



SAN MIGUEL PURE FOODS COMPANY, INC.

**NOTICE OF REGULAR MEETING
OF STOCKHOLDERS**

May 11, 2007

The Regular Meeting of the Stockholders of San Miguel Pure Foods Company, Inc. will be held on **Friday, May 11, 2007, at 2:00 P.M.** at the **Executive Dining Room, 2nd Floor, San Miguel Head Office Complex, No. 40 San Miguel Avenue, Mandaluyong City.**

The Agenda of the Meeting is as follows:

1. Certification of Notice and Quorum
2. Approval of the Minutes of the Regular Stockholders' Meeting held on May 12, 2006 and Special Stockholders' Meetings held on September 25, 2006 and January 31, 2007
3. Presentation of the Annual Report
4. Ratification of Acts and Proceedings of the Board of Directors and Corporate Officers
5. Appointment of External Auditors
6. Election of the Board of Directors
7. Other Matters
8. Adjournment

Minutes of the last Regular and Special Stockholders' Meetings and resolutions of the Board of Directors since the date of the 2006 Regular Stockholders' Meeting will be available for examination during office hours at the office of the Corporate Secretary.

For your convenience in registering your attendance, please present some form of identification, such as passport, driver's license, or company I.D. Registration will start at 12:00 P.M. and the registration booths will be closed at 2:00 P.M.


FRANCIS H. JARDELEZA
Corporate Secretary

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 20-IS

**INFORMATION STATEMENT PURSUANT TO SECTION 20
OF THE SECURITIES REGULATION CODE**

1. Check the appropriate box:

Preliminary Information Sheet
 Definitive Information Sheet

2. Name of Registrant as specified in its charter:

SAN MIGUEL PURE FOODS COMPANY, INC.

3. Province, country and other jurisdiction of incorporation or organization:

Metro Manila, Philippines

4. SEC Identification Number: **11840**

5. BIR Tax Identification Code: **000-100-341-000**

6. Address of principal office Postal code

**JMT Building, ADB Avenue, 1605
Ortigas Center, Pasig City**

7. Registrant's telephone number, including area code: **(632) 702-5000**

8. Date, time and place of the meeting of security holders:

Date: **MAY 11, 2006, Friday**
Time: **2:00 P.M.**
Place: **Executive Dining Room, 2nd Floor,
San Miguel Head Office Complex,
No. 40 San Miguel Avenue, Mandaluyong City**

9. Approximate date at which the Information Statement is to be first sent or given to security holders:

April 16, 2007

10. Securities registered pursuant to Sections 8 and 12 of the SRC:

<u>Title of Each Class</u> (As of February 28, 2007)	<u>Authorized</u>	<u>Issued and Outstanding</u>
Common Class "A"	50,628,000	37,747,257
Common Class "B"	<u>33,372,000</u>	<u>18,751,581</u>
	84,000,000	56,498,838*

11. Are any or all of Registrant's securities listed on a Stock Exchange?

Yes

No

If yes, disclose the name of such Stock Exchange and the class of securities listed thereon:

Philippine Stock Exchange - Common Class "A" and Common Class "B" shares

* Exclusive of the 9,436,814 Common Class "A" shares and 4,442,620 Common Class "B" shares, the denial of pre-emptive rights to the issuance of which have been approved by the SEC on February 9, 2006 and which have been issued to San Miguel Corporation on March 15, 2007, but are pending listing with the PSE.

INFORMATION STATEMENT

GENERAL INFORMATION

Date, Time and Place of Annual Meeting

Date: May 11, 2007, Friday
Time: 2:00 P.M.
Place: Executive Dining Room, 2nd Floor, San Miguel HOC,
No. 40 San Miguel Avenue, Mandaluyong City

Mailing address of the principal office of the Registrant: JMT Building, ADB Avenue, Ortigas Center, Pasig City

Approximate date on which the Information Statement is to be first sent or given to security holders

April 16, 2007

**WE ARE NOT ASKING YOU FOR A PROXY
AND YOU ARE REQUESTED NOT TO SEND US A PROXY.**

Dissenters' Right of Appraisal

There are no corporate matters or actions that will entail dissenting stockholders to exercise their right of appraisal as provided in Title X of the Corporation Code.

Interest of Certain Persons in Matters to be Acted Upon

No director, nominee for election as director, associate of the nominee or executive officer of the Company at any time since the beginning of the last fiscal year has had any substantial interest, direct or indirect, by security holdings or otherwise, in any of the matters to be acted upon in the meeting, other than election to office.

None of the incumbent directors has informed the Company in writing of an intention to oppose any action to be taken by the Company at the meeting.

CONTROL AND COMPENSATION INFORMATION

Voting Securities and Principal Holders Thereof

As of February 28, 2007, the Company had the following outstanding shares of common stock:

<u>Title of Class</u>	<u>No. of shares outstanding</u>
Common Class "A" Shares	37,747,257
Common Class "B" Shares	<u>18,751,581</u>
	56,498,838 ¹

¹ Exclusive of the 9,436,814 Common Class "A" shares and 4,442,620 Common Class "B" shares, the denial of pre-emptive rights to the issuance of which have been approved by the SEC on February 9, 2006 and which have been issued to San Miguel Corporation on March 15, 2007, but are pending listing with the PSE.

All stockholders as of March 23, 2007 are entitled to vote at the Annual Stockholders' Meeting.

Every stockholder entitled to vote shall be entitled to one (1) vote for each share of stock in his name in the books of the Company, provided the conditions as regards payment subject to which it was issued have been complied with. However, in electing members to the Board of Directors, every stockholder is entitled to accumulate his votes in accordance with the provisions of law. Accordingly, at a stockholders' meeting where the election of directors takes place, a stockholder shall have as many votes as he has number of shares multiplied by the number of the directors up for election.

Security Ownership of Certain Record and Beneficial Owners

Owners of record of more than 5% of the Company's voting securities as of February 28, 2007 are as follows:

Title of Class	Name, Address of Record Owner and Relationship with Issuer	Name of Beneficial Owner and Relationship with Record Owner	Citizenship	No. of Shares Held	Percent
Class "A"	San Miguel Corporation ² SMC Head Office Complex 40 San Miguel Avenue, Mandaluyong City 1550, parent company of issuer	N.A.	Filipino	37,634,306	99.789% ¹
Class "B"				18,745,324	

The following are the number of shares of the Company's capital stock (all of which are voting shares) owned of record by the Chairman, key officers of the Company and directors as of February 28, 2007:

Title of Class	Name of Owner	Citizenship	Total No. of Shares
Common (Class "A")	Eduardo M. Cojuangco, Jr.	Filipino	1 (r)
Common (Class "A")	Ramon S. Ang	Filipino	1 (r)

² The Board of Directors of San Miguel Corporation (SMC) authorizes any one Group A signatory or any two Group B signatories to act and vote, in person or by proxy, shares held by SMC in other corporations. The Group A signatories of SMC are Eduardo M. Cojuangco, Jr., Ramon S. Ang, Ferdinand K. Constantino, Francis H. Jardeleza, Lubin B. Nepomuceno, Ma. Belen C. Buensuceso, Yoshinori Isozaki and Carlos Antonio M. Berba. The Group B signatories of SMC are Roberto N. Huang, Minerva Lourdes B. Bibonia, David S. Santos, Eleanor P. Blomdahl, Bella O. Navarra, Pablo P. Pacquing, Joseph N. Pineda, Virgilio S. Jacinto, Emmanuel E. Eraña and Mercy Marie L. Amador.

Common (Class "A")	Minerva Lourdes B. Bibonia	Filipino	1 (r)
Common (Class "A")	Roberto N. Huang	Filipino	1 (r)
Common (Class "A")	Iñigo Zobel	Filipino	1 (r)
Common (Class "A")	Leo S. Alvez	Filipino	1 (r)
Common (Class "A")	Menardo R. Jimenez	Filipino	1 (r)
Common (Class "A")	Jose T. Pardo	Filipino	1 (r)
Common (Class "A")	Francisco S. Alejo III	Filipino	1 (r)

The aggregate number of shares owned of record by the Chairman, key officers and directors as a group as of February 28, 2007 is nine (9) shares or approximately 0.0000159% of the Company's outstanding capital stock.

The aggregate number of shares owned by all officers and directors as a group as of February 28, 2007 is nine (9) shares or approximately 0.0000159% of the Company's outstanding capital stock.

The foregoing beneficial or record owners have no right to acquire additional shares within thirty (30) days from options, warrants, conversion privileges or similar obligations or otherwise.

DIRECTORS AND EXECUTIVE OFFICERS

Directors, Including Independent Directors and Nominees, and Executive Officers

The names of the incumbent directors, nominees for election as directors, and senior executive officers of the Company, and their respective ages, periods of service, directorships in other reporting companies and positions in the last five (5) years are as follows:

Eduardo M. Cojuangco, Jr., Filipino, 71, is the Chairman of the Company, a position he has held since May 22, 2001. He is also Chairman and Chief Executive Officer of San Miguel Corporation and Ginebra San Miguel, Inc. He is also the Chairman of ECJ and Sons Agricultural Enterprises, Inc. and the Eduardo Cojuangco, Jr. Foundation, Inc.; and a Director of Cainaman Farms, Inc.

Ramon S. Ang, Filipino, 53, has been a Director of the Company since May 22, 2001. He also holds the following positions: Vice Chairman, President and Chief Operating Officer of San Miguel Corporation; Chairman of San Miguel Properties, Inc., The Purefoods-Hormel Company, Inc., Anchor Insurance Brokerage Corporation, San Miguel Brewery Hong Kong Limited (Hong Kong), National Foods Limited (Australia), Del Monte Pacific Limited (BVI) and Del Monte Philippines, Inc.; and a Director of Ginebra San Miguel, Inc. He is also the Chairman of Philippine Diamond Hotel & Resort, Inc., Philippine Oriental Realty Development, Inc., Atea Tierra Corporation and Cyber Bay Corporation.

Francisco S. Alejo III, Filipino, 59, is the President of the Company (since May 20, 2005). He has been a Director of the Company since May 22, 2001. He also holds the following positions: Chairman and Chief Executive Officer of Monterey Foods Corporation; President of Magnolia, Inc., San Miguel Foods, Inc., The Purefoods-Hormel Company, Inc. and San Miguel Super Coffeemix Co., Inc.; and Chairman and President of Sugarland Corporation and Star Dari, Inc.

Menardo R. Jimenez, Filipino, 74, has been a Director of the Company since April 25, 2002. He is also a Director of San Miguel Corporation and Magnolia, Inc. He also holds the following positions: President and Chief Executive Officer of Albay-Agro Industrial Development Corporation; Chairman and President of Majent Management and Development Corporation, Majent Agro Industrial Corporation, M. A. Jimenez Enterprises, Inc., Pac Rim Realty Development Corporation, Television International Corporation, Alta Tierra Resources, Inc. and Fibers Trading, Inc.; Chairman of Cable Entertainment Corporation, Majent Foundation, Inc., Marathon Building Technologies, Inc. and Meedson Properties Corporation; and a Director of First Metro Investment Corporation, Cunickel Mining Corporation, Electronic Realty Associates, Inc., Mabuhay Philippines Satellite Corporation, Franchise One Corporation, CBTL Holdings, Inc., CCC Insurance Corporation and Pan-Phil Aqua Culture Corporation.

Leo S. Alvez, Filipino, 64, has been a Director of the Company since April 25, 2002. He is also a Director of San Miguel Corporation and Ginebra San Miguel, Inc. Major General Alvez is a former Security Consultant to the Prosecution Panel of the Senate Impeachment Trial of President Joseph Estrada (2000-2001); Vice Commander of the Philippine Army (1998); and Division Commander of the 7th Infantry Division (1996-1998).

Jose T. Pardo, Filipino, 67, has been a Director of the Company since April 25, 2002. He also holds the following positions: Chairman of Philippine Savings Bank, ABC Development Corporation, Associated Broadcast Marketing Corporation, Electronic Commerce Payment Network, Inc., OCCC General Construction Corporation and Asian Holdings Corporation; and a Director of Bank of Commerce, JG Summit Holdings, Inc. and Mabuhay Philippine Satellite Corporation. He is also the Chairman of the Foundation for Crime Prevention, PCCI Council of Business Leaders, ECOP, Council of Leaders, Free Legal Assistance for Good Cops and Assumption College (Antipolo). Mr. Pardo is a former Cabinet Secretary of the Department of Finance (2000-2001) and the Department of Trade and Industry (1998-2000); Governor for the Philippines of the Asian Development Bank and World Bank Group; Alternate Governor for the Philippines of the International Monetary Fund; Chairman of Land Bank of the Philippines and Philippine Deposit Insurance Company; and Bangko Sentral Monetary Board Member (1998-2001).

Roberto N. Huang, Filipino, 58, has been a Director of the Company since April 26, 2004. He is also the President of San Miguel Beverages, Inc. and a Director of Ginebra San Miguel, Inc. His previous work experience in San Miguel Corporation includes the following: Senior Vice President, Corporate Sales (2002-2003); Vice President and Director, Corporate Sales (2001-2002); and Vice President and Sales and Marketing Manager, San Miguel Beer Division (1999-2001).

Minerva Lourdes B. Bibonia, Filipino, 48, has been a Director of the Company since May 12, 2006. She is Senior Vice President for Corporate Marketing of San Miguel Corporation (since 2002); a Director of San Miguel Brewery Hong Kong Limited (Hong Kong) and J. Boag & Son Limited (Australia); and a Commissioner of PT Delta Djarkarta Tbk (Indonesia). Ms. Bibonia previously served San Miguel Corporation in the following capacities: Vice President and Head of the Centralized Key Accounts Group (2001) and Consultant to the Office of the Chairman (2000-2001).

Iñigo Zobel, Filipino, 50, has been a Director of the Company since May 12, 2006; and a Member of the Company's Executive Committee, Audit Committee and Nominations and Hearing Committee. He is also a Director of San Miguel Corporation (Member of its Executive Committee, Executive Compensation Committee and Nominations and Hearing Committee),* Ginebra San Miguel, Inc. (Chairman of its Executive Compensation Committee and Member of its Audit Committee),* and San Miguel Properties, Inc. (Chairman of its Audit Committee and Member of its Executive Compensation Committee and Nominations and Hearing Committee)* He also holds the following positions: President and Chief Executive Officer of E. Zobel, Inc., President of Ayala International España, Diamond Star Agro Products, Inc., Calatagan Golf Club, Inc. and Hacienda Bigaa, Inc.; and a Director of Calatagan Resort, Inc., Calatagan Gulf Realty, Inc., and Mermac, Inc.

Francis H. Jardeleza, Filipino, 57, is the Corporate Secretary of the Company (since May 22, 2001). He is also the Corporate Secretary, Senior Vice President and General Counsel of San Miguel Corporation; Corporate Secretary of Ginebra San Miguel, Inc., San Miguel Properties, Inc. and The Purefoods-Hormel Company, Inc.; Chairman of SMC Stock Transfer Service Corporation; and a Director of Del Monte Pacific Limited (BVI).

Zenaida M. Postrado, Filipino, 51, is the Division Finance Officer of the Company (since May 2005). She also holds the following positions: a Director of Monterey Foods Corporation; Treasurer and a Director of The Purefoods-Hormel Company, Inc., San Miguel Mills, Inc., Star Dari, Inc. and Sugarland Corporation; Vice President and Treasurer of Magnolia, Inc. and San Miguel Foods, Inc.; and Treasurer of San Miguel Super Coffeemix Co., Inc. She was a former General Manager (2005) and OIC-General Manager (2003-2004) of The Purefoods-Hormel Company, Inc.

Term of Office

Pursuant to the Company's Amended By-Laws, the members of the Board of Directors shall be elected by a plurality vote of the subscribed capital stock at the annual meeting, for a term of one (1) year and until the election and qualification of their successors. At least two (2) directors shall be residents of the Philippines, and all of them should be stockholders of record of the Company.

The nominees for election to the Board of Directors on May 11, 2007 are as follows:

1. Eduardo M. Cojuangco, Jr.
2. Ramon S. Ang
3. Francisco S. Alejo III
4. Leo S. Alvez
5. Menardo R. Jimenez
6. Jose T. Pardo
7. Roberto N. Huang
8. Minerva Lourdes B. Bibonia
9. Iñigo Zobel

Independent Directors

The independent director of the Company is Mr. Iñigo Zobel.

* *Independent Director*

The nominee for election as independent director of the Board of Directors on May 11, 2007 is as follows:

Nominee for Independent Director (a)	Person/Group recommending nomination (b)	Relation of (a) and (b)
Iñigo Zobel	Eduardo M. Cojuangco, Jr.	None

In approving the nomination for independent director, the Nominations Committee took into consideration the guidelines on the nomination of independent directors prescribed in SRC Rule 38.

Significant Employees

The Company has no employee who is not an executive officer but who is expected to make a significant contribution to the business.

Family Relationships

There are no family relationships up to the fourth civil degree either by consanguinity or affinity among the directors, executive officers, or nominees for election as directors.

Certain Relationships and Related Transactions

There were no transactions with directors, officers or any principal stockholders (owning at least 10% of the total outstanding shares of the Company) that are not in the ordinary course of business of the Company. The Company observes an arm's length policy in its dealings with related parties.

Parent Company

As of February 28, 2007, the Company is 99.789% owned by San Miguel Corporation.³

Involvement in Certain Legal Proceedings

None of the directors, nominees for election as director, executive officers, underwriters or control persons of the Company have been involved in any legal proceeding, including without limitation being the subject of any (a) bankruptcy petition, (b) conviction by final judgment, (c) order, judgment or decree, or (d) violation of a securities or commodities law, for the past five (5) years up to the latest date that is material to the evaluation of his ability or integrity to hold the relevant position in the Company.

³ Please refer to footnote 1.

COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

The following table summarizes the aggregate compensation paid or accrued during the last two (2) fiscal years, as well as those estimated to be paid in the ensuing fiscal year, to the Company's President and senior executive officers:

NAME	YEAR	SALARY	BONUS	OTHERS	TOTAL
Total Compensation of the President and Senior Officers (the most highly compensated officers of the Company) ⁴	2007 (estimated)	P 31.7 Million	P 9.0 Million	P 8.9 Million	P 49.6 Million
	2006	P 29.4 Million	P 9.1 Million	P 8.4 Million	P 46.9 Million
	2005	P 33.2 Million	P 10.7 Million	P 9.3 Million	P 53.2 Million
All other officers and directors as a group unnamed	2007 (estimated)	P 50.3 Million	P 14.4 Million	P 19.9 Million	P 84.6 Million
	2006	P 48.1 Million	P 18.4 Million	P 20.1 Million	P 86.6 Million
	2005	P 78.5 Million	P 23.4 Million	P 29.7 Million	P 131.6 Million
TOTAL	2007 (estimated)	P 82.0 Million	P 23.4 Million	P 28.8 Million	P 134.2 Million
	2006	P 77.5 Million	P 27.5 Million	P 28.5 Million	P 133.5 Million
	2005	P 111.7 Million	P 34.1 Million	P 39.0 Million	P 184.8 Million

Article II, Section 5 of the Amended By-laws of the Company provides that the members of the Board of Directors shall each be entitled to a director's fee in the amount to be fixed by the stockholders at a regular or special meeting duly called for that purpose.

Each director receives a per diem of P5,000.00 per attendance at Board meetings of the Company.

There were no other arrangements pursuant to which any of the Directors was compensated or is to be compensated, directly or indirectly, during the last fiscal year, and the ensuing fiscal year.

There were no employment contracts between the Company and a named executive officer.

⁴ The President and senior officers of the Company are as follows: (for 2007 and 2006) Francisco S. Alejo III, Arthur O. Juan, Rolando A. Cabredo, George A. Nava and Zenaida M. Postrado; and (for 2005) Enrique A. Gomez, Jr., Francisco S. Alejo III, Arthur O. Juan, Emmanuel E. Eraña and Zenaida M. Postrado.

There were neither compensatory plans nor arrangements with respect to a named executive officer.

ACTION WITH RESPECT TO REPORTS

The approval of the following will be considered and acted upon at the meeting:

1. Annual Report of the Company for the year ended December 31, 2006;
2. Minutes of the 2006 Annual Stockholders' Meeting with the following items:
 - a) Approval of the Minutes of the 2005 Annual Stockholders' Meeting;
 - b) Approval of Annual Report;
 - c) Ratification of all acts of the Board of Directors and Officers since the 2005 Annual Stockholders' Meeting;
 - d) Election of Board of Directors; and
 - e) Appointment of External Auditors;
3. Minutes of the Special Stockholders' Meeting held on September 25, 2006 approving the amendment to Article IV of the Amended Articles of Incorporation of the Company to extend the corporate term of the Company, which shall expire on October 30, 2006, for another fifty (50) years from and after October 30, 2006;
4. Minutes of the Special Stockholders' Meeting held on January 31, 2007 containing the following items:
 - a) Approval of increase in the authorized capital stock of the Company from P840 Million Pesos consisting of 50,628,000 Common Class "A" shares and 33,372,000 Common Class "B" shares to P1.46 Billion Pesos consisting of 95,128,000 Common Class "A" shares and 50,872,000 Common Class "B" shares, both classes with a par value of P10.00 each; and
 - b) Approval of the following amendments to Article VII of the Amended Articles of Incorporation of the Company:
 - i) increase in the authorized capital stock of the Company; and
 - ii) denial of pre-emptive rights to the issuance to San Miguel Corporation of 3,058,473 Common Class "A" shares and 6,355,497 Common Class "B" shares out of the unissued capital stock of the Company as of December 7, 2006; and (ii) 44,421,129 Common Class "A" shares and 17,029,979 Common Class "B" shares from the increase in the authorized capital stock of the Company; and
5. Ratification of the following acts of the Board of Directors and Officers since the 2006 Annual Stockholders' Meeting, which acts were all adopted in the ordinary course of business such as:
 - a) Election of officers;
 - b) Approval of signing authorities and limits; and
 - c) Approval of investments.

Minutes of the 2006 Annual and Special Stockholders' Meetings and resolutions of the Board of Directors since the date of the 2006 Annual Stockholders' Meeting will be available for examination during office hours at the office of the Corporate Secretary.

VOTING PROCEDURES

In the election of directors, the nine (9) nominees with the greatest number of votes will be elected directors. The approval of the other proposals or matters submitted to a vote will require an affirmative vote of the majority of the shares of stock present or represented by proxy at the meeting.

Counting of the Ayes and Nays or a show of hands will be the methods by which votes will be counted.

FINANCIAL AND OTHER INFORMATION

Brief Description of the General Nature and Business of the Company

San Miguel Pure Foods Company, Inc. ("SMPFC" or the "Company") was incorporated in 1956 to engage primarily in the business of manufacturing and marketing of processed meat products. The Company, through its subsidiaries, later on diversified into poultry and livestock operations, flour milling, franchise operations (*Smokey's*) and young animal ration manufacturing and distribution. The Company has been listed on the Philippine Stock Exchange since 1971.

The acquisition of SMPFC by San Miguel Corporation ("SMC") from Ayala Corporation in May 2001, followed by a series of corporate restructuring and business integration activities, resulted in further diversification and in the ownership of a portfolio of leading brands capable of delivering even stronger volume growth, improved margins and higher shareholder value. To date, SMPFC owns a business portfolio that is unparalleled in the industry, offering a variety of food products and services for both individual and food service customers. Its products range from vegetable oils, feeds, flour and flour-based products, poultry, fresh and processed meats, dairy, snacks, coffee and condiments.

Having established partnerships with world-renowned food companies – Hormel Foods International Corporation of the United States, Super Coffeemix Manufacturing of Singapore and the La Salle Financials of Indonesia as well as NFL of Australia, through parent company SMC and King's Creameries of Malaysia – SMPFC enjoys access to global and regional technical expertise.

Products

The Company operates its businesses through the following subsidiaries, associates and division:

- ***San Miguel Foods, Inc. (SMFI)*** - is a 63.89%-owned subsidiary of SMPFC and operates the integrated Poultry and Feeds businesses and the San Miguel Food Shop franchising operations.
 - a) *Poultry business* - engages in integrated poultry operations and sells live birds, frozen and fresh chilled birds and cut-ups. The business supplies the chicken meat requirements of The Purefoods-Hormel Company, Inc. for the latter's manufacture of chicken-based value-added products.

- b) *Feeds business* - manufactures and sells different types of feeds to commercial growers under the *B-meg*, *Pureblend*, *PBxcellent* and *Jumbo* brands. In 2004, the business launched the SMC Animal Health Care veterinary medicines. Internal requirements of SMFI's Poultry Business and Monterey Foods Corporation, an affiliate, are likewise being served by the Feeds business.
 - c) *San Miguel Food Shop* - engages in franchising operations, established primarily to showcase San Miguel Group's food and beverage products and to further enhance consumer awareness. There are twenty nine (29) outlets operating as of December 2006.
- ***San Miguel Mills, Inc. (SMMI)*** – is a wholly-owned subsidiary of SMFI and was incorporated in September 2005 to engage in the manufacture and distribution of flour, premixes, vegetable oil and related cereal-based branded products like snack foods, instant noodles and biscuits. In December 2005, SMFI and SMMI executed a Deed of Assignment transferring certain assets (at historical book value) and liabilities of the former's Flour business in exchange for the latter's shares effective January 1, 2006. In July 2006, SMMI took over the condiments operations and handled the marketing of *Supremo* cane vinegar. Other products of SMMI include *Bake Best* baking powder, *Emperor* hard flour, *King* hard flour, *Queen* soft flour, *Baron* all-purpose flour, *Prince* noodle flour, *Princess* cake flour, hard and soft pollard, wheat germs, yeast, bread improver mixes, *E-aji Dip Snax* and *Pancake Plus*.
- ***The Purefoods-Hormel Company, Inc. (PF-Hormel)*** - a 60%-40% joint venture between the Company and Hormel Netherlands B.V., which produces and markets processed meats (hotdogs, hams, bacons, cold cuts and gourmet meat) and canned meat products (corned beef, luncheon meat, Vienna sausage, pork and beans, liver spread and meat loaf) under the *Purefoods*, *Hormel*, *Gusto*, *Vida*, *Spam*, *Moby* and *Valiente* brands. PF-Hormel also distributes value-added pork, beef and poultry products such as chicken/pork nuggets, chicken balls, chicken hotdog, premium marinated chicken, cordon bleu, beef burger, budget patty, longganisa lines and ready-to-eat meat products under the *Monterey*, *Magnolia*, *Purefoods* and *Vida* brands.
- ***Magnolia, Inc. (Magnolia)*** – is a 70.91%-owned subsidiary of SMPFC and manufactures and markets butter, margarine and cheese under the *Magnolia*, *Star*, *Dari Crème* and *Daily Quezo* brands. The business also handles the sale and marketing of jellies and desserts under the *Jellyace* brand, toll-manufactured by its 100%-owned subsidiary, ***Sugarland Corporation***. In 2004, Magnolia re-entered the Ice Cream and Milk segments. In July 2006, the business took over from SMC's Agribusiness the selling, marketing and operations of *Magnolia Cooking Oil*.
- ***PT San Miguel Pure Foods Indonesia (PTSMPFI, formerly PT Pure Foods Suba Indah)*** - started as a 49%-51% joint venture between the Company and the Hero Group of Companies and organized in 1995 for the manufacture and distribution of processed meats in Indonesia. In March 2004, SMPFC increased its share to 51%, after the Hero Group sold its 49% share to Lasalle Financial Inc. ("LFI"). SMPFC eventually acquired additional shares of LFI in October 2004 and now owns significant majority interest in PTSMPFI at 75%.

- ***San Miguel Super Coffeemix Co., Inc. (SMSCCI)*** - a 70%-30% joint venture between the Company and Super Coffeemix Manufacturing, Ltd. of Singapore, started commercial operations in April 2005 by marketing its 3-in-1 coffee mix under the brand name *San Mig Coffee*. By middle of 2005, SMSCCI launched its *San Mig Coffee Sugar-free* line and just before year-end, introduced its premium line of coffeemixes under the brand name *Grandeur*. The business officially marked its entry to the black coffee segment in September 2006 when it introduced *San Mig Coffee 100% Premium Instant Coffee*.
- ***RealSnacks Mfg. Corp. (RealSnacks)*** – was incorporated in April 2004 as a 100%-owned subsidiary of SMPFC, however, commercial operations have yet to commence.
- ***Monterey Foods Corporation (Monterey)*** - 58.59%-owned by SMC and 37.36%-owned by the Company, engages in livestock and piggery operations, as well as meat processing. Monterey is considered a major player in the highly fragmented domestic pork and beef industries. Fresh produce from Monterey’s farms, as well as further processed or value added meat products, are sold in *Monterey* meat shops located in major cities throughout the country. Monterey also supplies the live hog requirements of PF-Hormel, an affiliate.
- ***Great Food Solutions (GFS)*** - is the food service unit of the Company that caters to hotels, restaurants and institutional accounts for their meat, poultry, dairy and flour-based requirements, as well as provides food solutions/recipes and menus. GFS also handles *Smokey’s* franchising operations and operates *San Mig Café* restaurant.

Financial Statements

The Consolidated Audited Financial Statements of the Company as of December 31, 2006 are attached hereto as **Annex “A.”**

Management’s Discussion and Analysis or Plan of Operation

Management’s Discussion and Analysis or Plan of Operation of the Company is attached hereto as **Annex “B.”**

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

There are no disagreements with accountants on accounting and financial disclosure.

Market Price of and Dividends on the Company’s Common Equity and Related Stockholder Matters

The Company’s common equity is traded in the Philippine Stock Exchange.

The Company’s high and low prices for each quarter of the last two (2) fiscal years are as follows:

Quarter	2005				2006			
	Class A		Class B		Class A		Class B	
	High	Low	High	Low	High	Low	High	Low
1 st	55.00	55.00	-	-	-	-	-	-
2 nd	82.00	56.00	74.50	74.50	60.00	56.00	-	-
3 rd	56.00	55.00	-	-	-	-	-	-
4 th	56.00	55.00	-	-	-	-	-	-

The closing prices as of the latest practicable trading date:

Class "A"	P	60.00	June 30, 2006
Class "B"	P	74.50	May 26, 2005

The approximate number of shareholders, as of February 28, 2007, of (a) Class "A", (b) Class "B" and (c) Class "A" and "B" combined is 109, 55 and 33, respectively. Total number of shareholders of holding Class "A" or Class "B" shares is 131 shareholders.

The top 20 stockholders of the Company as of February 28, 2007 are as follows:

Rank	Name of Stockholders	Class "A"	Class "B"	Total No. of Shares	% of Total O/S
1	San Miguel Corporation	37,634,306	18,745,324	56,379,630	99.789% ⁵
2	PCD Nominee Corporation	28,453	98	28,551	0.051%
3	PFC ESOP/ESOWN Account	22,975	0	22,975	0.041%
4	Ortigas, Cecille Y.	18,231	1,143	19,374	0.034%
5	Chua, Ramon L.	6,538	0	6,538	0.012%
6	Ramos, Jorge	5,868	0	5,868	0.010%
7	Ortigas, Ana Maria de Olondriz	4,334	354	4,688	0.008%
8	de Ocampo, Pacifico	3,665	0	3,665	0.006%
9	Garcia, Antonio G.	2,755	155	2,910	0.005%
10	Pendarvis, William	0	2,489	2,489	0.004%
11	Buendia, Honesto	1,198	0	1,198	0.002%
12	Quijano, Teodoro	1,198	0	1,198	0.002%
13	Reyes, Principe P.	1,198	0	1,198	0.002%
14	Senga, Maxima A.	1,106	0	1,106	0.002%
15	Fernan, Francis	1,026	12	1,038	0.002%
16	Buendia, Honesto B.	997	0	997	0.002%
17	Sucgang, Josefa L.	899	0	899	0.002%
18	Avellana, Jose	814	17	831	0.001%
19	TMG International Holdings Co., Ltd.	700	0	700	0.001%
20	Metcalfe, Peter F.	0	628	628	0.001%

No dividend declarations, nor cash dividends payout, took place in 2005 and 2006.

The Company has not sold any unregistered securities within the past three (3) years.

⁵ Please refer to footnote 1.

Independent Public Accountants

The accounting firm of SyCip, Gorres, Velayo & Co. (“SGV”) served as the Company’s external auditors for the last fiscal year.

In compliance with the Company’s policy on rotation of external auditors, the Board of Directors will nominate Manabat Sanagustin & Company (formerly Laya Mananghaya & Co.) as the Company’s external auditors for this fiscal year.

Fees billed for the services rendered by the external auditor to the Company and its subsidiaries in connection with the Company’s annual financial statements and other statutory and regulatory filings for 2005 and 2006 are P 11.5 million and approximately P 8.0 million, respectively. No other services were rendered by the external auditor to the Company or its subsidiaries.

The stockholders approve the appointment of the Company’s external auditors. The Audit Committee reviews the audit scope and coverage, strategy and results for the approval of the board and ensures that audit services rendered shall not impair or derogate the independence of the external auditors or violate SEC regulations.

Compliance with leading practice on Corporate Governance

The Company has complied with its Manual on Corporate Governance, which incorporates the leading practices and principles of good governance; and no deviations have been made from the same since its adoption by the Company.

Pursuant to its commitment to good governance and business practice, the Company continues to review and strengthen its policies and procedures, giving due consideration to developments in the area of corporate governance which it determines to be in the best interests of the Company and its stockholders.

UNDERTAKING

Upon the written request of the stockholder, the Company shall furnish such stockholder a copy of SEC Form 17-A free of charge. Such written request for a copy of SEC Form 17-A shall be addressed to:


**SMC Stock Transfer Service Corporation
Podium, San Miguel Corporation
No. 40 San Miguel Avenue, Mandaluyong City,
1550 Metro Manila, Philippines**

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this report is true, complete and correct. This report is signed in the City of Mandaluyong on April 13, 2007.

SAN MIGUEL PURE FOODS COMPANY, INC.

By:



FRANCIS H. JARDELEZA
Corporate Secretary

**SAN MIGUEL PURE FOODS COMPANY, INC.
AND SUBSIDIARIES**

**Consolidated Financial Statements
December 31, 2006 and 2005
and Years Ended December 31, 2006, 2005 and 2004**

and

Independent Auditors' Report

COVER SHEET

ANNEX "A"

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SEC Registration Number

S	A	N		M	I	G	U	E	L		P	U	R	E		F	O	O	D	S		C	O	M	P	A	N	Y	,		I	N
C	.		A	N	D		S	U	B	S	I	D	I	A	R	I	E	S														

(Company's Full Name)

J	M	T		C	o	r	p	o	r	a	t	e		C	o	n	d	o	m	i	n	i	u	m	,		A	D	B		A	v	
e	n	u	e	,		O	r	t	i	g	a	s		C	e	n	t	e	r	,		P	a	s	i	g		C	i	t	y		

(Business Address: No. Street City/Town/Province)

Ms. Zenaida M. Postrado
(Contact Person)

7025000
(Company Telephone Number)

1	2		3	1
<i>Month</i>			<i>Day</i>	
(Fiscal Year)				

A	A	C	F	S
(Form Type)				

0	5		1	1
<i>Month</i>			<i>Day</i>	
(Annual Meeting)				

(Secondary License Type, If Applicable)

Dept. Requiring this Doc.

Amended Articles Number/Section

Total No. of Stockholders

Total Amount of Borrowings	
Domestic	Foreign

To be accomplished by SEC Personnel concerned

File Number

_____ LCU

Document ID

_____ Cashier

STAMPS

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INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
San Miguel Pure Foods Company, Inc.
JMT Corporate Condominium
ADB Avenue, Ortigas Center
Pasig City

We have audited the accompanying financial statements of San Miguel Pure Foods Company, Inc. and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2006 and 2005, and the related consolidated statements of income, consolidated statements of changes in stockholders' equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2006, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of San Miguel Pure Foods Company, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Melinda Gonzales-Manto
Partner
CPA Certificate No. 26497
SEC Accreditation No. 0085-AR-1
Tax Identification No. 123-305-056
PTR No. 0267366, January 2, 2007, Makati City

March 8, 2007

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
San Miguel Pure Foods Company, Inc.

