,841)</b>	9,786,966
Prepaid expenses and other current assets	<b>1,342,489</b>	2,179,540
Increase (decrease) in:		
Accounts payable and accrued expenses	<b>3,630,780</b>	(3,650,438)
Liabilities under letters of credit and trust receipts	<b>2,051,259</b>	(5,042,388)
Due to related parties	<b>(1,047,081)</b>	(8,692,159)
Net cash flows from (used in) operations	<b>4,090,444</b>	(5,561,800)
Income taxes paid	<b>(1,727,391)</b>	(163,664)
Interest received	<b>585,974</b>	354,858
Interest paid	<b>(235,205)</b>	(976,270)
Net cash flows from (used in) operating activities	<b>2,713,822</b>	(6,346,876)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment (Note 7)	<b>(4,081,378)</b>	(1,871,205)
Increase in other noncurrent assets	<b>(454,546)</b>	(131,468)
Proceeds from sale of property, plant and equipment	<b>–</b>	251,433
Net cash flows used in investing activities	<b>(4,535,924)</b>	(1,751,240)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of capital stock	<b>–</b>	11,855,447
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>		
	<b>(719)</b>	–
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(1,822,821)</b>	3,757,331
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>5,001,173</b>	1,243,842
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 3)</b>	<b>₱3,178,352</b>	₱5,001,173

*See accompanying Notes to Financial Statements.*

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## **KEMWATER PHIL. CORP.**

### **NOTES TO FINANCIAL STATEMENTS**

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#### **1. Corporate Information**

Kemwater Phil. Corp. (the Company), a 60%-owned company of LMG Chemicals Corp. (LMG or the parent company) is incorporated in the Philippines and is primarily engaged in the manufacture and trade of chemicals such as water and sewage treatment chemicals, inorganic coagulants for the paper industry and ground alum for the detergent industry. LMG is 73.93% owned by Chemical Industries of the Philippines, Inc. (CIP), the ultimate parent company. The registered office address of the Company is Chemphil Building, 851 A. Arnaiz Avenue, Legaspi Village, Makati City. The average number of employees of the Company was 15 in 2004 and 14 in 2003.

The accompanying financial statements of the Company were authorized for issue by the Board of Directors through its Executive Committee on March 29, 2005.

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#### **2. Summary of Significant Accounting Policies**

##### Basis of Preparation

The accompanying financial statements were prepared in conformity with accounting principles generally accepted in the Philippines under the historical cost basis except for the land, which is carried at revalued amount.

##### Change in Accounting Policy

Effective January 1, 2004, the Company adopted Statements of Financial Accounting Standards (SFAS 12)/International Accounting Standards (IAS 12), *Income Taxes*, which prescribes the accounting treatment for income taxes. The standard requires the use of the balance sheet liability method in accounting for deferred income taxes. It also provides the recognition of a deferred income tax liability with respect to asset revaluations. The adoption of the standard resulted in the recognition of a deferred income tax liability on revaluation increment in land amounting to ₱1,263,236. Liabilities and stockholders' equity as of December 31, 2002 increased and decreased, respectively, by the same amount.

##### New Accounting Standards Effective in 2005

The Accounting Standards Council (ASC) has approved the issuance of new and revised accounting standards, which are based on the revised IAS and new International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The ASC has renamed the standards that it issues to correspond better with the issuances of the IASB. Philippine Accounting Standards (PAS) correspond to adopted IAS while Philippine Financial Reporting Standards correspond to adopted IFRS. The new standards are effective for annual periods beginning on or after January 1, 2005.

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The Company will adopt PAS 19, *Employee Benefits* beginning January 1, 2005. This standard requires the use of the projected unit credit method in measuring retirement benefit expense and a change in the manner of computing benefit expense relating to the past service cost and actuarial gains and losses. It requires the Company to determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity so that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet dates. Adoption of this standard has no material impact on the Company's financial position and results of operations.

