Annex B of SEC Form 17-Q for the period ended June 30, 2018 of San Miguel Food and Beverage, Inc. as filed with the Securities and Exchange Commission on August 14, 2018

Annex "B"

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND FINANCIAL PERFORMANCE

INTRODUCTION

The following discussion should be read in conjunction with the attached unaudited condensed consolidated interim financial statements of San Miguel Food and Beverage, Inc. (SMFB or "the Company", formerly San Miguel Pure Foods Company Inc. or SMPFC) and its subsidiaries (collectively, referred to as the "Group") as at and for the period ended June 30, 2018 (with comparative figures as at December 31, 2017 and for the period ended June 30, 2017). All necessary adjustments to present fairly the unaudited condensed consolidated interim financial position, financial performance and cash flows of the Group as at June 30, 2018, and for all the other periods presented, have been made. Certain information and footnote disclosures normally included in the audited consolidated financial statements prepared in accordance with the Philippine Financial Reporting Standards have been omitted.

Operating Segments
The Group has three primary operating segments, namely, the Beer and Non-alcoholic Beverages (NAB) segment, the Spirits segment and the Food segment.

The Beer and NAB segment is engaged in the production, marketing and selling of fermented, malt-based and non-alcoholic beverages within the Philippines and several foreign markets.

The Spirits segment is engaged in the production of hard liquor in the form of gin, Chinese wine, brandy, rum, vodka and other hard liquor variants which are available nationwide, while some are exported to select countries.

The Food segment is engaged in (i) the processing and marketing of branded value-added refrigerated processed meats and canned meat products, manufacturing and marketing of butter, margarine, cheese, milk, ice cream, jelly-based snacks and desserts, specialty oils, salad aids, snacks and condiments, marketing of flour mixes and the importation and marketing of coffee and coffee-related products; (ii) the production and sale of feeds; (iii) the poultry and livestock farming, processing and selling of poultry and fresh meats; and (iv) the milling, production and marketing of flour and bakery ingredients, grain terminal handling, food services, franchising and international operations.

I. MAJOR DEVELOPMENTS

Reporting Entity
As discussed in the Company's Audited Consolidated Financial Statements as at December 31, 2017 and 2016, and for each of the three years in the period ended December 31, 2017, the Board of Directors (BOD) of San Miguel Corporation (SMC, the intermediate Parent Company of SMPFC) approved on November 3, 2017 the internal restructuring of the San Miguel Group of Companies to consolidate its food and beverage businesses under SMPFC. To implement such consolidation, SMC will transfer all of its 7,859,319,270 common shares in San Miguel Brewery Inc. (SMB) and all of its 216,972,000 common shares in Ginebra San Miguel, Inc. (GSMI) (collectively, the "Exchange Shares") to SMPFC. In consideration for the Exchange Shares, SMPFC will issue 4,242,549,130 new common shares (the "New Shares") to SMC.

In this connection, the following corporate actions were approved by the BOD of SMPFC on November 3, 2017: (a) amendments to the Articles of Incorporation to change/expand the primary purpose of SMPFC to include the beverage business and accordingly change its corporate name from "San Miguel Pure Foods Company Inc." to "San Miguel Food and Beverage, Inc.", reduce the par value of SMPFC common shares from P10.00 per share to P1.00 per share, and deny pre-emptive rights for issuances or dispositions of all common shares (collectively, the "First Amendments"); (b) upon approval by the Securities and Exchange Commission (SEC) of the First Amendments, the increase in SMPFC's authorized capital stock by P9,540,000,000.00 divided into 9,540,000,000 common shares with a par value of P1.00 per share, and the amendment to the Articles of Incorporation to reflect such increase (the "Increase"); (c) the acquisition of the Exchange Shares from SMC and the issuance by SMPFC of New Shares to SMC from the Increase, as consideration for the Exchange Shares; (d) the tender offer for SMB and GSMI shares held by minority shareholders, if required; and (e) the listing on the Philippine Stock Exchange(PSE) of the additional shares resulting from the reduction of par value of common shares and the New Shares to be issued to SMC.