We have audited the accompanying financial statements of San Miguel Pure Foods Company, Inc. and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2006 and 2005, and the related consolidated statements of income, consolidated statements of changes in stockholders' equity and consolidated statements of cash flows for each of the three years in the period ended December 31, 2006, and a summary of significant accounting policies and other explanatory notes.

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Auditors' Responsibility

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

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

*** SGVMC209116 ***

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of San Miguel Pure Foods Company, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Melinda Gonzales-Manto
Partner
CPA Certificate No. 26497
SEC Accreditation No. 0085-AR-1
Tax Identification No. 123-305-056
PTR No. 0267366, January 2, 2007, Makati City

March 8, 2007

SAN MIGUEL PURE FOODS COMPANY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in Thousands)

	December 31	
	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents (Notes 6, 28 and 29)	P2,132,281	P1,383,923
Trade and other receivables - net (Notes 3, 7, 25, 28 and 29)	5,621,383	5,599,044
Inventories - net (Notes 3 and 8)	8,889,105	9,023,465
Biological assets (Note 12)	731,327	717,626
Derivative assets (Note 29)	148,970	240,602
Prepayments and other current assets	713,779	501,095
Total Current Assets	18,236,845	17,465,755
Noncurrent Assets		
Investments and advances (Notes 3 and 9)	660,385	623,037
Investment properties (Notes 3 and 10)	45,889	43,990
Property, plant and equipment - net (Notes 3, 11 and 25)	7,613,895	7,083,614
Biological assets - net (Notes 3 and 12)	444,741	450,730
Goodwill and intangible assets - net (Notes 3 and 13)	339,529	347,760
Deferred tax assets (Notes 3 and 23)	640,663	597,258
Pension and other noncurrent assets (Notes 3, 24 and 29)	229,752	104,113
Total Noncurrent Assets	9,974,854	9,250,502
	P28,211,699	P26,716,257
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Notes payable (Notes 14, 28 and 29)	P7,027,492	P7,464,404
Trade payables and other current liabilities (Notes 15, 25, 28 and 29)	7,077,087	6,164,727
Income tax payable	134,809	112,811
Current portion of long-term installment payables (Notes 25, 28 and 29)	1,108	7,533
Total Current Liabilities	14,240,496	13,749,475
Noncurrent Liabilities		
Pension liability (Notes 3 and 24)	72,811	112,403
Long-term installment payables - net of current portion (Notes 25, 28 and 29)	78,828	79,935
Deferred tax liabilities (Note 23)	242,861	225,710
Total Noncurrent Liabilities	394,500	418,048
Stockholders' Equity		
Equity Attributable to Equity Holders of the Parent		
Capital stock (Note 16)	745,859	607,065
Additional paid-in capital (Note 16)	1,938,944	1,227,738
Deposit for future stock subscription (Note 16)	-	850,000
Revaluation surplus	18,219	18,219
Cumulative translation adjustments	(33,937)	(37,946)
Retained earnings (Note 16)	5,476,530	4,844,953
Treasury stock (Note 16)	(182,094)	(182,094)
	7,963,521	7,327,935
Minority Interests		
Total Stockholders' Equity	5,613,182	5,220,799
	13,576,703	12,548,734
	P28,211,699	P26,716,257

* SGVMC209116 *

See accompanying Notes to Consolidated Financial Statements.

SGVMC209116

SAN MIGUEL PURE FOODS COMPANY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Amounts in Thousands, Except Basic Earnings Per Share)

	Years Ended December 31		
	2006	2005	2004
REVENUE (Notes 8, 17 and 25)	₱52,963,218	₱50,423,627	₱45,324,641
COST OF SALES (Notes 18, 25 and 31)	44,629,193	43,232,877	39,598,234
GROSS PROFIT	8,334,025	7,190,750	5,726,407
SELLING AND ADMINISTRATIVE EXPENSES (Notes 19 and 25)	(6,441,110)	(5,474,789)	(4,331,077)
INTEREST EXPENSE (Note 22)	(528,922)	(541,255)	(503,762)
INTEREST INCOME (Note 22)	83,150	69,214	56,679
EQUITY IN NET EARNINGS (Note 9)	37,348	9,693	49,382
OTHER INCOME (CHARGES) - Net (Note 22)	13,511	3,832	(126,969)
INCOME BEFORE INCOME TAX	1,498,002	1,257,445	870,660
PROVISION FOR (BENEFIT FROM) INCOME TAX - Net (Note 23)			
Current	532,826	474,669	260,630
Deferred	(38,368)	(234,210)	45,330
	494,458	240,459	305,960
NET INCOME	₱1,003,544	₱1,016,986	₱564,700
ATTRIBUTABLE TO			
Equity holders of the Parent	₱631,577	₱677,209	₱346,170
Minority interests	371,967	339,777	218,530
	₱1,003,544	₱1,016,986	₱564,700
Basic Earnings Per Share (Note 26)	₱8.97	₱11.99	₱6.12

See accompanying Notes to Consolidated Financial Statements.

* SGVMC209116 *

SAN MIGUEL PURE FOODS COMPANY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004
(Amounts in Thousands, Except Par Value)

	Equity Attributable to Equity Holders of the Parent							Minority Interests	Total Stockholders' Equity	
	Capital Stock (Note 16)	Additional Paid-In Capital (Note 16)	Deposit for Future Stock Subscription (Note 16)	Revaluation Surplus	Cumulative Translation Adjustments	Retained Earnings (Note 16)	Treasury Stock (Note 16)	Total		
At January 1, 2006	P607,065	P1,227,738	P850,000	P18,219	(P37,946)	P4,844,953	(P182,094)	P7,327,935	P5,220,799	P12,548,734
Change in fair value of available-for-sale financial assets	-	-	-	-	787	-	-	787	-	787
Changes in fair value of cash flow hedges	-	-	-	-	(157,042)	-	-	(157,042)	-	(157,042)
Transferred to income and expenses and cost basis adjustment	-	-	-	-	156,878	-	-	156,878	-	156,878
Tax effect of items taken directly to or transferred from equity	-	-	-	-	58	-	-	58	-	58
Net effect of translation adjustments	-	-	-	-	3,328	-	-	3,328	-	3,328
Net income	-	-	-	-	-	631,577	-	631,577	371,967	1,003,544
Total income and expense for the year	-	-	-	-	4,009	631,577	-	635,586	371,967	1,007,553
Issuances/Additions	138,794	711,206	(850,000)	-	-	-	-	-	-	-
Additions to minority interest	-	-	-	-	-	-	-	-	20,416	20,416
At December 31, 2006	P745,859	P1,938,944	P-	P18,219	(P33,937)	P5,476,530	(P182,094)	P7,963,521	P5,613,182	P13,576,703
At January 1, 2005	P607,065	P1,227,738	P-	P18,219	(P 25,941)	P4,167,361	(P182,094)	P5,812,348	P4,838,825	P10,651,173
Effect of change in accounting for financial statements	-	-	-	-	-	383	-	383	2,948	3,331
Changes in fair value of cash flow hedges	-	-	-	-	(80,973)	-	-	(80,973)	-	(80,973)
Transferred to income and expenses and cost basis adjustment	-	-	-	-	81,062	-	-	81,062	-	81,062
Tax effect of items taken directly to or transferred from equity	-	-	-	-	(31)	-	-	(31)	-	(31)
Net effect of translation adjustments	-	-	-	-	(12,063)	-	-	(12,063)	-	(12,063)
Net income	-	-	-	-	-	677,209	-	677,209	339,777	1,016,986
Total income and expense for the year	-	-	-	-	(12,005)	677,592	-	665,587	342,725	1,008,312
Issuances/Additions	-	-	850,000	-	-	-	-	850,000	-	850,000
Additions to minority interest	-	-	-	-	-	-	-	-	39,249	39,249
At December 31, 2005	P607,065	P1,227,738	P850,000	P18,219	(P37,946)	P4,844,953	(P182,094)	P7,327,935	P5,220,799	P12,548,734
At January 1, 2004	P607,065	P1,227,738	P-	P-	(P16,754)	P3,821,191	(P182,094)	P5,457,146	P4,553,500	P10,010,646
Net effect of translation adjustments	-	-	-	-	(9,187)	-	-	(9,187)	-	(9,187)
Net income	-	-	-	-	-	346,170	-	346,170	218,530	564,700
Total income and expense for the year	-	-	-	-	(9,187)	346,170	-	336,983	218,530	555,513
Additions to minority interest	-	-	-	-	-	-	-	-	57,500	57,500
Revaluation surplus from business combination	-	-	-	18,219	-	-	-	18,219	9,295	27,514
At December 31, 2004	P607,065	P1,227,738	P-	P18,219	(P25,941)	P4,167,361	(P182,094)	P5,812,348	P4,838,825	P10,651,173

See accompanying Notes to Consolidated Financial Statements.

SGVMC209116

SAN MIGUEL PURE FOODS COMPANY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in Thousands)

	Years Ended December 31		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	₱1,498,002	₱1,257,445	₱870,660
Adjustments for:			
Depreciation and amortization (Note 20)	1,370,372	1,288,101	1,216,613
Interest expense (Note 22)	528,922	541,255	503,762
Net gain on fair value changes of derivatives and other charges (Note 22)	(136,254)	(111,040)	-
Interest income (Note 22)	(83,150)	(69,214)	(56,679)
Equity in net earnings (Note 9)	(37,348)	(9,693)	(49,382)
Loss (gain) on sale of property and equipment	(6,711)	2,765	(4,692)
Operating income before working capital changes	3,133,833	2,899,619	2,480,282
Provisions for:			
Doubtful accounts	83,132	77,545	42,461
Inventory losses	31,777	9,389	1,666
Decrease (increase) in:			
Trade and other receivables	(66,587)	106,670	(1,592,582)
Inventories	82,379	(1,249,977)	(2,529,746)
Biological assets - current	(13,701)	222,167	(234,219)
Prepayments and other current assets	(226,955)	52,710	(398,719)
Increase (decrease) in:			
Trade payables and other current liabilities	1,010,215	336,175	1,615,610
Pension liability - net	(39,592)	41,149	59,159
Cash generated from (used in) operations	3,994,501	2,495,447	(556,088)
Interest paid	(546,549)	(550,120)	(462,677)
Income taxes paid (including final tax)	(510,828)	(478,983)	(553,778)
Interest received	83,148	69,169	58,224
Net cash flows provided by (used in) operating activities	3,020,272	1,535,513	(1,514,319)
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to (deductions from):			
Property, plant and equipment (Note 11)	(1,107,643)	(1,321,047)	(2,079,613)
Investment properties (Note 10)	(2,025)	(5,043)	-
Intangible assets - net (Note 13)	4,461	(38,361)	(266,711)
Advances to affiliate	-	(200,000)	-
Decrease (increase) in:			
Biological assets - noncurrent	(670,865)	(653,252)	(672,200)
Pension and other noncurrent assets	(83,547)	52,783	88,071
Proceeds from sale of property and equipment	12,362	4,347	6,604
Cash paid on acquisition of additional investment in associate, net of cash acquired	-	-	(246,961)
Net cash flows used in investing activities	(1,847,257)	(2,160,573)	(3,170,810)

(Forward)

* SGVMC209116 *

	Years Ended December 31		
	2006	2005	2004
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from (payments of) notes payables	(P436,912)	(P1,236,585)	P5,323,145
Increase in minority interests	19,788	46,125	9,295
Payments of:			
Long-term installment payables	(7,533)	(14,760)	-
Long-term debt	-	(80,000)	(80,000)
Proceeds from deposit for future stock subscription	-	850,000	-
Net cash flows provided by (used in) financing activities	(424,657)	(435,220)	5,252,440
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	748,358	(1,060,280)	567,311
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,383,923	2,444,203	1,876,892
CASH AND CASH EQUIVALENTS AT END OF YEAR	P2,132,281	P1,383,923	P2,444,203

See accompanying Notes to Consolidated Financial Statements.

SAN MIGUEL PURE FOODS COMPANY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in Thousands, Unless Otherwise Indicated)

1. Corporate Information

San Miguel Pure Foods Company, Inc. (the Parent Company) is incorporated in the Philippines. The Parent Company is a public company under Section 17.2 of the Securities Regulation Code and its shares are listed in the Philippine Stock Exchange. The Parent Company and its subsidiaries (the Group) are involved in poultry operations, processing and marketing of refrigerated and canned meat products, manufacturing and wholesaling of flour and feeds products and manufacturing and marketing of breadfill, snacks, desserts and dairy-based products.

The ultimate parent company of the Group is San Miguel Corporation (SMC).

The registered office address of the Parent Company is JMT Corporate Condominium, ADB Avenue, Ortigas Center, Pasig City.

The consolidated financial statements of the Group as of and for the years ended December 31, 2006 and 2005 were authorized for issue by the Board of Directors (BOD) on March 8, 2007.

2. Basis of Preparation

The consolidated financial statements of the Group have been prepared on the historical cost basis, except for derivative financial instruments, available-for-sale (AFS) investments and agricultural produce which have been measured at fair value.

The consolidated financial statements are presented in Philippine peso, which is the Group's functional and presentation currency, and all values are rounded to the nearest thousand (₱000), except when otherwise indicated.

Statement of Compliance

The consolidated financial statements of the Group have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards (PAS), including interpretations, issued by the Financial Reporting Standards Council.

Basis of Consolidation

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

	Country of Incorporation	Percentage of Ownership	
		2006	2005
San Miguel Foods, Inc. and subsidiary (SMFI)	Philippines	63.89	63.89
The Purefoods-Hormel Company, Inc. (PF-Hormel)	Philippines	60.00	60.00
Magnolia, Inc. and subsidiary (Magnolia)	Philippines	70.91	51.00
PT San Miguel Pure Foods Indonesia Ltd. (PTSMPI)	Indonesia	75.00	75.00
San Miguel Super Coffeemix Co., Inc. (SMSCCI)	Philippines	70.00	70.00
RealSnacks Mfg. Corp. (RealSnacks)*	Philippines	100.00	100.00

* Incorporated in April 2004 and has not yet started commercial operation.

The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

The consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. Intercompany balances and transactions, including intercompany profits and unrealized profits and losses, are eliminated in full.

Minority interests represent the portion of income and net assets not held by the Group in SMFI, PF-Hormel, Magnolia, PTSMPFI and SMSCCI and are presented separately in the consolidated statements of income and within the stockholders' equity in the consolidated balance sheets.

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial periods except as follows:

Starting January 1, 2006, the Group adopted the following new and amended PAS and Philippine interpretations from International Financial Reporting Interpretation Committee (IFRIC). Except for additional disclosures, the adoption did not have a significant impact on the consolidated financial statements of the Group.

- PAS 19, *Amendments to Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures*, requires additional disclosures about trends in the assets and liabilities in the defined benefit plans and the assumptions underlying the components of the defined benefit costs. The adoption did not have a recognition or measurement impact as the Group chose not to apply the new option offered to recognize actuarial gains and losses outside of the consolidated statements of income.
- PAS 21, *Amendments to the Effects of Changes in Foreign Exchange Rates*, states that all exchange differences arising from a nonmonetary item that forms part of a company's net investment in foreign operations are recognized in a separate component of stockholders' equity in the financial statements regardless of the currency in which the monetary item is denominated.
- PAS 39, *Financial Instruments: Recognition and Measurement - Amendments for Financial Guarantee Contracts*, requires the initial recognition of financial guarantee contracts at fair value and generally re-measured at the higher of the amount determined in accordance with PAS 37, Provisions, Contingent Liabilities and Contingent Assets, and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with PAS 18, Revenue Recognition. As the Group has no such transactions, the amendment did not have an effect on the consolidated financial statements.
- PAS 39, *Financial Instruments: Recognition and Measurement - Amendment for Hedges of Forecast Intragroup Transactions*, permits the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into the transaction and that the foreign currency risk will affect the

consolidated statements of income. As the Group has no such transactions, the amendment did not have an effect on the consolidated financial statements.

- PAS 39, *Financial Instruments: Recognition and Measurement - Amendment for the Fair Value Option*, restricts the use of the option to designate any financial asset or any financial liability to be measured at fair value through the consolidated statements of income. The Group had not previously used this option hence the amendment did not have an effect on the consolidated financial statements.
- Philippine Interpretation IFRIC 4, *Determining Whether an Arrangement Contains a Lease*, provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied.

The adoption of these amendments to PAS and Philippine interpretation from IFRIC did not have a significant effect on the Group's financial statements.

Standards Not Yet Effective

The Group did not opt for the early adoption of the following standards and amendments that have been approved but are not yet effective:

- PFRS 7, *Financial Instruments: Disclosures* - This requires disclosures that enable users to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The revised disclosures from the amendments will be included in the Group's consolidated financial statements when the amendments are adopted in 2007.
- PFRS 8, *Operating Segments* - This will be effective January 1, 2009 and will replace PAS 14, *Segment Reporting*. PFRS 8 adopts a management approach to reporting segment information. It is required for adoption only by entities whose debt or equity instruments are publicly traded, or are in the process of filing with the Philippines Securities and Exchange Commission (SEC) for purposes of issuing any class of instruments in a public market. The Group will assess the impact of this standard to its current manner of reporting segment information when it adopts the standard on January 1, 2009.
- IFRIC Interpretation 8, *Scope of IFRS 2* - This requires IFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. The interpretation will have no impact on the financial position of the Group.
- IFRIC Interpretation 9, *Reassessment of Embedded Derivatives* - This becomes effective for financial years beginning on or after June 1, 2006. This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Group assessed that the adoption of this interpretation will have no significant impact on its consolidated financial statements.
- IFRIC Interpretation 10, *Interim Financial Reporting and Impairment* - This standard provides that the frequency of financial reporting does affect the amount of impairment charge to be recognized in the annual financial reporting with respect to goodwill and available-for-sale investments. This interpretation has no significant impact on the consolidated financial statements of the Group.

- IFRIC 11, *IFRS 2 - Company and Treasury Share Transactions* - This interpretation will be effective January 1, 2008. This requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholders of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent. The Group will assess the impact of this standard upon adoption.
- IFRIC 12, *Service Concession Arrangements* - This will become effective beginning January 1, 2008. This interpretation, which covers contractual arrangements arising from entities providing public services, is not relevant to the Group's current operations.
- PAS 1, *Presentation of Financial Statements* - This standard requires the Group to make additional disclosures to enable the users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital. These new disclosures will be included in the Group's financial statements when the standard is adopted in 2007.