The Company will also adopt in 2005 the following revised standards:

- PAS 1, *Presentation of Financial Statements*, provides a framework within which an entity assesses how to present fairly the effects of transactions and other events, provides the base criteria for classifying liabilities as current or noncurrent; prohibits the presentation of income from operating activities and extraordinary items as separate line items in statement of income; and specifies the disclosures about key sources of estimation, uncertainty and judgments management has made in the process of applying the entity's accounting policies.
- PAS 2, *Inventories*, reduces the alternatives for measurement of inventories.
- PAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, removes the concept of fundamental error and the allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors. It defines material omission or misstatements, and describes how to apply the concept of materiality when applying accounting policies and correcting error.
- PAS 10, *Events After the Balance Sheet Date*, provides a limited clarification of the accounting for dividends declared after the balance sheet date.
- PAS 16, *Property, Plant and Equipment*, provides additional guidance and clarification on recognition and measurement of items of property, plant and equipment. It also provides that each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.
- PAS 17, *Leases*, provides a limited revision to clarify the classification of a lease of land and buildings and prohibits expensing of initial direct costs in the financial statements of the lessors.
- PAS 24, *Related Party Disclosures*, provides additional guidance and clarity in the scope of the Standard, the definitions and disclosures for related parties. It also requires disclosure of the compensation of key management personnel by benefit type.

The Company does not expect any significant changes in the accounting policies when it adopts the above new and revised standards in 2005.

Revenue

Revenue is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of revenue can be reliably measured.

Sales revenue is recognized upon delivery of goods and acceptance by the customers.

Interest income is recognized as the interest accrues.

Cash and Cash Equivalents

Cash consists of 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 and that are subject to an insignificant risk of changes in value.

Receivables

Receivables are recognized and carried at original invoice amounts less an allowance for any uncollectible amount.

Inventories

Inventories are valued at the lower of cost and net realizable value. Costs incurred in bringing each product to its present location and condition are accounted for as follows:

- |   |   |  |
|---|---|--|
| Finished goods and semi-processed inventories                   | - | Cost includes direct materials and labor and a proportion of manufacturing overhead; determined on a moving average method |
| Merchandise, raw materials and spare parts and factory supplies | - | Purchased cost on a moving average method  |

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion, marketing and distribution.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value except for land, which is carried at appraised values as determined on November 20, 2002 by an independent firm of appraisers.

The initial cost of property, plant and equipment consists of its purchase price, taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the property, plant and equipment have been put into operation, such as repairs and maintenance, are normally charged to income in the year 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, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property, plant and equipment.

The net appraisal increment resulting from the revaluation was credited to the “Revaluation increment in land” account shown under the stockholders’ equity section of the balance sheets.

Depreciation is computed on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Land improvements	10
Plant, machinery and equipment	10
Buildings and structures	8
Transportation equipment	5
Office furniture and fixtures	2

The useful life and depreciation method are reviewed periodically to ensure that the period and method of depreciation are consistent with the expected pattern of economic benefits from items of property and equipment.

When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation and impairment in value, if any, are removed from the accounts and any resulting gain or loss is reflected in income for the year.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amounts. The recoverable amount of property, plant and equipment is the greater of the net selling price and the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses, if any, are recognized in the statements of income.

#### Foreign Currency Transactions and Translations

Transactions in foreign currencies are recorded using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated using the closing rate at the balance sheet date. Foreign exchange gains and losses arising from foreign currency transactions and translations of foreign currency-denominated assets and liabilities are credited to or charged against current operations.

#### Retirement Benefits Cost

Retirement benefits cost is determined using the projected unit credit method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees’ projected salaries. Retirement benefits cost includes current service cost plus amortization of past service cost, experience adjustments, and the effects of the changes in the actuarial assumptions over the expected remaining service years of employees.