On January 18, 2018, the stockholders of the Company, in its special stockholders meeting, approved the foregoing corporate actions.

On March 14, 2018, the following amendments to the By-laws of the Company were approved by the BOD of SMPFC: (i) the change in corporate name of the Company to "San Miguel Food and Beverage, Inc." in the Title of the By-laws; (ii) the change in Official Seal of the Company to reflect the said new corporate name in Article XI of the By-laws; and (iii) the disqualification for director in the Company to the effect that persons engaged in any business that competes with or is antagonistic to that of SMFB are disqualified from sitting in the Board of Directors of the Company, in Article II, Section 1 of the By-laws (collectively, the "Corporate Name Related Amendments").

On March 23, 2018, the SEC approved the First Amendments to the Articles of Incorporation of the Company.

On April 5, 2018, SMC and SMFB signed the Deed of Exchange of Shares pursuant to which SMC will transfer to SMFB the Exchange Shares at the total transfer value of P336,349 million. As consideration for its acquisition of the Exchange Shares, SMFB shall issue unto SMC the New Shares which will be taken out of the Increase. As such, the issuance of the New Shares to SMC and the transfer of the Exchange Shares to SMFB was conditioned upon the approval by the SEC of the Increase.

On May 11, 2018, the stockholders of SMFB, in its regular stockholders meeting, approved the (i) amendments to the By-laws of the Company to reflect the Corporate Name Related Amendments, and (ii) delegation to management of the authority previously approved by the BOD on March 14, 2018, to sign, execute and deliver all documents on behalf of SMFB, as well as to take all other actions in order for SMFB to comply with the minimum public ownership requirement of the SEC and PSE for publicly listed companies, including the offer and issuance of new common shares to the public.

On June 18, 2018, the SEC approved the Corporate Name Related Amendments to the By-laws of the Company.

On June 29, 2018, the SEC approved the Increase by virtue of the issuance to SMFB of the Certificate of Approval of Increase of Capital Stock and Certificate of Filing of Amended Articles of Incorporation. As a result of the approval of the Increase, which involved the issuance by the Company of the New Shares to SMC in consideration for the Exchange Shares, the consolidation of the food and beverage businesses of SMC under SMFB was completed.

With the approval of the increase in the authorized capital stock of SMFB, the SEC consequently accepted and approved the transfer value of the Exchange Shares amounting to P336,349 million, the investment value of SMFB in SMB and GSMI.

As the issuance of the New Shares resulted in SMFB's public ownership level falling below the minimum ten percent (10%) requirement under the PSE's Amended Rule on Minimum Public Ownership ("MPO Rule"), the PSE suspended the trading of SMFB's common and preferred shares (collectively, the "FB Shares") commencing July 6, 2018 and until the Company is able to secure a favorable ruling/opinion from the Bureau of Internal Revenue (BIR) on the appropriate taxes to be imposed on the trades of FB Shares through the PSE during the period not exceeding six months (the "MPO Exemption Period").

On July 20, 2018, SMFB received BIR Ruling No. 1092-2018, granting temporary exemption from the MPO Rule and states that the share swap and the follow-on offer of common shares and all trades of FB Shares through the PSE during the MPO Exemption Period are not subject to capital gains tax of 15% under of Revenue Regulations (RR) No.16-2012 as amended by RR No. 11-2018 (TRAIN Law), and that the stock transaction tax at the rate of six-tenths of one percent (6/10 of 1%) shall be imposed on all trades through the PSE of FB Shares during the same period. The temporary exemption is effective until December 31, 2018.

On July 23, 2018, the PSE lifted the trading suspension of FB Shares.

Food segment
On February 6, 2018, the BOD and shareholders of San Miguel Super Coffeemix Co. Inc. (SMSCCI) ratified, among others, the increase in SMSCCI's authorized capital stock from P500.0 million, consisting of 50,000,000 million common shares at a par value of 10.00 per share, to 1,000 million, consisting of 100,000,000 million common shares at the same par value, as previously approved by the BOD and shareholders of SMSCCI on December 14, 2016.