3. Significant Accounting Judgments, Estimates and Assumptions

The Group's consolidated financial statements prepared in accordance with PFRS require management to make judgments and estimates that affect amounts reported in the consolidated financial statements and related notes.

Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Operating Leases. The Group has entered into various lease agreements as a lessee. The Group has determined that the lessor retains all significant risks and rewards of ownership of these properties which are leased out on operating lease.

Rent expense charged to operations amounted to ₱664.5 million, ₱554.8 million and ₱612.8 million in 2006, 2005 and 2004, respectively (see Notes 18 and 19).

Functional Currency. The Parent Company and other subsidiaries have determined that their functional currency is the Philippine peso. PTSMPFI's functional currency is Indonesian rupiah. Functional currency is the currency of the primary economic environment in which the Group operates.

Estimates

The estimates and assumptions used in the consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the Group's consolidated financial statements. Actual results could differ from such estimates.

Estimating Allowances for Doubtful Accounts. Provisions are made for specific and groups of accounts where objective evidence of impairment exists. The Group evaluates these accounts based on available facts and circumstances, including, but not limited to, the length of the Company's relationship with the customers, the customers' current credit status based on third party credit reports and known market forces, average age of accounts, collection experience and historical loss experience.

The allowance for doubtful accounts amounted to ₱462.0 million and ₱438.7 million as of December 31, 2006 and 2005, respectively. The carrying value of trade and other receivables amounted to ₱5,621.4 million and ₱5,599.0 million as of December 31, 2006 and 2005, respectively (see Note 7).

Estimating Allowances for Inventory Losses. The Group provides allowance for inventories whenever the net realizable value of inventories becomes lower than cost due to damage, physical deterioration, obsolescence, changes in price levels or other causes. The allowance account is reviewed on a monthly basis to reflect the accurate valuation in the financial records.

The allowance for inventory obsolescence amounted to ₱79.4 million and ₱47.6 million as of December 31, 2006 and 2005, respectively. The carrying value of inventories as of December 31, 2006 and 2005 amounted to ₱8,889.1 million and ₱9,023.5 million, respectively (see Note 8).

Estimating Useful Lives of Investment Properties and Property, Plant and Equipment. The Group estimates the useful lives of investment properties and property, plant and equipment based on the period over which the assets are expected to be available for use. The estimated useful lives of property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of assets. In addition, estimation of the useful lives of the assets is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in estimates brought about by changes in the factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of the assets would increase recorded operating expenses and decrease noncurrent assets.

Accumulated depreciation and amortization amounted to ₱5,759.3 million and ₱5,200.4 million as of December 31, 2006 and 2005, respectively. Investment properties and property, plant and equipment net of accumulated depreciation and amortization amounted to ₱7,659.8 million and ₱7,127.6 million as of December 31, 2006 and 2005, respectively (see Notes 10 and 11).

Estimating Useful Lives of Intangible Assets with Finite Lives. The useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Intangible assets are regarded to have an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group.

Intangible assets with finite useful life amounted to ₱61.8 million and ₱70.0 million as of December 31, 2006 and 2005, respectively (see Note 13).

Estimating Realizability of Deferred Tax Assets. The Group reviews its deferred tax assets at each balance sheet date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. This projection is based on the Company's past and future results of operations.

Deferred tax assets amounted to ₱640.7 million and ₱597.3 million as of December 31, 2006 and 2005, respectively (see Note 23).

Impairment of Non-financial Assets. Except for intangible assets with indefinite useful lives, PFRS requires that an impairment review be performed when certain impairment indicators are present. For intangible assets with indefinite useful lives, impairment testing is performed on an annual basis. Determining the net recoverable value of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse impact on the consolidated results of operations.

The aggregate amount of investments and advances, investment properties, property, plant and equipment, biological assets and goodwill and intangible assets amounted to ₱9,104.4 million and ₱8,549.1 million as of December 31, 2006 and 2005, respectively (see Notes 9, 10, 11, 12 and 13).

Pension and Other Retirement Benefits. The determination of the Group's obligation and cost for pension and other retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. The assumptions described in Note 24, *Employee Benefits*, include, among others, discount rates, expected returns on plan assets and salary increase rate. In accordance with PFRS, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect the recognized expense and recorded obligation in such future periods.

Pension liability amounted to ₱72.8 million and ₱112.4 million as of December 31, 2006 and 2005, respectively. Pension asset amounted to ₱23.1 million and ₱10.0 million as of December 31, 2006 and 2005, respectively (see Note 24).

Fair Value of Agricultural Produce. The Group determines the fair value of its agricultural produce based on most recent market transaction price provided that there has been no significant change in economic circumstances between the date of transactions and balance sheet date. Point-of-sale cost is estimated based on most recent transaction and is deducted from the fair value in order to measure agricultural produce at point of harvest.

Unrealized fair value adjustments included in the cost of inventories as of December 31, 2006 and 2005 amounted to ₱15.0 million and ₱15.3 million, respectively (see Note 8).

Financial Assets and Liabilities. The Group carries certain financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgment. The significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates). However, the amount of changes in fair value would differ if the Group utilized different valuation methodologies and assumptions. Any changes in fair value of these financial assets and liabilities would affect profit and loss and equity.

The fair values of financial assets and liabilities are enumerated in Note 29.

Asset Retirement Obligation. Determining asset retirement obligation requires estimation of the cost of dismantling, installation and restoring leased properties to their original condition. The Group determined that there are no significant asset retirement obligations as of December 31, 2006 and 2005.

4. **Summary of Significant Accounting and Financial Reporting Policies**

Cash and Cash Equivalents

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

Financial Assets and Liabilities

Date of Recognition. The Group recognizes a financial asset or a financial liability in the consolidated balance sheets when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using settlement date accounting.

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at fair value, which is the fair value of the consideration given (in case of an asset) or received (in case of a liability). The fair value of the consideration given or received is determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities. The initial measurement of financial instruments, except for those designated at fair value through profit and loss (FVPL), includes transaction cost.

Subsequent to initial recognition, the Group classifies its financial assets in the following categories: held-to-maturity (HTM) financial assets, AFS investments, FVPL financial assets, and loans and receivables. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

Determination of Fair Value. The fair value for financial instruments traded in active markets at balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and asking prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which market observable prices exist, options pricing models, and other relevant valuation models.

Day 1 Profit. Where the transaction price in a non-active market is different from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a Day 1 profit) in the consolidated statements of income unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statements of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' profit amount.

Financial Assets

Financial Assets at FVPL. Financial assets at FVPL include financial assets held for trading and financial assets designated upon initial recognition as at FVPL.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Gains or losses on investments held for trading are recognized in the consolidated statements of income.

Financial assets may be designated by management at initial recognition as at FVPL, when any of the following criteria is met:

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

Derivatives are also classified as held for trading unless they are designated as effective hedging instruments.

The Group accounts for its derivative transactions (including embedded derivatives) under this category with fair value changes being reported directly to profit or loss, except when the derivative is treated as an effective accounting hedge (see policy on derivatives and hedging).

The Group has no investments designated as financial assets at fair value through profit or loss.

Loans and Receivables. Loans and receivables are nonderivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS or financial asset at FVPL. Loans and receivables are carried at cost or amortized cost, less impairment in value. Amortization is determined using the effective interest method.

Loans and receivables are classified as current assets when the Group expects to sell the asset within twelve months from the balance sheet date.

The Group's trade and other receivables are included in this category (Note 7).

HTM Investments. HTM investments are quoted nonderivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS investments. After initial measurement, these investments are measured at amortized cost using the effective interest method, less impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate.

Gains and losses are recognized in the consolidated statements of income when the HTM investments are derecognized or impaired, as well as through the amortization process.

The Group has no investments classified as held to maturity as of December 31, 2006 and 2005.

AFS Investments. AFS investments are nonderivative financial assets that are designated in this category or are not classified in any of the other categories. Subsequent to initial recognition, AFS investments are carried at fair value in the consolidated balance sheets. Changes in the fair value of such assets are reported in the equity section of the consolidated balance sheets until the investment is derecognized or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously reported in equity is transferred to the consolidated statements of income. Interest earned on holding AFS investments are recognized in the consolidated statements of income using effective interest rate.

The Group's investments in shares of stocks (included under "Pension and other noncurrent assets") are classified under this category.

Financial Liabilities

Financial Liabilities at FVPL. Financial liabilities are classified in this category if these result from trading activities or derivative transactions that are not accounted for as accounting hedges, or when the Group elects to designate a financial liability under this category.

Included in this category are the Group's derivative financial instruments with negative fair values that are not accounted for under cash flow hedge accounting (see Note 29).

Other Financial Liabilities. This category pertains to financial liabilities that are not held for trading or not designated as at FVPL upon the inception of the liability. These include liabilities arising from operations or borrowings.

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

This category includes notes payable, trade payables and other current liabilities and long-term installment payables.

Derivatives and Hedge Accounting

Freestanding Derivatives

For the purpose of hedge accounting, hedges are classified as either: a) fair value hedges when hedging the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (except for foreign currency risk); b) cash flow hedges when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction or the foreign currency risk in an unrecognized firm commitment; or c) hedges of a net investment in a foreign operation.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an on-going basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

Fair Value Hedge. Derivatives classified as fair value hedges are carried at fair value with the corresponding change in fair value recognized in the consolidated statements of income. The carrying amount of the hedged asset or liability is also adjusted for changes in fair value attributable to the hedged item and the gain or loss associated with that remeasurement is also recognized in the consolidated statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued and the adjustment to the carrying amount of a hedged financial instrument is amortized immediately.

As of December 31, 2006 and 2005, the Group has no outstanding derivatives accounted for as fair value hedges.

Cash Flow Hedge. Changes in the fair value of a hedging instrument that qualifies as a highly effective cash flow hedge are included in the consolidated statements of changes in stockholders' equity under "Cumulative translation adjustments" account. The ineffective portion is immediately recognized in the consolidated statements of income.

If the hedged cash flow results in the recognition of an asset or a liability, all gains and losses previously recognized directly in equity are transferred from equity and included in the initial measurement of the cost or carrying value of the asset or liability. Otherwise, for all other cash-flow hedges, gains and losses initially recognized in equity are transferred from equity to net income in the same period or periods during which the hedged forecasted transaction or recognized asset or liability affect the consolidated statements of income.

When the hedge ceases to be highly effective, hedge accounting is discontinued prospectively. In this case, the cumulative gain or loss on the hedging instrument that has been reported directly in equity is retained in equity until the forecasted transaction occurs. When the forecasted transaction is no longer expected to occur, any net cumulative gain or loss previously reported in equity is recognized in the consolidated statements of income.

As of December 31, 2006, certain fuel derivatives of the Group are designated as effective cash flow hedges (see Note 29).

Net Investment Hedge. As of December 31, 2006 and 2005, the Group has no hedge of a net investment in a foreign operation.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value of derivatives are taken directly to net profit or loss during the year incurred.

Embedded Derivatives

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at fair value through profit or loss.

Derecognition of Financial Assets and Liabilities

Financial Assets. A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset.

Financial Liabilities. A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expired.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

Impairment of Financial Assets

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Assets Carried at Amortized Cost. If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of the loss shall be recognized in the consolidated statements of income.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statements of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Assets Carried at Cost. If there is objective evidence of an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or of a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

AFS Investments. For AFS investments, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

In case of equity investment classified as AFS, this would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the statements of income, is removed from equity and recognized in the consolidated statements of income. Impairment losses on equity investments are not reversed through the consolidated statements of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS, impairment is based on the same criteria as loans and receivables and HTM financial assets. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset. If, in the subsequent year, the fair value of a debt instrument can be objectively related to an asset occurring after the impairment loss was recognized in the consolidated statements of income, the impairment loss is reversed through the consolidated statements of income.

Classification of Financial Instruments Between Debt and Equity

A financial instrument is classified as debt if it provides for a contractual obligation to:

- Deliver cash or another financial asset to another entity; or
- Exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or
- Satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated balance sheets if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated balance sheets.

Inventories

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

- | | |
|---|---|
| Finished goods and in process | - cost includes direct materials and labor and a proportion of manufacturing overhead costs based on normal operating capacity but excluding borrowing costs; finished goods are determined on a moving average method; |
| Raw materials, feeds, feed ingredients, factory supplies and others | - purchase cost on a moving average method. |

Net realizable value for finished goods and in process is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

Net realizable value for raw materials, feeds, feed ingredients, factory supplies and others and materials in transit represents the current replacement cost.

Biological Assets and Agricultural Produce

The Group's biological assets include breeding, growing poultry livestock and goods in process which are grouped mainly according to their physical state, transformation capacity (growing or laying), as well as their particular stage in the production process.

Growing poultry livestock and goods in process are carried at accumulated cost while breeding livestock are carried at accumulated cost, net of amortization. The costs and expenses incurred up to the start of the productive stage are accumulated and amortized over the estimated productive lives of the breeding stocks. The Group uses this method of valuation since fair value cannot be measured reliably. The Group's biological assets have no active market and no active market for similar assets are available in the Philippine poultry industry. Further, the existing sector benchmarks are determined to be irrelevant and the estimates (i.e., revenues due to highly volatile prices, input costs, efficiency values, production) necessary to compute for the present value of expected net cash flows comprise a wide range of data which will not result in a fair basis for determining the fair value.

The carrying values of the biological assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

The Group's agriculture produce, which consists of grown broilers harvested from the Group's biological assets, are measured at their fair value less estimated point-of-sale costs at the point of harvest. The fair value is based on the quoted prices for harvested mature grown broilers in the market at the time of harvest. The Group, in general, does not carry any inventory of agricultural produce at any given time as these are either sold as live broilers or transferred to the different poultry processing plants and immediately transformed into processed or dressed chicken.

Investment in Associate

The Group's investment in its associate is accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in an associate is carried in the consolidated balance sheets at cost plus post-acquisition changes in the Group's share in net assets of the associate. Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized. After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associate. The consolidated statements of income reflect the share in the results of operations of the associate. Where there has been a change recognized directly in the equity of the associate, the Group recognizes its share in any changes and discloses this, when applicable, in the consolidated statements of changes in stockholders' equity. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

An investment in an associate is accounted for using the equity method from the date when it becomes an associate. On acquisition of the investment, any difference between the cost of the investment and the investor's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with PFRS 3, *Business Combinations*. Consequently:

- a. Goodwill relating to an associate is included in the carrying amount of the investment. However, amortization of that goodwill is not permitted and is therefore not included in the determination of the Group's share in the associate's profits or losses.
- b. Any excess of the Group's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group discontinues applying the equity method when its investment in an associate is reduced to zero. Additional losses are provided only to the extent that the Group has incurred obligations or made payments on behalf of the associate to satisfy obligations of the investee that the Group has guaranteed or otherwise committed. If the investee subsequently reports profits, the Group resumes applying the equity method only after its share of the profits equals the share of net losses not recognized during the period the equity method was suspended.

The investment carried under the equity method consists of investment in Monterey Foods Corporation (Monterey) at 37.36% and 28.9% in 2006 and 2005, respectively. Monterey is incorporated in the Philippines.

The reporting dates of the associate and the Group are identical and the associate's accounting policies conform to those used by the Group for like transactions and events in similar circumstances.

Interest in Joint Venture

The Group has an interest in a joint venture which is a jointly controlled entity. A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest. The Group's 50% interest in Philippine Nutrition Technologies, Inc. (PNTI), a company incorporated in the Philippines, is accounted for under the equity method. The consolidated statements of income reflect the Group's proportionate share in the results of operations of the joint venture.

The Group shall discontinue the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, a jointly controlled entity.

Investment Properties

Investment properties represent land and buildings held to earn rentals and/or for capital appreciation. Buildings are measured at cost less accumulated depreciation and any impairment in value. The carrying amount of buildings includes the cost of replacing part of an existing investment property at the time the cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property. Land is stated at cost less any impairment in value.

Depreciation of buildings is computed using the straight-line method over 20 to 40 years.

An investment property is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefit is expected from its disposal.

Transfers are made to investment properties when, and only when, there is a change in use, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment properties when, and only when, there is a change in use, evidenced by commencement of the Group's occupation or commencement of development with a view to sale.

Property, Plant and Equipment

Property, plant and equipment, except land, are stated at cost less accumulated depreciation and amortization and any impairment in value. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation and interest incurred during the construction period on funds borrowed to finance the construction of the projects. Expenditures incurred after the item has been put into operations, such as repairs and maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have improved the condition of the asset beyond the originally assessed standard of performance, the expenditures are capitalized as additional costs of property, plant and equipment.

Construction in progress represents structures under construction and is stated at cost. This includes the costs of construction, property and equipment and other direct costs. Borrowing costs that are directly attributable to the construction of property and equipment are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are ready for use.

Depreciation and amortization is computed using the straight-line method over the following estimated useful lives of the assets:

Land improvements	5-10 years
Buildings and improvements	5-50 years
Machinery and equipment	5-20 years
Office furniture and equipment	3-5 years
Transportation equipment	5 years
Factory furniture, equipment and others	3-5 years

The remaining useful lives and depreciation method are reviewed periodically to ensure that the periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property, plant and equipment.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation is credited or charged to current operations.

When each major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statements of income in the year the asset is derecognized.

Business Combinations and Goodwill

Business combinations are accounted for using the purchase method of accounting. The cost of acquisition is the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control over the net assets of the acquired company, plus any directly attributable costs. The identifiable assets, liabilities and contingent liabilities that satisfy certain recognition criteria have to be measured initially at their fair values at acquisition date, irrespective of the extent of any minority interest.

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated:

- represents the lowest level within the Group at which the goodwill is monitored for internal management purposes; and
- is not larger than a segment based on either the Group's primary or the Group's secondary reporting format determined in accordance with PAS 14, Segment Reporting.

Impairment is determined by assessing the recoverable amount of the cash-generating unit or group of cash-generating units, to which the goodwill relates. Where the recoverable amount of the cash-generating unit or group of cash-generating units is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit or group of cash-generating units and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Negative goodwill which is not in excess of the fair values of acquired identifiable nonmonetary assets of subsidiaries and associate is charged directly to income. Transfers of assets between commonly controlled entities are accounted for under historical cost accounting.