### Income Taxes

Deferred income tax is provided, using the balance sheet liability method, 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, including asset revaluations. Deferred tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits and unused tax losses can be utilized. The carrying amount of deferred income tax assets is revised 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 deferred income tax assets to be utilized.

Deferred income tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the period in which those temporary differences are expected to be recovered or settled.

### Provisions

Provisions are recognized when the Company 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.

### Contingencies

Contingent liabilities are not recognized in the 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 financial statements but disclosed when an inflow of economic benefit is probable.

### Subsequent Events

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

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### 3. Cash and Cash Equivalents

	2004	2003
Cash on hand and in banks	<b>₱3,178,352</b>	₱1,001,173
Short-term deposits	-	4,000,000
	<b>₱3,178,352</b>	₱5,001,173

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

#### 4. Receivables

	2004	2003
Trade	<b>₱25,618,799</b>	₱14,718,410
Others	<b>834,429</b>	2,473,854
	<b>26,453,228</b>	17,192,264
Less allowance for doubtful accounts	<b>165,776</b>	127,928
	<b>₱26,287,452</b>	₱17,064,336

In 2004, certain accounts receivable amounting to ₱37,083, which were fully provided with allowance for doubtful accounts were written-off.

#### 5. Inventories

	2004	2003
At net realizable value:		
Finished goods	<b>₱683,121</b>	₱4,247,005
Spare parts and factory supplies	<b>3,324,283</b>	1,923,970
	<b>4,007,404</b>	6,170,975
At cost:		
Finished goods	<b>814,048</b>	-
Merchandise:		
On hand	<b>84,093</b>	28,264
In transit	<b>531,373</b>	-
Work in process	<b>373,500</b>	148,891
Raw materials		
On hand (Note 9)	<b>1,855,143</b>	4,302,526
In transit	<b>8,892,070</b>	13,824
Spare parts and factory supplies in transit	-	55,393
	<b>12,550,227</b>	4,548,898
	<b>₱16,557,631</b>	₱10,719,873

Under the terms of the trust receipt agreements covering liabilities under letters of credit, some raw materials and supplies have been released to the Company in trust for the banks. The Company is accountable to the banks for the trustee materials and supplies or their sales proceeds.

## 6. Prepaid Expenses and Other Current Assets

	2004	2003
Prepaid expenses	<b>₱1,412,485</b>	₱504,303
Input taxes	-	2,284,242
Others	<b>33,971</b>	400
	<b>₱1,446,456</b>	<b>₱2,788,945</b>

## 7. Property, Plant and Equipment

	Land Improvements	Plant Machinery and Equipment	Buildings and Structures	Transportation Equipment	Office Furniture And Fixtures	Construction In progress	2004 Total	2003 Total
<b>At Cost</b>								
<b>Cost</b>								
Beginning balances	₱2,893,879	₱19,434,042	₱4,395,788	₱2,044,337	₱509,979	₱-	<b>₱29,278,025</b>	₱28,093,184
Additions	-	3,275,835	-	36,364	68,618	700,561	<b>4,081,378</b>	1,871,205
Disposals	-	-	-	-	-	-	-	(686,364)
Ending Balances	2,893,879	22,709,877	4,395,788	2,080,701	578,597	700,561	<b>33,359,403</b>	29,278,025
<b>Accumulated Depreciation</b>								
Beginning balances	540,498	9,661,833	3,059,902	855,988	407,873	-	<b>14,526,094</b>	10,982,886
Depreciation	289,388	1,811,370	281,926	429,770	74,430	-	<b>2,886,884</b>	4,183,814
Disposals	-	-	-	-	-	-	-	(640,606)
Ending Balances	829,886	11,473,203	3,341,828	1,285,758	482,303	-	<b>17,412,978</b>	14,526,094
<b>Net Book Values</b>	<b>₱2,063,993</b>	<b>₱11,236,674</b>	<b>₱1,053,960</b>	<b>₱794,943</b>	<b>₱96,294</b>	<b>₱700,561</b>	<b>₱15,946,425</b>	<b>₱14,751,931</b>
<b>Land at Appraised Value</b>								
<b>Cost</b>								
							<b>₱28,121,388</b>	₱28,121,388
Appraisal increase							<b>3,947,612</b>	3,947,612
							<b>₱32,069,000</b>	<b>₱32,069,000</b>

Certain property and equipment with an aggregate cost of ₱9,221,624 and ₱1,743,132 were fully depreciated as of December 31, 2004 and 2003, respectively. These property and equipment are still being used in the Company's operations.