When a business combination involves more than one exchange transaction (occurs in stages), each exchange transaction is treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of goodwill associated with that transaction. Any adjustment to fair values relating to the previously held interest is a revaluation and shall be accounted for as such.

When subsidiaries are sold, the difference between the selling price and the net assets plus goodwill is recognized in the consolidated statements of income.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is charged against profits in the year in which the expenditure is incurred. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at each balance sheet date. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income in the expense category consistent with the function of the intangible asset.

Amortization of computer software and licenses is computed using the straight-line method over the estimated useful life of 2 to 8 years.

Trademarks and formulas and recipes with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortized. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from disposition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the consolidated statements of income when the asset is disposed.

Impairment of Non-financial Asset with Definite Useful Life

The carrying values of property, plant and equipment and other long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and if the carrying value exceeds the estimated recoverable amount, the asset or cash-generating unit is written down to its recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price or value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's-length transaction less costs to sell. 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 of continuing operations are recognized in the consolidated statements of income in the expense category consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event; it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the receipt of the reimbursement is virtually certain.

Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized:

Sales. Revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably, which is normally upon delivery.

Agricultural Produce. Revenue from initial recognition of agricultural produce is measured at fair value less cost to sell at point of harvest. Fair value is based on the most recent relevant market price at point of harvest.

Interest. Revenue is recognized as the interest accrues, taking into account the effective yield on the asset.

Dividend. Income is recognized when the right to receive the payment is established.

Share-based Transactions

Under SMC's Employee Stock Purchase Plan (ESPP), employees of the Group receive remuneration in the form of share-based payments transactions, whereby the employees render services as consideration for equity instruments of SMC. Such transactions are handled centrally by SMC.

Share-based transactions in which SMC grants option rights to its equity instruments direct to the Group's employees are accounted for as equity settled transactions. SMC charges the Group for the costs related to such transactions with its employees. The amount is charged to operations by the Group.

The cost of ESPP is measured by reference to the market price at the time of the grant less subscription price. The cumulative expense recognized for share-based transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and SMC's best estimate of the number of equity instruments that will ultimately vest. Where the terms of a share-based award are modified, as a minimum, an expense is recognized as if the terms had not been modified. In addition, an expense is recognized for any modification, which increases the total fair value of the share-based payment agreement, or is otherwise beneficial to the employee as measured at the date of modification. Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award.

Operating Lease

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term.

Borrowing Costs

Borrowing costs are generally expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded.

Research and Development Costs

Research costs are expensed as incurred. Development cost incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortized in line with the expected future sales from the related project.

The carrying value of development costs is reviewed for impairment annually when the related asset is not yet in use, and otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

Retirement Costs

The Parent Company and majority of its subsidiaries have funded, noncontributory retirement plans, administered by trustees, covering their permanent employees. Retirement costs are actuarially determined using the projected unit credit method. This method reflects service rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses for each individual plan at the end of the previous reporting year exceeded 10% of the higher of the present value of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The past service cost, if any, is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, the plan, past service cost is recognized immediately.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not recognized, reduced by past service cost not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

If the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan, net actuarial losses of the current period and past service cost of the current period are recognized immediately to the extent that they exceed any reduction in the present value of those economic benefits. If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period are recognized immediately. Similarly, net actuarial gains of the current period after the deduction of past service cost of the current period exceeding any increase in the present value of the economic benefits stated above are recognized immediately if the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period are recognized immediately.

Foreign Currency Transactions and Translations

The consolidated financial statements are presented in Philippine peso, which is the Parent Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. 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 of exchange at balance sheet date. All differences are taken to the consolidated statements of income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currency of the foreign operation, PTSMPFI, is the Indonesian rupiah. As at the reporting date, the assets and liabilities of this subsidiary are translated into the presentation currency of the Parent Company at the rate of exchange ruling at balance sheet date and its income and expense accounts are translated at the weighted average exchange rates for the year. The resulting translation differences are included in the consolidated statements of changes in stockholders' equity under "Cumulative translation adjustments" account. On disposal of a foreign operation, the accumulated exchange differences are recognized in the consolidated statements of income as a component of the gain or loss on disposal.

Taxes

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

Deferred Tax. Deferred income tax is provided, using the balance sheet liability method, on all temporary differences at 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 except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of unused tax credits and unused tax losses can be utilized except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

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

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statements of income.

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

Sales Tax. Revenue, expenses and assets are recognized net of the amount of sales tax except:

- where the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables that are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated balance sheets.

Earnings Per Share (EPS)

Basic EPS is computed by dividing the net income by the weighted average number of common shares outstanding during the year, with retroactive adjustments for any stock dividends declared.

Diluted EPS is computed in the same manner, adjusted for the effect of the shares issuable to employees and executives under the Parent Company's ESPP and Long-term Incentive Plan, respectively, which are assumed to be exercised at the date of grant.

Where the EPS effect of the assumed conversion of shares issuable to employees and executives under the Parent Company's stock purchase and option plans would be anti-dilutive, diluted EPS is not presented.

Segments

The Group's operating businesses are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognized in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

Events After the Balance Sheet Date

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

5. **Business and Geographical Segments**

Business Segments

For management purposes, the Group has the following major business units: (a) meat and poultry; (b) feeds and flour; and (c) dairy and others. These are also the basis of the Group in reporting its primary segment information.

The meats and poultry segment includes, among others, the integrated poultry operations and the processing and marketing of refrigerated and canned meat products.

The feeds and flour segment is involved in the manufacturing and marketing of flour and feeds products.

The Group's other activities consist of manufacturing and wholesaling of breadfill, desserts, dairy-based products, snacks, coffee and condiments.

Geographical Segment

The significant operations of the Group are in the Philippines, separated between Luzon and VisMin areas. The Group also has operations in Indonesia.

Segment Assets and Liabilities

Segment assets include all operating assets used by a segment and consist principally of operating cash, receivables, inventories, biological assets and property, plant and equipment, net of allowances and accumulated depreciation and amortization. Segment liabilities include all operating liabilities and consist principally of accounts, wages, taxes currently payable and accrued liabilities. Segment assets and liabilities do not include deferred income taxes.

Inter-segment Transactions

Segment revenues, expenses and performance include sales and purchases between business segments and between geographical segments. Such sales and purchases are eliminated in consolidation.

Financial information about business and geographical segments follow:

Business Segments

	Meat and Poultry			Feeds and Flour			Dairy and Others			Total		Eliminations		Consolidated				
	2006	2005	2004	2006	2005	2004	2006	2005	2004	2006	2005	2004	2006	2005	2004			
<i>(In Millions)</i>																		
Revenue																		
External	P23,182	P22,431	P21,049	P20,005	P19,100	P17,509	P9,776	P8,893	P6,767	P52,963	P50,424	P45,325	P-	P-	P-	P52,963	P50,424	P45,325
Inter-segment	3,579	3,164	2,088	180	168	123	765	738	400	4,524	4,070	2,611	(4,524)	(4,070)	(2,611)	-	-	-
Total Revenue	P26,761	P25,595	P23,137	P20,185	P19,268	P17,632	P10,541	P9,631	P7,167	P57,487	54,494	P47,936	(P4,524)	(P4,070)	(P2,611)	P52,963	P50,424	P45,325
Result																		
Segment result	P1,230	P1,401	P890	P740	P660	P533	(P75)	(P343)	(P25)	P1,895	P1,718	P1,398	(P2)	(P2)	(P2)	P1,893	P1,716	P1,396
Interest expense - net	(178)	(161)	(150)	(137)	(149)	(222)	(131)	(162)	(75)	(446)	(472)	(447)	-	-	-	(446)	(472)	(447)
Equity in net earnings	-	-	-	-	-	-	637	626	394	637	626	394	(600)	(616)	(345)	37	10	49
Other income (charges)	(4)	54	64	78	9	(62)	(60)	(59)	(62)	14	4	(60)	-	-	(67)	14	4	(127)
Provision for income tax	(310)	(314)	(246)	(214)	(172)	(93)	29	249	33	(495)	(237)	(306)	1	(4)	-	(494)	(241)	(306)
Net income	P738	P980	P558	P467	P348	P156	P400	P311	P265	P1,605	P1,639	P979	(P601)	(P622)	(P414)	P1,004	P1,017	P565
Other Information																		
Segment assets	P14,008	P13,334	P12,975	P9,421	P8,554	P8,778	P5,672	P5,205	P4,261	P29,101	P27,093	P26,014	(P2,530)	(P1,945)	(P1,468)	P26,571	P25,148	P24,546
Investments and advances	-	-	-	-	-	-	9,955	7,675	6,356	9,955	7,675	6,356	(9,295)	(7,052)	(5,943)	660	623	413
Goodwill and intangible assets	133	255	219	12	17	13	134	139	141	279	411	373	61	(63)	(63)	340	348	310
Deferred tax assets	113	104	82	123	124	71	344	310	24	580	538	177	61	59	72	641	597	249
Consolidated total assets	P14,254	P13,693	P13,276	P9,556	P8,695	P8,862	P16,105	P13,329	P10,782	P39,915	P35,717	P32,920	(P11,703)	(P9,001)	(P7,402)	P28,212	P26,716	P25,518
Segment liabilities	P4,183	P3,705	P3,590	P3,192	P2,643	P2,095	P2,333	P2,008	P1,690	P9,708	P8,356	P7,375	(P2,478)	(P1,992)	(P1,555)	P7,230	P6,365	P5,821
Notes payable	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	7,027	7,464	8,701
Long-term debt	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	80
Income tax payable	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	135	113	117
Deferred tax liabilities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	243	226	148
Consolidated total liabilities	P4,183	P3,705	P3,590	P3,192	P2,643	P2,095	P2,333	P2,008	P1,690	P9,708	P8,356	P7,375	(P2,478)	(P1,992)	(P1,555)	P14,635	P14,168	P14,867
Property, plant and equipment - net	P3,731	P3,447	P3,182	P2,747	P2,606	P2,347	P1,084	P977	P858	P7,562	P7,030	P6,387	P52	P54	P-	P7,614	P7,084	P6,387
Capital expenditures	508	532	1,170	383	489	823	217	300	87	1,108	1,321	2,080	-	-	-	1,108	1,321	2,080
Depreciation and amortization	1,009	938	908	236	230	201	125	120	108	1,370	1,288	1,217	-	-	-	1,370	1,288	1,217
Non-cash items other than depreciation and amortization of property, plant and equipment	(31)	(80)	12	(87)	(36)	27	(14)	9	5	(132)	(107)	44	-	-	-	(132)	(107)	44

Geographical Segments (by customer domicile):

	Net Sales			Segment Assets		Capital Expenditures	
	2006	2005	2004	2006	2005	2006	2005
	<i>(In Millions)</i>						
Philippines							
LUZON	P38,962	P37,509	P33,709	P23,292	P23,053	P1,089	P1,305
VISMIN	13,367	12,043	10,985	4,526	3,289	14	5
Indonesia and others	634	872	631	394	374	5	11
	P52,963	P50,424	P45,325	P28,212	P26,716	P1,108	P1,321

6. Cash and Cash Equivalents

This account consists of:

	2006	2005
Cash on hand and in banks	P1,135,149	P978,247
Short-term placements	997,132	405,676
	P2,132,281	P1,383,923

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

7. Trade and Other Receivables

This account consists of:

	2006	2005
Trade receivables	P4,768,828	P5,107,559
Amounts owed by related parties (see Note 25)	624,645	307,726
Other receivables	689,921	622,436
	6,083,394	6,037,721
Less allowance for doubtful accounts	462,011	438,677
	P5,621,383	P5,599,044

Trade receivables are non-interest bearing and are generally on 30 days term.

8. Inventories

This account consists of:

	2006	2005
Finished goods and in process - at net realizable value in 2006; at cost in 2005	₱1,517,113	₱1,507,970
Raw materials, feeds and feed ingredients - at net realizable value	6,212,374	6,533,144
Factory supplies and others - at net realizable value	119,284	148,184
Materials in transit - at cost	1,040,334	834,167
Total inventories at lower of cost and net realizable value	₱8,889,105	₱9,023,465

The cost of finished goods and in process amounted to ₱1,518.5 million in 2006. The cost of raw materials, feeds and feed ingredients amounted to ₱6,289.4 million and ₱6,575.6 million as of December 31, 2006 and 2005, respectively. The cost of factory supplies and others amounted to ₱120.3 million and ₱153.3 million as of December 31, 2006 and 2005, respectively.

Finished goods and in process includes net unrealized gain on fair valuation of agricultural produce amounting to ₱15.0 million and ₱15.3 million as of December 31, 2006 and 2005. The fair value of agricultural produce less point-of-sale-cost, which formed part of finished goods inventory, amounted to ₱125.7 million and ₱100.4 million as of December 31, 2006 and 2005, respectively, with corresponding cost at point-of-harvest amounting to ₱110.7 million and ₱85.1 million, respectively.

9. Investments and Advances

Investments in Associate and Joint Venture

This account consists of:

	2006	2005
Investments in associate and joint venture - at equity:		
Acquisition cost:		
Balance at beginning of year	₱314,132	₱314,132
Additional investments in Monterey	200,000	-
Balance at end of year	514,132	314,132
Accumulated equity in net earnings:		
Balance at beginning of year	108,905	99,212
Equity in net earnings - net of equity in net losses of PNTI (2005 only)	37,348	9,693
Balance at end of year	146,253	108,905
Advances to an associate	-	200,000
	₱660,385	₱623,037

Following are the condensed financial information of Monterey and PNTI:

	Monterey		PNTI	
	2006	2005	2006	2005
Total assets	₱5,624,105	₱5,361,469	₱2,916	₱40,552
Total liabilities	3,636,724	3,497,420	515	38,696
Net sales	6,084,247	5,998,051	–	98,975
Net income (loss)	164,165	108,766	–	(2,414)

On August 19, 2005, the BOD of PNTI approved the filing of dissolution of the joint venture company with the SEC. PNTI ceased commercial operations in September 2005. In October 2005, the Group discontinued the use of the equity method for its joint venture with PNTI. Both parties ceased to have joint control over PNTI.

As of March 8, 2007, the application for the dissolution of PNTI is yet to be filed with the SEC, pending the receipt of clearance from the Bureau of Internal Revenue.

10. Investment Properties

The movements in investment properties follow:

	2006	2005
Cost:		
Balance at beginning of year	₱45,049	₱40,006
Additions	2,025	5,043
Balance at end of year	47,074	45,049
Accumulated depreciation:		
Balance at beginning of year	1,059	991
Depreciation during the year	126	68
Balance at end of year	1,185	1,059
Net book value	₱45,889	₱43,990

The fair value of investment properties as of December 31, 2006 and 2005 amounted to ₱244.0 million and ₱230.3 million, respectively, determined based on valuations performed by the credit management group of the Parent Company.

11. Property, Plant and Equipment

This account consists of:

	Land and Improvements	Buildings and Improvements	Machinery, Equipment, Furniture and Others	Transportation Equipment	Construction in Progress	Total
Cost						
Balance at January 1, 2005	₱1,112,195	₱1,904,197	₱5,610,713	₱453,218	₱1,980,072	₱11,060,395
Additions	151,203	1,453	223,246	17,472	927,673	1,321,047
Disposals	–	(1,344)	(41,974)	(9,470)	–	(52,788)

(Forward)

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	Land and Improvements	Buildings and Improvements	Machinery, Equipment, Furniture and Others	Transportation Equipment	Construction in Progress	Total
Transfers, reclassifications and others	₱43,653	₱1,145,153	₱976,694	₱13,233	(₱2,224,476)	(₱45,743)
Balance at December 31, 2005	1,307,051	3,049,459	6,768,679	474,453	683,269	12,282,911
Additions	743	2,946	371,161	6,528	726,265	1,107,643
Disposals	–	(3,595)	(12,897)	(4,811)	(2,732)	(24,035)
Transfers, reclassifications and others	2,832	193,631	434,285	14,552	(639,776)	5,524
Balance at December 31, 2006	1,310,626	3,242,441	7,561,228	490,722	767,026	13,372,043
Accumulated Depreciation and Amortization						
Balance at January 1, 2005	133,282	822,730	3,375,497	342,149	–	4,673,658
Depreciation for the year	15,921	127,139	402,126	39,802	–	584,988
Disposals	–	(814)	(35,952)	(8,910)	–	(45,676)
Transfers, reclassifications and others	–	17,744	(30,192)	(1,225)	–	(13,673)
Balance at December 31, 2005	149,203	966,799	3,711,479	371,816	–	5,199,297
Depreciation for the year	14,904	131,677	394,248	39,077	–	579,906
Disposals	–	(3,595)	(12,184)	(2,605)	–	(18,384)
Transfers, reclassifications and others	–	77	(3,142)	394	–	(2,671)
Balance at December 31, 2006	164,107	1,094,958	4,090,401	408,682	–	5,758,148
Net Book Value						
At December 31, 2006	₱1,146,519	₱2,147,483	₱3,470,827	₱82,040	₱767,026	₱7,613,895
At December 31, 2005	1,157,848	2,082,660	3,057,200	102,637	683,269	7,083,614
At January 1, 2005	978,913	1,081,467	2,235,216	111,069	1,980,072	6,386,737

Depreciation and amortization charged to operations amounted to ₱579.9 million in 2006 and ₱585.0 million in 2005 (see Note 20). These amounts include annual amortizations of capitalized interest amounting to ₱5.2 million and ₱5.5 million, respectively. Unamortized balance of capitalized interest as of December 31, 2006 and 2005 amounted to ₱38.8 million and ₱44.0 million, respectively.

No borrowing cost was capitalized in 2006 and 2005.

12. Biological Assets

This account consists of:

	2006	2005
Current:		
Growing stocks	₱581,138	₱575,533
Goods in process	150,189	142,093
Total Current	731,327	717,626
Noncurrent breeding stocks - net	444,741	450,730
	₱1,176,068	₱1,168,356

The amortization of breeding stocks charged to operations amounted to ₱676.9 million in 2006 and ₱660.4 million in 2005 (see Note 20).

Growing stocks pertain to growing broilers and goods in process pertain to hatching eggs.

The movements in biological assets are as follows:

	2006	2005
Cost:		
Balance at beginning of year	₱1,168,356	₱1,397,658
Increase due to purchases	13,717,425	18,011,192
Decrease due to sales	(8,653)	(58,928)
Decrease due to harvest	(13,024,206)	(17,521,179)
Amortization (see Note 20)	(676,854)	(660,387)
	₱1,176,068	₱1,168,356

The Group harvested approximately 277.9 million kilograms and 261.5 million kilograms of grown broilers in 2006 and 2005, respectively.

13. Goodwill and Intangible Assets

This account consists of:

	2006	2005
Goodwill	₱187,575	₱187,575
Trademark	32,558	32,558
Formulas and recipes	57,591	57,591
Computer software and licenses - net	61,805	70,036
	₱339,529	₱347,760

Goodwill represents the excess of cost over fair value arising from the acquisition of additional shares of PTSMPFI and goodwill of Magnolia from the acquisition of Sugarland Corporation (a subsidiary of Magnolia).

In 2005, the Parent Company acquired an additional 19.91% and 8.46% equity in Magnolia and Monterey, respectively. Its share in the identifiable assets and liabilities of Magnolia and Monterey had been provisionally determined as of acquisition date because the fair values to be assigned to Magnolia's and Monterey's identifiable assets and liabilities or contingent liabilities can be determined only provisionally. The Parent Company accounted for the acquisition using provisional values and no goodwill was recognized as of acquisition date.

The movements in computer software and licenses are shown below:

	2006	2005
Cost:		
Balance at beginning of year	P76,773	P32,569
Addition during the year	7,763	44,204
Balance at end of year	84,536	76,773
Accumulated amortization:		
Balance at beginning of year	6,737	894
Amortization for the year	15,994	5,843
Balance at end of year	22,731	6,737
Net book value	P61,805	P70,036

14. Notes Payable

Notes payable consist of short-term unsecured peso-denominated loans obtained from local banks. Interests range from 4.8% to 8.9% in 2006 and 6.3% to 8.4% in 2005.

15. Trade Payables and Other Current Liabilities

This account consists of:

	2006	2005
Trade payables	P3,471,458	P2,609,245
Amounts owed to related parties (see Note 25)	632,834	615,784
Acceptances payable	61,192	80,882
Accrued expenses and other payables	2,911,603	2,858,816
	P7,077,087	P6,164,727

Accrued expenses and other payables include derivative liability amounting to P85 in 2006 (see Note 29).

16. Stockholders' Equity

The Parent Company's capital stock, at P10 par value, consists of the following number of shares:

	Class A	Class B
Authorized	50,628,000	33,372,000
Issued	47,569,527	27,016,503

Class A and Class B shares are identical in all respects, except that Class A shares are transferable only to Philippine nationals and shall at all times be not less than 60% of the voting capital stock.

Treasury shares, totaling 385,456 Class "A" shares and 3,822,302 Class "B" shares in 2006 and in 2005, are carried at cost.

In December 2005, SMC subscribed to an additional 13.9 million shares of the Parent Company which effectively increased SMC's ownership from 99.75% to 99.83%. The consideration received from SMC amounting to ₱850 million was recognized as deposit for future stock subscription in the 2005 balance sheet, pending approval to the amendment in the Parent Company's Articles of Incorporation to include a provision on the denial of pre-emptive rights to minority stockholders with respect to the issuance of the Parent Company's shares to SMC. On February 9, 2006, the SEC approved the amendments and accordingly, the deposit was transferred to capital stock and additional paid-in capital in the 2006 consolidated balance sheet. As of March 8, 2007, the subscribed shares is still pending listing with the Philippine Stock Exchange, Inc.

In December 2006 and January 2007, the Parent Company's BOD and stockholders, respectively, approved the increase in its authorized capital stock from 84 million to 146 million shares to partly cover the issuance of shares to SMC in exchange for the latter's remaining interest in SMFI, Magnolia and Monterey. The application for the increase in authorized capital stock is yet to be filed with the SEC.

The retained earnings account is restricted for dividend declaration to the extent of the cost of treasury shares of ₱182.1 million as of December 31, 2006 and 2005.

The balance of retained earnings includes the Parent Company's accumulated equity in undistributed net earnings of the consolidated subsidiaries and associate accounted for under the equity method amounting to ₱4,185.2 million and ₱3,548.3 million as of December 31, 2006 and 2005, respectively. These amounts are also not available for dividend distribution until declared as dividends by the subsidiaries and associate.

17. Revenue

Revenue consists of sales of goods and gain on fair valuation of agricultural produce. Total invoiced sales amounted to ₱52,948.2 million, ₱50,408.3 million and ₱45,297.1 million for the years ended December 31, 2006, 2005 and 2004, respectively. The aggregate fair value less estimated point-of-sale costs of agricultural produce harvested during the year, determined at point of harvest, amounted to ₱15,929.9 million, ₱14,650.7 million and ₱13,717.0 million for the years ended December 31, 2006, 2005 and 2004, respectively.

18. Cost of Sales

This account consists of:

	2006	2005	2004
Inventories used	₱39,190,940	₱38,522,527	₱35,708,092
Depreciation and amortization (see Note 20)	1,161,518	1,143,750	1,075,352
Personnel (see Note 21)	1,110,958	1,062,497	896,677
Communications, light and water	888,275	720,639	459,508
Freight, trucking and handling	777,141	572,158	314,799
Rentals	374,907	263,608	359,701
Repairs and maintenance	331,323	285,544	295,150
Others	794,131	662,154	488,955
	₱44,629,193	₱43,232,877	₱39,598,234

19. Selling and Administrative Expenses

This account consists of:

	2006	2005	2004
Personnel (see Note 21)	₱1,322,855	₱1,369,741	₱1,210,596
Freight, trucking and handling	1,261,116	980,397	747,209
Advertising and promotions	1,043,686	1,011,170	746,306
Contracted services	439,034	241,763	154,172
Rentals	289,573	291,155	253,054
Depreciation and amortization (see Note 20)	208,854	144,351	141,261
Communication, light and water	173,961	167,566	146,556
Repairs and maintenance	161,562	243,135	186,008
Taxes and licenses	150,128	125,700	107,029
Travel and transportation	130,671	175,605	143,427
Professional fees	109,086	277,213	252,114
Entertainment, amusement and recreation	11,672	12,268	6,938
Others	1,138,912	434,725	236,407
	₱6,441,110	₱5,474,789	₱4,331,077

Depreciation and amortization include depreciation and amortization of idle properties, deferred containers, trademark (in 2004 only) and others amounting to ₱89.5 million, ₱31.9 million and ₱25.7 million in 2006, 2005 and 2004, respectively.

20. Depreciation and Amortization

Depreciation and amortization are distributed as follows:

	2006	2005	2004
Cost of sales:			
Property, plant and equipment	₱460,539	₱472,588	₱348,485
Biological assets	676,854	660,387	726,867
Others	24,125	10,775	-
	1,161,518	1,143,750	1,075,352
Selling and administrative expenses:			
Property, plant and equipment	119,367	112,400	115,586
Deferred containers and others	89,487	31,951	25,675
	208,854	144,351	141,261
	₱1,370,372	₱1,288,101	₱1,216,613

21. Personnel Expenses

This account consists of:

	2006	2005	2004
Salaries and allowances	₱1,723,750	₱1,738,033	₱1,495,288
Pension costs (see Note 24)	172,886	218,985	164,300
Other employee benefits	537,177	475,220	447,685
	₱2,433,813	₱2,432,238	₱2,107,273

The above amounts are distributed as follows:

	2006	2005	2004
Cost of sales	₱1,110,958	₱1,062,497	₱896,677
Selling and administrative expenses	1,322,855	1,369,741	1,210,596
	₱2,433,813	₱2,432,238	₱2,107,273

22. Interest Expense, Interest Income and Others

These accounts consist of:

	2006	2005	2004
Interest expense:			
Short-term loans	(P528,922)	(P537,833)	(P493,047)
Long-term loans	-	(3,422)	(10,715)
	(P528,922)	(P541,255)	(P503,762)
Interest income:			
Money market placements	P61,385	P45,691	P45,457
Cash in banks	21,765	23,523	11,222
	P83,150	P69,214	P56,679
Other income (charges):			
Gain on derivatives	P220,372	P193,724	P-
Research and development costs	(99,374)	(113,885)	(130,687)
Foreign exchange loss - net (see Note 28)	(18,318)	(14,522)	3,383
Dividend income	56	57	100
Others - net	(89,225)	(61,542)	235
	P13,511	P3,832	(P126,969)

Research and development costs consist of various expenses related to expansion projects of the Group.

23. Income Taxes

a. The components of the Group's deferred tax assets and liabilities are as follows:

	2006	2005
Deferred tax assets:		
Net operating loss carry over (NOLCO)	P194,691	P201,132
Allowance for doubtful accounts and provision for inventory obsolescence	190,788	176,906
Unamortized past service cost and others	110,040	91,068
Minimum corporate income tax (MCIT)	38,552	35,677
Unrealized mark-to-market loss	35,977	29,990
Others	70,615	62,485
	P640,663	P597,258
Deferred tax liabilities:		
Unrealized marked-to-market gain	P86,217	P17,303
Accelerated depreciation	75,209	66,690
Others	81,435	141,717
	P242,861	P225,710

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- b. As of December 31, 2006, the NOLCO and MCIT that can be claimed as deduction from future taxable income and deduction from corporate income tax due, respectively, are as follows:

Year Incurred/Paid	Carryforward Benefit Up To	NOLCO	MCIT
2004	December 31, 2007	₱60,203	₱16,030
2005	December 31, 2008	501,217	18,056
2006	December 31, 2009	–	4,466
		₱561,420	₱38,552

NOLCO incurred in 2004 and 2005 amounting to ₱12.7 million and ₱0.5 million, respectively, were applied as deductions from taxable income in 2006. MCIT incurred in 2003, amounting to ₱1.6 million, expired in 2006.

- c. The components of the provision for income tax consist of:

	2006	2005	2004
Current:			
Corporate tax	₱516,051	₱462,395	₱248,573
Final tax withheld on interest income	16,775	12,274	12,057
	532,826	474,669	260,630
Deferred	(38,368)	(234,210)	45,330
	₱494,458	₱240,459	₱305,960

- d. The reconciliations between the statutory income tax rate on income before income tax and minority interests and the Group's effective income tax rates follow:

	2006	2005	2004
Statutory income tax rate	35.00%	32.50%	32.00%
Additions to (reductions in) income tax resulting from the tax effects of:			
Interest income subjected to final tax	(1.94)	(1.79)	(2.08)
Equity in net earnings	(0.87)	(0.25)	(1.81)
Others - net	0.82	(11.34)	7.03
Effective income tax rates	33.01%	19.12%	35.14%

24. Employee Benefits

The Parent Company and majority of its subsidiaries have funded, noncontributory retirement plans covering all of their permanent employees. Contributions and costs are determined in accordance with the actuarial studies made for the plans. Annual cost is determined using the projected unit credit method. The Group's latest actuarial valuation date is December 31, 2006. Valuations are obtained on a periodic basis.

In its 2005 transition to PFRS, the Group chose to recognize the transition liability in its December 31, 2005 financial statements arising from the change in accounting for employee benefits as an expense on a straight-line basis over five years as permitted under PAS 19. Hence, in its 2006 financial statements, only two-year comparative disclosures about trends in the assets and liabilities in the defined benefit plans and the assumptions underlying the components of the defined benefit cost were available.

Retirement costs charged by the Parent Company to operations amounted to ₱2.8 million and ₱3.1 million in 2006 and 2005, respectively, inclusive or net of imputed interest, while those charged by the subsidiaries amounted to ₱170.1 million and ₱215.9 million in 2006 and 2005, respectively. The Group's annual contribution to the retirement plans consists of payments covering the current service cost and amortization of past service liability.

The components of net pension cost recognized in the consolidated statements of income for the years ended December 31, 2006 and 2005 and the amounts recognized in the consolidated balance sheets as of December 31, 2006 and 2005, respectively, are as follows:

a. Net pension cost

	2006	2005
Current service cost	₱73,520	₱66,366
Interest cost	163,712	187,296
Expected return on plan assets	(125,646)	(99,988)
Net actuarial gain (loss) during the year	(4,938)	136
Past service cost	226	(147)
Effect of asset limit	690	-
Amortization of transitional liability	65,322	65,322
Net pension cost	₱172,886	₱218,985
Actual return on plan assets	₱319,667	₱196,681

b. Pension asset

	2006	2005
Defined benefit obligation	₱428,832	₱487,691
Fair value of plan assets	(506,145)	(506,938)
Unrecognized:		
Net actuarial gains	78,389	41,452
Net transitional liability	(24,820)	(32,184)
Amount not recognized as asset due to limit	690	-
Pension asset	₱23,054	₱9,979

c. Pension liability

	2006	2005
Defined benefit obligation	₱1,167,912	₱1,006,669
Fair value of plan assets	(983,440)	(713,552)
Unrecognized:		
Past service costs	(1,646)	(1,840)
Net actuarial gains	61,132	50,232
Net transitional liability	(171,147)	(229,106)
Pension liability	₱72,811	₱112,403

Changes in the present value of the defined benefit obligation are as follows:

	2006	2005
Beginning balance	₱1,494,360	₱1,341,938
Interest cost	163,712	187,296
Current service cost	73,520	66,366
Transfer from other plans	94,302	3,246
Benefits paid	(273,631)	(21,318)
Actuarial losses (gains)	141,002	(55,549)
Transfer to other plans	(96,827)	(27,619)
Cumulative translation adjustments	306	-
	₱1,596,744	₱1,494,360

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

	2006	2005
Beginning balance	₱1,220,490	₱999,886
Expected return	125,646	99,988
Contributions during the year	225,585	126,822
Transfer from other plans	94,302	3,246
Benefits paid	(273,631)	(21,318)
Transfer to other plans	(96,827)	(27,619)
Actuarial gains	194,020	39,485
	₱1,489,585	₱1,220,490

The Group expects to contribute about ₱130 million to its defined benefit pension plan in 2007.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

Stock trading portfolio	30%
Fixed income portfolio	70%

The overall expected rate of return is determined based on historical performance of the investments.

The principal actuarial assumptions used to determine pension costs are as follows:

	2006	2005
Discount rate	7.3% to 10.5%	10% to 14%
Return on plan assets	10% to 10.5%	10%
Salary increase rate	6% to 8%	6% to 9%

25. Related Party Disclosures

The following are the significant related party transactions entered into by the Group:

a. Magnolia, Inc.

In November 2006, Magnolia and Star Dari, Inc. (SDI), a 100%-owned subsidiary of SMC, executed a Deed of Assignment, which was later amended on January 10, 2007, for the transfer of certain machinery and equipment of SDI with an appraised value of ₱19.8 million as of November 27, 2006, in favor of Magnolia. In exchange, Magnolia will issue 11.1 million shares of stocks valued at net book value as of May 31, 2006. The BOD of SDI approved the declaration of the said Magnolia shares as property dividend in favor of SMC.

Magnolia issued the shares to SDI on February 5, 2007.

As of March 8, 2007, the declaration of the shares as property dividend by SDI in favor of SMC is still pending approval with the SEC.

b. In December 2006, SMC's BOD approved the transfer to the Parent Company of its remaining interest in SMFI, Magnolia and Monterey at their respective book values as of September 30, 2006 totaling ₱4.6 billion effective January 1, 2007. In exchange, the Parent Company will issue equivalent shares to SMC valued at the latest traded price of its shares of stocks as of September 30, 2006.

In the same month, the Parent Company's BOD approved the issuance of shares to SMC in exchange for the latter's remaining interest in SMFI, Magnolia and Monterey for the same values consistent with the SMC board approval, and the increase in the Parent Company's authorized capital stock from 84 million to 146 million shares.

As of March 8, 2007, the application for the denial of pre-emptive rights to the issuance of shares to SMC is yet to be filed with the SEC.

c. In September 2005, San Miguel Mills, Inc. (SMMI), a wholly-owned subsidiary of SMFI, was incorporated with an initial capital of ₱0.25 million.

In December 2005, SMFI and SMMI executed a Deed of Assignment transferring certain assets (at historical book value) and liabilities of the former's Flour Division in exchange for the latter's shares effective January 1, 2006. The transfer of the net assets at historical book value totaling ₱1,645.5 million will be the consideration for SMFI's subscription to 16.4 million common shares to be issued out of the increase in authorized capital stock of SMMI.

As of December 31, 2006, SMMI's application for the increase in its authorized capital stock is still pending approval with the SEC.

- d. On December 28, 2004, SMC and Monterey executed a Trademark Licensing Agreement with PF-Hormel to license the Monterey and Gannado trademarks for a period of 20 years renewable for the same period for a royalty based on net sales revenue. The royalty fee will apply only for as long as SMC and any of its subsidiaries own at least 51% of PF-Hormel. In the event that the ownership of SMC and any of its subsidiaries is less than 51%, the parties will negotiate and agree on the royalty fee on the respective licenses of the Monterey and Gannado trademarks.
- e. PF-Hormel purchased from San Miguel Campocarne Corporation (SMCC) certain intangible assets for ₱36.2 million under a Deed of Sale of Intangible Assets dated December 31, 2002. The intangible assets purchased include trademarks. The purchase price is payable as follows:
- i. ₱10.0 million on closing date (December 31, 2002); and
 - ii. remaining balance in four equal annual installments.
- f. Also, on December 31, 2002, PF-Hormel entered into a Sale By Installment Agreement with Monterey, for the purchase of a parcel of land. The selling price of the parcel of land amounted to ₱94 million and is payable as follows:
- i. ₱10.7 million on closing date (December 31, 2002); and
 - ii. remaining balance in 24 annual installments of ₱10.7 million inclusive of interest, on the declining balance of the principal at the rate of 12% per annum.
- g. Shared Services Agreement

In January 2006, SMFI renewed its Shared Services Agreement (Agreement) with various related parties, wherein the parties agreed to share defined services and costs under certain terms and conditions. The Agreement shall have a term of one year with automatic renewal for additional period of one year thereafter, unless either party to the individual Agreement provides a notice of termination.