## 8. Accounts Payable and Accrued Expenses

	2004	2003
Trade (Note 9)	<b>₱4,414,580</b>	₱2,224,991
Accrued operating expenses	<b>1,362,341</b>	848,965
Output tax	<b>924,736</b>	-
Accrued retirement benefits (Note 13)	<b>205,238</b>	106,945
Accrued interest	-	42,048
Others	<b>1,064,833</b>	1,160,047
	<b>₱7,971,728</b>	<b>₱4,382,996</b>

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## 9. Related Party Transactions

Significant transactions with related parties consist of:

- a. Purchase of merchandise inventories and raw materials in the ordinary course of business from its stockholders, Kemira Chemicals Oy of Finland (Kemira) and LMG, respectively. Total purchases amounted to ₱13,420,412 in 2004 and ₱7,135,293 in 2003. Purchases from Kemira amounted to ₱1,535,919 in 2004. There were no purchases from Kemira in 2003.
- b. Share in common costs and expenses under a plant support services agreement with LMG and a management support services agreement with CIP. The shared services fees are billed by LMG and CIP using activity-based costing, under which services rendered are based on man-hours spent or number of items processed or output produced as applicable. The Company's share in common services, included under "Cost of goods sold" account, under the agreement with LMG amounted to ₱1,335,737 in 2004 and ₱1,262,778 in 2003. The Company's share in common services, included under "Operating expenses" account, under the agreement with CIP amounted to ₱5,324,160 in 2004 and ₱5,133,120 in 2003.
- c. Risk management services from Vision Insurance Consultants (VIC), which are billed based on actual time charges. Risk management fees under share in common services charged to cost of goods sold amounted to ₱8,864 in 2004.
- d. Lease of its warehouse space from LMG for one year renewable at the option of both parties. Rental expense amounted to ₱1,941,911 in 2004 and ₱1,921,596 in 2003.
- e. Lease of its office space from CIP for one year renewable at the option of both parties. Rental expense amounted to ₱207,172 in 2004 and ₱243,135 in 2003.
- f. Noninterest-bearing and interest-bearing cash advances and reimbursable expenses with parent company and affiliates. The interest-bearing cash advances bear interest ranging from 8.25% to 9.75% in 2004 and 7% to 9% in 2003. Related interest income amounted to ₱695,746 in 2004 and ₱299,913 in 2003. Related interest expense amounted to ₱41,751 in 2004 and ₱143,671 in 2003.
- g. Outstanding balances of the related party accounts in the balance sheets are as follows:

	Advances		Loans		Interest Receivable		Insurance Premiums		2004	2003
	2004	2003	2004	2003	2004	2003	2004	2003	Total	Total
Due from:										
CAWC	₱7,166	P-	₱13,675,000	P-	₱139,405	P-	P-	P-	₱13,821,571	P-
CIP	475,908	-	2,300,000	184,334	21,973	-	-	-	2,797,881	184,334
	<b>₱483,074</b>	<b>P-</b>	<b>₱15,975,000</b>	<b>₱184,334</b>	<b>₱161,378</b>	<b>P-</b>	<b>P-</b>	<b>P-</b>	<b>₱16,619,452</b>	<b>₱184,334</b>
Due to:										
LMG	₱3,780,174	₱3,302,406	P-	P-	P-	P-	P-	P-	₱3,780,174	₱3,302,406
Kemira	531,373	2,151,180	-	-	-	-	-	-	531,373	2,151,180
VIC	-	-	-	-	-	-	464,763	365,777	464,763	365,777
CAWC	-	3,533	-	-	-	-	-	-	-	3,533
Perfumeria Espanola Corp.	-	495	-	-	-	-	-	-	-	495
	<b>₱4,311,547</b>	<b>₱5,457,614</b>	<b>P-</b>	<b>P-</b>	<b>P-</b>	<b>P-</b>	<b>₱464,763</b>	<b>₱365,777</b>	<b>₱4,776,310</b>	<b>₱5,823,391</b>