Other significant transactions with related parties and the related balances are as follows:

Name of Company	Relationship	Nature of Transactions/ Outstanding Accounts	2006	2005
SMC	Ultimate parent	Sales	₱4,681,537	₱2,090,000
		Purchases	1,979,040	1,886,636
		Trade and other receivables	171,914	–
		Trade payables and other current liabilities	–	142,536
San Miguel International, Ltd.	Affiliate	Purchases	71,835	35,118
		Trade payables and other current liabilities	29,073	61,530
SMC Stock Transfer Service Corporation	Affiliate	Trade and other receivables	71	61
Anchor Insurance Brokerage Corporation	Affiliate	Purchases	1,837	10,411
		Trade payables and other current liabilities	528	2,080
Ginebra San Miguel, Inc.	Affiliate	Sales	764	908
		Trade and other receivables	13,678	20,110

* SGVMC209116 *

Name of Company	Relationship	Nature of Transactions/ Outstanding Accounts	2006	2005
Monterey	Associate	Sales	₱2,520,102	₱2,271,300
		Purchases	448,715	381,612
		Trade and other receivables	438,920	287,359
		Current portion of long-term installment payables	1,108	989
		Long-term installment payable	78,828	79,935
		Rightpak International Corporation*	Affiliate	Purchases
		Trade payables and other current liabilities	–	13,253
San Miguel Rengo Packaging Corporation	Affiliate	Purchases	217,645	173,786
		Trade payables and other current liabilities	61,065	50,897
SMCC	Affiliate	Trade and other receivables	1	123
		Current portion of long-term installment payables	–	6,544
San Miguel Properties, Inc.	Affiliate	Purchases	225	–
		Noncurrent receivables	4,935	4,935
		Trade payable and other current liabilities	54	1,125
SMC Shipping and Lighterage Corporation	Affiliate	Purchases	15,307	13,901
		Trade payables and other current liabilities	368,111	228,795
SMITS, Inc.	Affiliate	Sales	174	271
		Purchases	9,022	1,843
		Trade payables and other current liabilities	36,417	30,187
SDI	Affiliate	Purchases	176,497	–
		Trade payables and other current liabilities	32,634	82,393
Challenger Aero Air Corp.	Affiliate	Trade and other receivables	5	5
San Miguel Packaging Specialists, Inc. (SMPSI)	Affiliate	Trade and other receivables**	–	68
		Purchases	215,299	–
		Trade payables and other current liabilities	99,004	–
ArchEn Technologies, Inc.	Affiliate	Purchases	217	54
		Trade payables and other current liabilities	2,640	40
San Miguel Yamamura Asia Corporation	Affiliate	Purchases	21,116	16,510
		Trade payables and other current liabilities	3,272	2,990
SM Bulk Water Company, Inc.	Affiliate	Purchases	488	–
		Trade payables and other current liabilities	36	–
SM Logistics Asia Corporation	Affiliate	Purchases	1,864	–
		Trade and other receivables	56	–

* Merged with SMPSI in 2006.

** Receivables from San Miguel Yamamura Ball Corporation in 2005.

Affiliates refer to companies owned by SMC.

*** SGVMC209116 ***

Several key management personnel of the Group are employees of SMC. The compensation of these key management personnel, which are charged by SMC to the Group as management fee, amounted to P58.7 million and P64.5 million in 2006 and 2005, respectively.

The compensation of the key management personnel, who are employees of the Group, are as follows:

	2006	2005	2004
Short-term employee benefits	P28,341	P66,555	P55,456
Pension benefits	2,897	16,305	12,188
Share-based payments	-	1,572	354
	P31,238	P84,432	P67,998

26. Basic Earnings Per Share

Basic EPS is computed as follows:

	2006	2005	2004
Net income attributable to equity holders of the Parent (a)	P631,577	P677,209	P346,170
Common shares issued	56,498,838	56,519,838	56,519,838
Add weighted average number of shares issued during the year	13,879,434	-	-
Less weighted average number of treasury shares acquired during the year	-	21,000	-
Weighted average number of shares (b)	70,378,272	56,498,838	56,519,838
Basic EPS (a/b)	P8.97	P11.99	P6.12

27. Operating Lease Agreements

The Group entered into various operating lease agreements. These non-cancelable leases will expire in various years. All leases include a clause to enable upward revision of the rental charge on an annual basis based on prevailing market conditions. The minimum rental payables under these operating leases as of December 31 are as follows:

	2006	2005
Within one year	P77,204	P101,941
After one year but not more than five years	156,731	147,053
After more than five years	81,541	79,206
	P315,476	P328,200

28. Financial Risk Management Objectives and Policies

The Group's principal financial instruments include nonderivative instruments such as cash and cash equivalents, investments, short-term and long-term loans and derivative instruments such as commodity options, swaps and futures and embedded currency forwards. The main purpose of these financial instruments include raising financing for the Group's operations and managing identified financial risks. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. The main risks arising from the use of financial instruments are interest rate risk, foreign exchange risk, commodity price risk, liquidity risk and credit risk.

The Group uses derivatives to manage its exposures to price risk arising from the Group's operations. It is the Group's policy to ensure that capabilities exist for active and prudent management of its financial risk. The Group does not engage in any speculative derivative transactions.

Interest Rate Risk

The Group's exposure to changes in interest rates relates primarily to the Group's notes payable (see Note 14) and long-term installment payables (see Note 25).

The Group follows a prudent policy to ensure that its exposure to fluctuations of interest rates are kept within acceptable limits.

The Group uses a mix of fixed and variable rate debt to manage interest costs.

Foreign Exchange Risk

The Group's exposure to foreign exchange risk results from its business transactions and financing arrangements denominated in foreign currencies. It is the Group's policy to ensure that capabilities exist for active but conservative management of its foreign exchange.

Information on the Group's foreign currency-denominated monetary assets and liabilities and their Philippine peso equivalents are as follows:

	2006		2005	
	U.S. Dollar	Peso Equivalent	U.S. Dollar	Peso Equivalent
Assets:				
Cash and cash equivalents	US\$1,849	₱90,656	US\$1,313	₱69,707
Short-term placements (included under "Cash and cash equivalents" account in the consolidated balance sheets)	3,005	147,335	730	38,756
Accounts receivable (included under "Trade and other receivables" account in the consolidated balance sheets)	1,319	64,671	991	52,612
Total Assets	6,173	302,662	3,034	161,075

(Forward)

* SGVMC209116 *

	2006		2005	
	U.S. Dollar	Peso Equivalent	U.S. Dollar	Peso Equivalent
Liabilities (included under "Trade payables and other current liabilities" account in the consolidated balance sheets):				
Acceptances payable	US\$1,248	₱61,189	US\$1,532	₱81,334
Trade payables	1,032	50,599	3,400	180,506
Total Liabilities	2,280	111,788	4,932	261,840
Net foreign currency -denominated assets (liabilities)	US\$3,893	₱190,874	(US\$1,898)	(₱100,765)

With the translation of these foreign currency-denominated assets and liabilities, the Group reported net foreign exchange losses (gain) amounting to ₱18.3 million and ₱14.5 million in 2006 and 2005, respectively.

Commodity Price Risk

The Group, through SMC, enters into various commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show mark-to-market losses; however, any loss in the mark-to-market positions is offset by the resulting lower physical raw material cost.

The Group uses commodity swaps, futures and options to manage the Group's exposures to volatility of prices of certain commodities such as soybean meal, wheat and fuel oil.

Liquidity Risk

Liquidity risk arises from the possibility that the Group may encounter difficulties in raising funds to meet commitments from financial instruments or that a market for derivatives may not exist in some circumstances.

The Group's objectives to manage its liquidity profile are: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

Credit Risk

Credit risk, or the risk of counterparties defaulting, is controlled by the application of credit approvals, limits and monitoring procedures. It is the Group's policy to enter into transactions with a diversity of creditworthy parties to mitigate any significant concentration of credit risk. The Group ensures that sales of products are made to customers with appropriate credit history and has internal mechanism to monitor the granting of credit and management of credit exposures. The Group has made provisions, where necessary, for potential losses on credits extended. Where appropriate, the Group obtains collateral or arranges master netting agreements.

The Group's exposure to credit risk arises from default of the counterparty with a maximum exposure equal to the carrying amount of these instruments, net of the value of collaterals, if any.

The Group has no significant concentration of credit risk with any counterparty.

Financial and Other Risk Relating to Livestock

The Group is exposed to financial risks arising from the change in cost and supply of feed ingredients and the selling price of chicken and related products, all of which are determined by constantly changing market forces of supply and demand, and other factors. The other factors include environmental regulations, weather conditions and livestock diseases for which the Group has little control. The mitigating factors are listed below.

The Group is subject to risks affecting the food industry, generally, including risks posed by food spoilage and contamination. Specifically, the fresh meat industry is regulated by environmental, health and food safety organizations and regulatory sanctions. The Group has put into place systems to monitor food safety risks throughout all stages of manufacturing and processing to mitigate these risks. Furthermore, representatives from the government regulatory agencies are present at all times during the processing of dressed chicken in all dressing plants and issue certificates accordingly. The authorities, however, may impose additional regulatory requirements that may require significant capital investment at short notice.

The Group is subject to risks relating to its ability to maintain animal health status considering that it has no control over neighboring livestock farms. Livestock health problems could adversely impact production and consumer confidence. However, the Group monitors the health of its livestock on a daily basis and proper procedures are put in place.

The livestock industry is exposed to risk associated with the supply and price of raw materials, mainly grains prices. Grain prices fluctuate depending on the harvest results. The shortage in the supply of grain will result in adverse fluctuation in the price of grain and will ultimately increase the Group's production cost. If necessary, the Group enters into forward contacts to secure the supply of raw materials at reasonable price.

29. Financial Assets and Liabilities

Fair Value of Financial Instruments

The table below presents a comparison by category of carrying amounts and fair values of the Group's financial instruments as of December 31, 2006:

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	₱2,132,281	₱2,132,281	₱1,383,923	₱1,383,923
Trade and other receivables – net	5,621,383	5,621,383	5,599,044	5,599,044
Derivative assets	148,970	148,970	240,602	240,602
Available-for-sale investments (included under "Pension and other noncurrent assets")	3,614	3,614	2,861	2,861

(Forward)

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial liabilities:				
Notes payable	₱7,027,492	₱7,027,492	₱7,464,404	₱7,464,404
Trade payables and other current liabilities	7,077,087	7,077,087	6,164,727	6,164,727
Installment payables (including current portion)	79,936	104,767	87,468	92,697
Derivative liabilities (included under trade payables and other current liabilities)	85	85	–	–

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents and Trade and other receivables. The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturity of these financial instruments.

Available-for-sale investments. The fair values of publicly traded instruments and similar investments are estimated based on the quoted market prices. For unquoted equity securities, the carrying amounts (cost less allowance for impairment) approximate fair value due to the unpredictable nature of future cash flows and lack of suitable methods of arriving at reliable fair value.

Notes payable and Trade payables and other current liabilities. The carrying amount of notes payable and trade payables and other current liabilities approximates fair value due to the relatively short-term maturity of these financial instruments.

Installment payables. The fair value of interest-bearing fixed-rate installment payables is based on the discounted value of expected future cash flows using the applicable rates for similar liability. Discount rate used is 5.6% to 8%.

Derivatives. The fair values of embedded currency forwards are calculated by reference to current forward exchange rates.

The fair values of commodity derivatives are determined based on prices obtained from the counterparties. For over the counter trades, fair values are based on standard valuation models.

Derivative Financial Instruments

The Group, through SMC, enters into various commodity derivative contracts to manage its exposure on commodity price risk. The portfolio is a mixture of instruments including swaps and options covering the Group's requirements on soybean meal, soft wheat and fuel oil.

The Group's freestanding and embedded derivative financial instruments are accounted for as hedges or transactions not designated as hedges. The table below sets out the information about the Group's derivative financial instruments and their fair values as of December 31, 2006:

	Notional Quantity (In Metric Tons)	Notional Amount	Derivative Assets	Derivative Liabilities
Derivative instruments designated as hedges -				
Cash flow hedges - Commodity options	635	US\$-	₱82*	₱-
Derivative instruments not designated as hedges:				
Freestanding - Commodity options	63,779	-	64,347	126
Embedded - Currency forwards		29,862	84,623	41
Net	64,414	US\$29,862	₱149,052	₱167

* Presented as a reduction against derivative liabilities, the amount of which is included under "Accrued expenses and other payables" account (see Note 15).

Derivative Instruments Accounted for as Hedges

Cash Flow Hedge. The Group has outstanding options (in combination with other trades) that have been entered into on its behalf by SMC to hedge fuel oil requirements in 2007. These options can be exercised at various calculation dates in 2007 with specified quantities on each calculation date. As of December 31, 2006, the notional quantity allocated to the Group is 635 metric tons. The positive fair value of these options amounted to ₱82 thousand.

Other Derivative Instruments Not Designated as Hedges

The Group enters into certain derivatives as economic hedges of certain underlying exposures. Such derivatives, which include freestanding commodity options and embedded currency forwards and options are not designated as accounting hedges. The gains or losses on these instruments are accounted for directly in the consolidated statements of income.

Freestanding Derivatives. Freestanding derivatives consist of various commodity derivatives entered into by the Group.

- Commodity Swaps

In 2006, the Group entered into swap transactions covering its freight requirements for 120 days. Under the agreement, payment is made either by the Group or its counterparty for the difference between the agreed fixed price of freight and the price based on the relevant price index. As of December 31, 2006, the Group has no outstanding swap agreements.

- Commodity Options

The Group has outstanding sold options (in combination with other trades) to hedge fuel oil requirements in 2007. These options can be exercised at various calculation dates in 2007 with specified quantities on each calculation date. As of December 31, 2006, the notional quantity allocated to the Group is 635 metric tons. The negative fair value of these options amounted to ₱126 thousand.

The Group also has outstanding structured soybean meal option with a notional quantity of 30,482 metric tons. These options have various maturity dates up to August 2007. As of December 31, 2006, the positive fair value of these options amounted to ₱58.2 million.

The Group also has outstanding sold and purchased wheat options. These options have various maturity dates up to April 2007. As of December 31, 2006, the notional quantity allocated to the Group is 32,662 metric tons. The positive fair value of these options amounted to ₱6.1 million.

Embedded Derivatives. The Group's embedded derivatives include currency forwards embedded in non-financial contracts. As of December 31, 2006, the total outstanding notional amount of such embedded currency forwards amounted to US\$29.9 million. These non-financial contracts consist mainly of foreign-currency denominated purchase orders, sales agreements and capital expenditures. As of December 31, 2006, the net positive fair value of these embedded currency forwards amounted to ₱84.58 million.

Fair Value Changes on Derivatives

The net movements in fair value changes of all derivative instruments for the periods ended December 31, 2006 and 2005 are as follows:

	2006	2005
Balance at beginning of year	₱240,602	₱10,635
Net changes in fair value of derivatives:		
Designated as accounting hedges	(156,314)	144,869
Not designated as accounting hedges	219,643	111,040
	303,931	266,544
Less fair value of settled instruments	155,046	25,942
Balance at end of year	₱148,885	₱240,602

Hedge Effectiveness Results. For the year ended December 31, 2006, the effective fair value changes on the Group's cash flow hedges that were deferred in equity, net of tax, amounted to ₱102.1 thousand. There were no ineffective marked-to-market values for the year ended December 31, 2006.

Cumulative Translation Adjustments

The net movement in the cumulative translation adjustments pertaining to cashflow hedges for the years ended December 31, 2006 and 2005 are as follows:

	2006	2005
Balance at beginning of year	₱57	(₱1)
Changes in fair value of cash flow hedges	(157,042)	(80,973)
Transferred to income and expenses and cost basis adjustment	156,878	81,062
Tax effects of items transferred from equity	58	(31)
Balance at end of year	(₱49)	₱57

30. Employee Stock Purchase Plan

All permanent employees of SMC and subsidiaries who have been employed for a continuous period of one year prior to the subscription period may subscribe to the Plan. The rights will vest if the employee remains in service for a period of two years from the exercise date. Prepayments are not allowed within two years from the exercise date except in cases specifically allowed under the Plan. A participant is also allowed to withdraw and cancel his subscription within two years from the exercise date subject to specific conditions under the Plan. The exercise price is based on average market price over three months immediately preceding the application less 15% discount. The vesting period is two years and there are no cash settlement alternatives.

The table below illustrates the number and weighted average exercise prices of grants:

	2006		2005	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Class A:				
Granted during the year	381,700	64.34	210,650	61.74
Cancelled during the year	2,500	62.50	1,000	66.50
Class B -				
Granted	245,000	76.38	580,500	90.90
Cancelled during the year	3,500	78.71	500	94.50

The exercise price for Class "A" shares ranges from P56.50 to P67.50 in 2006 and P56.18 to P66.50 in 2005 while that for Class "B" shares ranges from P73.00 to P94.50 in 2006 and P68.50 to P94.50 in 2005.

The average contractual life of the grants is 1.24 years and 0.71 year as of December 31, 2006 and 2005, respectively, for Class "A" shares and 0.89 year and 1.35 years as of December 31, 2006 and 2005, respectively, for Class "B" shares.

Expenses for share-based payments, charged to operations under "administrative expenses" account, amounted to P7.8 million and P10.0 million in 2006 and 2005, respectively.

31. Other Matters

a. Toll Agreements

The significant subsidiaries are into toll processing with various contract growers, breeders, contractors and processing plant operators (collectively referred to as "the Parties"). The terms of the agreements, among others, include the following:

- The Parties have the qualifications to provide the contracted services and have the necessary manpower, facilities and equipment to perform the services contracted.

- Tolling fees paid to the Parties are based on the agreed rate per acceptable output or processed product. The fees are normally subject to review in cases of changes in costs, volume and other factors.
- The period of the agreement varies. Negotiations for the renewal of any agreement generally commence six months before expiry date.

Total tolling expenses in 2006, 2005 and 2004 amounted to ₱2.2 billion, ₱2.1 billion, and ₱1.9 billion, respectively.

b. Contingencies

The Group is a party to certain lawsuits or claims (mostly labor related cases) filed by third parties which are either pending decision by the courts or are subject of settlement agreements. The outcome of these lawsuits or claims cannot be presently determined. In the opinion of management and its legal counsel, the eventual liability from these lawsuits or claims, if any, will not have a material effect on the Group's consolidated financial statements.

c. Commitments

The outstanding capital and purchase commitments as of December 31, 2006 and 2005 amounted to ₱20.0 billion and ₱25.6 billion, respectively.

d. Foreign Exchange Rates

For purposes of translating the Group's foreign currency-denominated monetary assets and liabilities, the exchange rates used were ₱49.03 to US\$1, ₱53.09 to US\$1 and ₱56.28 to US\$1 as of December 31, 2006, 2005 and 2004, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(A) Full Fiscal Year

2006 vs. 2005 GROUP PERFORMANCE

Financial Highlights

Amidst a challenging economic environment, San Miguel Pure Foods Company, Inc. and subsidiaries ("SMPFC" or the "Company") remained stable and ended 2006 on a profitable note. With sustained volume growth and better prices, the Company registered consolidated revenues of P 53 billion, an increase of 5% or P 2.5 billion versus 2005. SMPFC's core businesses reported healthy revenue increases in spite of competitive pressures. The new businesses of the Company, on the other hand, continued to grow registering double digit increases from their 2005 levels. Market leadership was sustained as SMPFC's products remained to be the preferred brands among consumers.

The growth in the Company's sales revenue turnover, combined with improved efficiencies and cost breaks in some major raw materials resulted in the 16% surge in gross profit versus last year.

Selling and administrative expenses increased by 18% largely due to higher power rates, manpower costs, distribution expenses, third party services, advertising and promotions spending for new products and operating costs of new installations and new businesses.

The increase in the monthly level of short-term money market placements explains the 20% growth in interest income.

The increase in the Company's investment in an associate, coupled with the improvement in its earnings, translated to a rise in equity in net earnings.

Other income (charges) - net increased due to the recognition of marked-to-market gains on certain financial instruments.

A subsidiary's higher taxable income, coupled with the increase in income tax rate, were the main reasons for the 12% increase in provision for income tax - current while benefit from income tax - deferred declined significantly due to a subsidiary's lower tax loss position in 2006 as against 2005.

The combined performance of subsidiaries in which SMPFC holds significant ownership declined, thus, the 7% drop in net income attributable to equity holders of the Parent.

On the other hand, net income attributable to minority interests grew by 9% versus 2005 level due to the better combined performances of subsidiaries where minority stockholders hold stake.

Financial Position

Although the volatile economic environment continued to put pressure on our corporate profitability and balance sheet, SMPFC's financial position continued to be strong as total stockholders' equity increased from P 7.3 billion to P 8 billion and total asset base rose from P 26.7 billion to P 28 billion.

With the improvement in operating profits and effective management of working capital, the Company ended the year with cash and cash equivalents higher than last year by 54% or P 748 million and notes payable trimmed down by 6% or P 437 million.

The 38% drop in derivative assets is primarily attributed to the matured soybean meal options of the Company's subsidiary entered into in 2005.

Prepayments and other current assets grew by 42% due to the increase in the level of input and withholding taxes creditable against future tax liabilities.

The 6% growth in investments and advances represents the Company's equity share in an associate.

Property, plant and equipment - net increased from P 7.1 billion in 2005 to P 7.6 billion in 2006 mainly due to the expansion-related projects of SMFI and PF-Hormel.

Deferred tax assets grew by 7% due to the recognition of tax asset on future benefit from a subsidiary's tax loss position for the year.

Pension and other noncurrent assets increased as a result of the recognition of a tax refund by a foreign subsidiary and the accrual of refund from Meralco by some domestic subsidiaries.

Trade payables and other current liabilities went up by 15% mainly due to SMFI and PF-Hormel's capital expenditure requirements while income tax payable was 20% higher versus 2005 level due to higher taxable profit recorded by a subsidiary.

The 85% decline in the current maturities of long-term installment payables was due to final payment made by PF-Hormel to an affiliate for the trademarks acquired on installment.

Pension liability decreased by 35% due to a subsidiary's settlement of unfunded contribution to its retirement plan.

The increase in deferred tax liabilities by 8% was brought about by the recognition of tax liability on unrealized marked-to-market gains on certain financial instruments.

The reclassification of the P 850 million additional capital subscription of SMC in the Company in December 2005 from deposit for future stock subscription to capital stock and additional paid-in capital explains the movements of these capital accounts. Listing of the subscribed shares is still pending with Philippine Stock Exchange, Inc.

Cumulative translation adjustments decreased by 11% due to the appreciation of Indonesia's Rupiah against the Philippine Peso.

The 13% and 8% increase in retained earnings and minority interests in consolidated subsidiaries, respectively, are largely on account of the favorable operating results for the year.

Key Performance Indicators

The following are the major performance measures that the Company uses. Analyses are employed by comparisons and measurements based on the financial data of the periods indicated below.

KPI	December 2006	December 2005
Liquidity: Current Ratio	1.28	1.27
Solvency: Debt to Equity Ratio	1.08	1.13
Profitability: Return on Average Stockholders' Equity	7.68%	8.77%

KPI	As of December 2006	As of December 2005
Operating Efficiency: Volume Growth	6.14%	8.90%
Revenue Growth	5.04%	11.25%
Operating Margin	3.57%	3.40%

The manner by which the Company calculates the above indicators is as follows:

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities (Current + Non-current)}}{\text{Minority Interest + Stockholders' Equity}}$
Return on Average Stockholders' Equity	$\frac{\text{Net Income}}{\text{Average Stockholders' Equity}}$
Volume Growth	$\left(\frac{\text{Sum of all Businesses' Revenue at Prior Period Prices}}{\text{Prior period Net Sales}} \right) - 1$
Revenue Growth	$\left(\frac{\text{Current period Net Sales}}{\text{Prior Period Net Sales}} \right) - 1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

REVIEW OF OPERATIONS

SMFI's Poultry Business sustained its strong financial performance with revenues surpassing last year's level by 7%. Favorable supply-demand conditions prevailed throughout most of 2006 thus allowing prices to be maintained at profitable levels. In spite of the damages brought about by the successive super typhoons that hit the country and the threat of chicken imports surging in the latter part of the year, the business delivered commendable operating profit, growing by double digit from last year.

SMFI Feeds Business posted 5% growth both in volume and revenue amidst the set-backs in feeds demand caused by the risks of animal diseases and damages resulting from the effects of super typhoons. Combined with effective management of variable and fixed costs, the business delivered an operating income that exceeded last year's level by 67%.

Amidst a relatively flat market and the threat posed by the continued influx of cheaper flour imports, *San Miguel Mills, Inc.*, which now operates the Flour business of SMFI, registered a 13% growth in revenues. Operating profit, however, declined from last year due to the increasing costs of wheat and freight and higher fixed costs with the addition of a new plant and advertising and promo spending to support the launch of its new snacks line.

The Processed Meats Business under *The Purefoods-Hormel Company, Inc.* posted modest revenue growth of 1% versus last year in spite of a contracting market brought about by weak consumer spending and stiff competition. Operating income was below previous year's level due to higher cost of most of the packaging and raw materials and sharp increases in operating costs such as power, distribution expenses and other overhead related to the addition of a new plant last year.

Magnolia, Inc. registered P 4.8 billion in revenues, 14% higher than last year due to increased volumes from margarine and cheese and contribution of new products such as milk and ice cream. Cost breaks in major local and imported raw materials, on the other hand, allowed the business to register margins better than last year. Magnolia started to turn around its performance in the last quarter of 2006 as the business managed to significantly cut down its operating loss.

San Miguel Super Coffeemix Co., Inc., which is on its second year of operation, sustained its strong presence in the market with its 3-in-1 coffee mix product, San Mig Coffee, continuously gaining additional market share. Its San Mig Coffee Sugar Free, which was launch barely eight months ago, already became leader in the Sugar Free Segment. Volume and revenue of the business increased by 69% and 87%, respectively, versus 2005 level.

Great Food Solutions, the food service division of the Company, posted sales revenue of P 4.7 billion, 4% higher than last year through continuous development of new accounts. Number of outlets served went up from 4,108 in 2005 to 7,164 in 2006.

The Company's interest in *Monterey*, whose volume and revenue increased by 4% and 1%, respectively, contributed P 37.3 million to the Company's income for 2006.

(B) Full Fiscal Year

2005 vs. 2004 GROUP PERFORMANCE

Financial Highlights

San Miguel Pure Foods Company, Inc. and subsidiaries ("SMPFC" or the "Company") registered another banner year performance for 2005 as the Company's consolidated revenues surpassed the P 50 billion mark, a commendable 11% growth, or more than 5 billion-peso increase from 2004 level. Amidst a difficult political and economic environment, our core businesses again rose to the challenge and reported healthy revenue increases despite intense competitive pressure from various fronts. Market leadership was likewise sustained as SMPFC's products remained to be the preferred brands among consumers.

Cost of sales increased by 9%, correspondingly with the growth in volumes across businesses and with the significant increase in cost to produce, as major raw materials, both imported and locally-sourced such as hog, beef, milk, cheese curd, as well as canning and packaging materials, remained high.

The growth in the Company's sales revenue turnover, combined with improved margins, translated into better results for the Company, thus the 26% surge in gross profit versus 2004.

Selling and administrative expenses increased by 26% largely due to higher manpower costs, advertising and promotions spending, distribution expenses, rentals and repairs and maintenance in most of the businesses.

Interest expense grew by 7% due to higher consolidated average monthly loan levels during the first three quarters of 2005 while the 22% improvement in interest income is attributed mainly to yields on short-term money market placements.

Equity in net earnings dropped by 80% mainly as a result of the decrease in earnings of an affiliate.

Other income (charges) - net registered a complete turnaround in 2005 mainly due to the first-time recognition of marked-to-market gains on certain financial instruments following the Company's adoption of Philippine Accounting Standards (PAS) 39, Financial Instruments: Recognition and Measurement effective January 1, 2005.

Provision for income tax - current substantially increased largely due to SMFI's higher taxable income registered in 2005 versus 2004 while benefit from income tax deferred grew significantly due to a subsidiary's tax loss position in 2005.

Net income, including the impact of P & L adjustments amounting to P 25 million - net as a result of the adoption of new accounting standards in 2005, surpassed 2004's level by 80% and this was primarily a result of the higher volumes across businesses, the strong rebound by SMFI's Poultry and Feeds businesses and the sustained favorable performance delivered by SMFI's Flour business. Share of equity holders and minority interest in the net income thus increased by 96% and 55%, respectively.

Financial Position

The favorable operating results achieved were likewise reflected in the Company's balance sheet. Financial position remained strong as total stockholders equity increased from P 10.7 billion to P 12.5 billion or a growth of about 18% while total asset base rose from P 25.5 billion to P 26.7 billion.

Cash and cash equivalents, as well as Notes payable, decreased by 43% and 14%, respectively primarily due to reduction in SMFI's short-term borrowings.

The increase in SMPFC's inventory level and trade payables and other current liabilities by 18% and 9%, respectively, is a result of a business' strategy to engage in protective bookings and advanced buying of imported raw materials.

Biological assets, a new account introduced in the Company's balance sheet with the adoption of PAS 41, decreased by 16% due to the decrease in the cost of SMFI Poultry Business' growing stocks and goods in process. Prior to PAS 41, growing stocks and goods in process of the Company are grouped under inventories while breeding stocks are reported as noncurrent assets.

SMPFC's adoption of PAS 39 resulted in the recognition of derivative assets amounting to P 241 million, a significant portion of which came from SMFI - Feeds Business' purchase of soybean meal options and the effect of subsequent restatements at fair value. These options are yet to expire or without physical deliveries as of year-end December 2005. Prior to PAS 39, options were either recorded only when there are physical deliveries or as prepaid expense in cases where there are payments involved. Derivative assets were also recognized from marked-to-market valuation of commitments under purchase orders that are to be settled using 3rd currencies.

Prepayments and other current assets decreased by 23% due to the reclassification of payments/advances related to hedging transactions from prepaid expenses to derivative assets.

Investments and advances increased by 51% due to SMPFC's deposit for the acquisition of additional shares in Monterey for P 200 million.

With the Company's adoption of PAS 40 on Investment Properties, land and buildings held to earn rentals and /or for capital appreciation that used to form part of property, plant & equipment, are now shown separately under the new account "investment properties." The 13% increase in 2005 is attributed to the additional investment properties of SMFI during the year.

Property, plant and equipment - net increased from P 6.4 billion in 2004 to P 7.1 billion in 2005 due to the expansion-related projects of SMFI, PF-Hormel and Magnolia.

PF-Hormel's acquisition of SAP software and license and SMFI's cost of SAP reconfiguration were the main factors for the 12% surge in goodwill and intangible assets - net.

Deferred tax assets grew substantially from P 249 million in 2004 to P 597 million in 2005 mainly due to the recognition of tax asset on future benefit from a subsidiary's tax loss position for the year.

Pension and other noncurrent assets dropped by 43% as a result of the reclassification of certain properties to property, plant & equipment and reclassification of the deposits made for the acquisition of a property to receivables.

The 83% growth in pension liability, which is a new account introduced in the Company's balance sheet with the adoption of PAS 19, was the result of the change in the measurement of pension benefits under the Company's defined noncontributory plans.

The 100% drop in the current maturities of long-term debt was due to SMFI's settlement of maturing amortization during the year while the 49% decline in the current maturities of long-term installment payables was due to payments made by PF-Hormel to affiliates for the land and trademarks acquired on installment.

On the other hand, the decrease in long-term installment payables - net of current portion in the amount of P 7.5 million was merely due to reclassification from non-current to current status.

Deferred tax liabilities increased due to the recognition of tax liability on unrealized marked-to-market gains on certain financial instruments.

SMC's additional capital infusion of P 850 million to the Company in December 2005 led to the recognition of deposit for future stock subscription, pending SEC approval of the amendment to the SMPFC's articles of incorporation.

Cumulative translation adjustments grew by 46% due to the depreciation of Indonesia's Rupiah against the Philippine Peso.

The 16% and 8% increase in retained earnings and minority interests in consolidated subsidiaries, respectively, is largely on account of the favorable P & L results in 2005.

Key Performance Indicators

The following are the major performance measures that the Company uses. Analyses are employed by comparisons and measurements based on the financial data of the periods indicated below.

KPI	December 2005	December 2004
Liquidity: Current Ratio	1.27	1.19
Solvency: Debt to Equity Ratio	1.13	1.38
Profitability: Return on Average Stockholders' Equity	8.77%	5.47%

KPI	As of December 2005	As of December 2004
Operating Efficiency: Volume Growth	8.90%	10.11%
Revenue Growth	11.25%	24.22%
Operating Margin	3.40%	3.08%

The manner by which the Company calculates the above indicators is as follows:

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities (Current + Non-current)}}{\text{Minority Interest + Stockholders' Equity}}$
Return on Average Stockholders' Equity	$\frac{\text{Net Income}}{\text{Average Stockholders' Equity}}$
Volume Growth	$\left(\frac{\text{Sum of all Businesses' Revenue at Prior Period Prices}}{\text{Prior period Net Sales}} \right) - 1$
Revenue Growth	$\left(\frac{\text{Current period Net Sales}}{\text{Prior Period Net Sales}} \right) - 1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

REVIEW OF OPERATIONS

SMFI's Poultry Business posted a 7% revenue increase from 2004 and remained to be the biggest contributor to SMPFC's revenue. Favorable supply-demand conditions and improved operational efficiencies, coupled with good selling prices, enabled the business to register remarkable operating profits. This performance is a record-high for the business and a remarkable contrast from the lackluster performance in 2004.

Amidst the stiff competition and the contraction in the hog industry brought about by high cost of feeds, limited piglet supply and threat of various animal diseases, revenue of **SMFI Feeds Business** grew by 11% to P 13.9 Billion driven by its 13% volume growth. Operating profits of the business surpassed income generated in 2004 by 44%.

SMFI's Flour Business sustained its profitable performance generating a modest volume growth of 2% in spite of a relatively flat industry growth. Better and more stable prices enabled the business to register revenue of P 5.3 billion, 5% higher than 2004. Variable costs likewise improved with wheat and FTH cost per metric ton averaging lower compared to 2004 levels. Although fixed costs increased due to expansion-related depreciation, favorable margins enabled the business to deliver operating income that is 14% higher than 2004.

The Purefoods-Hormel Company, Inc. registered another banner year in terms of volume and revenues. Amidst strong competition and unfavorable market conditions, the business exhibited resilience and managed to register double-digit sales volume and revenue growths of 14% and 17%, respectively. Operating income however, declined from 2004 due to further increases in raw material prices and higher fixed costs spending, majority of which are plant-expansion related.

Magnolia, Inc. posted P 4.2 billion in revenues, 15% higher than 2004 partly on account of the contribution of new products such as milk and ice cream. Combined effects, however, of factors like tight global supply of strategic raw materials which led to further increase in raw material costs, constraint in upward pricing and increase in fixed costs due to expansion-related expenses prevented the business from achieving its profitability target.

The coffee joint venture business under **San Miguel Super Coffeemix Co., Inc.**, whose San Mig Coffee products were launched in the market early part of 2004, has already captured a commendable market share. A manifestation of such widening market acceptance was the 2005 National Product Excellence Award given to San Mig Coffee by the National Council for Product and Service Quality in September for being the best instant 3-in-1 coffeemix.

Operating profits of **Great Food Solutions**, the food service division of the Company and which also operates the Smokey's franchise, grew by more than 4 times versus 2004 due to the transfer of the commissary operations of Monterey sometime in February. Number of outlets served increased from 3,961 in 2004 to 4,108 in 2005. Smokey's outlets opened in 2005 was recorded at 46, bringing the total number to 103 by the end of 2005.

The Company's interest in **Monterey**, whose volume and revenue increased by 3% and 6%, respectively, contributed P 13.8 million to the Company's income for 2005.

Philippine Nutrition Technologies Inc., the Company's joint venture operation with Taiwan-based Great Wall Group for the manufacture of feed supplements and feed rations for young animals, ceased commercial operations starting October 1, 2005 by virtue of the approved resolution of its board of directors shortening the corporate term up to September 30, 2005.

Other Matters

Except for the Processed Meats and Dairy businesses which consistently earn more revenues during the Christmas holiday season, the effect of seasonality or cyclicity on the operations of the Company's other businesses is not material.

There were no known events that will trigger direct or contingent financial obligation that is material to the Company, including any default or acceleration of an obligation, except for Note 31 (b) of the Consolidated Financial Statements.

There are no material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationship of the Company with unconsolidated entities or other persons created during the reporting period.