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**10. Cost of Goods Sold**

	2004	2003
Raw materials used (Note 9)	<b>₱74,680,176</b>	₱48,182,734
Direct labor (Note 12)	<b>2,090,659</b>	2,618,818
Manufacturing overhead		
Personnel expenses (Note 12)	<b>3,843,321</b>	2,825,574
Rent (Note 9)	<b>3,038,266</b>	2,943,269
Repairs and maintenance	<b>2,912,291</b>	3,047,254
Depreciation	<b>2,872,631</b>	4,116,373
Communication, light and water	<b>2,042,111</b>	498,810
Share in common services (Note 9)	<b>1,344,601</b>	1,262,778
Others	<b>4,626,792</b>	4,320,518
Changes in finished goods and semi-processed Inventories	<b>2,373,144</b>	5,134,086
Cost of merchandise inventories sold	<b>1,865,210</b>	1,687,539
	<b>₱101,689,202</b>	₱76,637,753

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**11. Operating Expenses**

	2004	2003
Share in common services (Note 9)	<b>₱5,324,160</b>	₱5,133,120
Amortization of deferred cost (Note 15)	<b>2,549,475</b>	1,133,100
Personnel expenses (Note 12)	<b>2,023,874</b>	1,927,955
Outside services	<b>783,290</b>	435,512
Communication, light and water	<b>302,660</b>	329,973
Rent (Note 9)	<b>207,172</b>	243,135
Insurance	<b>173,531</b>	95,270
Taxes and licenses	<b>166,517</b>	196,306
Provision for probable inventory losses	<b>152,083</b>	-
Entertainment, amusement and recreation	<b>59,302</b>	40,360
Depreciation and amortization	<b>14,253</b>	67,441
Others	<b>540,251</b>	708,415
	<b>₱12,296,568</b>	₱10,310,587

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**12. Personnel Expenses**

	2004	2003
Salaries and other compensation	<b>₱7,047,599</b>	₱6,534,466
Retirement benefits cost (Note 13)	<b>205,238</b>	227,073
Other employee benefits	<b>705,017</b>	610,808
	<b>₱7,957,854</b>	₱7,372,347

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**13. Retirement Benefits Cost**

The Company, together with its affiliated companies, is a participant in a multi-employer-funded and noncontributory-defined benefit retirement plan covering substantially all of its regular employees. The benefits are based on years of service and latest monthly compensation. Total retirement benefits cost charged to operations amounted to ₱205,238 in 2004 and ₱227,073 in 2003.

As of June 30, 2004, the latest actuarial valuation date, the actuarial present value of retirement benefits cost amounted to ₱1,653,306. The actuarial fund assets amounted to ₱1,328,960. The unfunded present value of retirement benefits amounted to ₱324,346. The principal actuarial assumptions used in determining retirement benefits cost were an annual salary increase of 6% and a return on plan assets of 8%. An actuarial valuation is made at least every three years. The Company's contribution to the retirement plan consists of a payment covering the current service cost for the year plus a payment toward funding the actuarial accrued liability.

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**14. Income Taxes**

- a. The Company's deferred income tax assets and liabilities consist of the following:

	<b>2004</b>	2003
Deferred income tax assets		
Tax effects of:		
Unamortized past service cost	<b>₱224,317</b>	₱256,196
Allowance for probable inventory losses	<b>175,882</b>	150,143
Accrued retirement benefits cost	<b>65,676</b>	34,222
Allowance for doubtful accounts	<b>53,048</b>	40,937
Unrealized foreign exchange losses	<b>230</b>	39,974
Others	-	9,582
	<b>₱519,153</b>	₱531,054
Deferred income tax liability on revaluation increment in land (Note 2)	<b>₱1,263,236</b>	₱1,263,236

Management, however, believes that it is improbable that any deferred income tax liability will arise from revaluation of land since it is unlikely that the revalued property will be sold, exclusive of the business, in the foreseeable future.

The components of the Company's unrecognized deferred income tax assets are as follows:

	<b>2004</b>	2003
Income tax effects of:		
NOLCO	<b>₱-</b>	₱5,713,887
Other accrued operating expense	-	143,733
MCIT	-	398,943
	<b>₱-</b>	₱6,256,563

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These deferred income tax assets were not recognized because management believes that the Company may not have sufficient taxable profit available to allow all or part of these to be utilized in the near future.

- b. As of December 31, 2004, the status of the Company's NOLCO and MCIT are as follows:

Year Incurred	Amount	Expired in 2003	Applied in 2004	Balance as of December 31, 2004	Available Until
<b><u>NOLCO</u></b>					
2000	₱6,676,525	(₱6,676,525)	₱-	₱-	2003
2001	9,580,138	-	9,580,138	-	2004
2002	4,651,356	-	4,651,356	-	2005
2003	3,624,402	-	3,624,402	-	2006
	<b>₱24,532,421</b>	<b>(₱6,676,525)</b>	<b>₱17,855,896</b>	<b>₱-</b>	

Year Incurred	Balance as of December 31, 2003	Applied in 2004	Balance as of December 31, 2004	Available Until
<b><u>MCIT</u></b>				
2001	₱80,019	₱80,019	₱-	2004
2002	155,260	155,260	-	2005
2003	163,664	163,664	-	2006
	<b>₱398,943</b>	<b>₱398,943</b>	<b>₱-</b>	

- c. The reconciliation of the statutory income tax, computed by multiplying income (loss) before income tax by the statutory tax rate, and the provision for income tax as shown in the statements of income follows:

	2004	2003
Statutory income tax	<b>₱7,860,713</b>	(₱1,353,605)
Adjustments for:		
Application of NOLCO and MCIT	<b>(6,112,830)</b>	-
Interest income already subjected to final tax	<b>(16,364)</b>	(17,732)
Nondeductible portion of interest expense	<b>7,773</b>	8,423
Write-off of expired NOLCO	-	2,136,488
Unrecognized deferred income tax assets	-	(669,282)
<b>Provision for income tax</b>	<b>₱1,739,292</b>	<b>₱104,292</b>

- d. The provision for current income tax in 2003 represents MCIT.

## 15. License Agreement with Kemira

The Company has a license agreement (Agreement) with Kemira for 10 years until November 2007, to manufacture and sell water treatment chemicals by using product technology developed and to be developed by Kemira. Under the Agreement, the Company will pay US\$550,000 covering license fees, basic designs, commissioning and start-up of a new aluminum sulfate plant; management and marketing; technical support; and production know-how. The license fee amount in the Agreement was later reduced to US\$400,000.

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Total payments made by the Company amounting to US\$300,000 or ₱11,331,000 (net of taxes), as of December 31, 2003, were deferred and included under the “Other noncurrent assets” account in the balance sheets.

Amortization of deferred costs charged to operations amounted to ₱2,549,475 in 2004 and ₱1,133,100 in 2003.

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**16. Registration with the Board of Investments (BOI)**

The Company is registered with the BOI as a preferred nonpioneer enterprise for the Aluminum Sulfate Modernization Project. Under the terms of the registration, the Company is entitled to tax and nontax incentives and is subject to certain requirements.

There were no incentives availed of in 2004 and 2003.