On May 30, 2018, the SEC issued the Certificate of Approval of Increase of Capital Stock and Certificate of Filing of Amended Articles of Incorporation approving, among others, the increase in SMSCCI's authorized capital stock.

II. FINANCIAL PERFORMANCE

(Amounts exclude inter-segment transactions)

Six months ended June 30, 2018 compared to six months ended June 30, 2017

The Group continued its robust growth in the market which resulted to a strong financial performance for the first half of 2018.

The consolidated sales for the six months ended June 30, 2018 amounted to P137,441 million, 15.4% higher compared to the same period last year. Food, Beer and NAB and Sprits increased their sales volume during the first half of the year. The consolidated net income amounted P15,370 million, 20.0% higher than last year, which is mainly attributed to higher sales volume and gross margin across all segment of the Group.

Sales
Our consolidated sales increased by 15.4% from P119,130 million for the six months ended June 30, 2017 to P137,441 million for the six months ended June 30, 2018. This increase resulted from the increase in sales in our Beer and NAB, Spirits, and Food segments.

Beer and NAB
Sales in our Beer and NAB segment increased by 17.8% from P53,060 million for the six months ended June 30, 2017 to P62,509 million for the six months ended June 30, 2018. This increase was primarily due to the 10.4% increase in volume driven by strong market demand and effective marketing campaigns. Increase in price implemented in October 2017 for domestic operations also resulted to the increase in sales.

Spirits
Sales in our Spirits segment increased by 19.0% from P10,123 million for the six months ended June 30, 2017 to P12,046 million for the six months ended June 30, 2018. This increase was primarily due to increase in sales volume of core brands Ginebra San Miguel and Vino Kulafu by 18% driven by effective marketing campaigns.

Food
Sales in our Food segment increased by 12.4% from P55,947 million for the six months ended June 30, 2017 to P62,886 million for the six months ended June 30, 2018 mainly on account of the 10.1% volume growth and better selling prices. This growth was primarily due to the strong performance of the Feeds, Poultry and Fresh Meats and Branded Value-Added businesses. Poultry and Fresh Meats business posted revenue and volume growth of 10.9% and 8.1%, respectively, while Feeds business posted revenue growth of 15.9% driven by the 15.1% volume growth which was augmented by the additional capacity coming from the newly built feedmill. On the other hand, Branded Value-Added business posted revenue growth of 14.4% driven by the 13.1% volume growth coming from the fast-growing mid-priced processed meat products, chicken nuggets, butter and cheese, supported by effective sales and marketing activities. Revenues of the flour milling business increased by 6.5% mainly on account of the increase in revenues of the grain terminal operations.

Cost of Sales
Our consolidated cost of sales increased by 15.5% from P80,152 million for the six months ended June 30, 2017 to P92,608 million for the six months ended June 30, 2018. This increase was primarily

due to the increase in volume across all segments and increase in prices of raw materials, particularly in feeds, dairy and processed meats and higher excise taxes for our beer and Spirits products.

The table summarizes the cost of sales for the six months ended June 30, 2018:

	Beer and NAB	Spirits	Food	Total
Inventories	P6,039	P4,371	P43,046	P53,456
Excise tax	25,297	3,741	-	29,038
Labor	830	142	724	1,696
Others	2,533	685	5,200	8,418
	P34,699	P8,939	P48,970	P92,608

Beer and NAB

Cost of sales in our Beer and NAB segment increased by 16.1% from P29,880 million for the six months ended June 30, 2017 to P34,699 million for the six months ended June 30, 2018. The increase was primarily due to the increase in sales volume and increase in excise taxes of domestic operations.

Spirits

Cost of sales in our Spirits segment increased by 18.1% from P7,569 million for the six months ended June 30, 2017 to P8,939 million for the six months ended June 30, 2018. The increase was primarily due to the increase in sales volume of core brands and increase in excise taxes.

Food

Cost of sales in our Food segment increased by 14.7% from P42,703 million for the six months ended June 30, 2017 to P48,970 million for the six months ended June 30, 2018 mainly due to the 10.1% increase in volume and generally higher cost of major raw materials, particularly in Feeds, Dairy and Processed Meats businesses, as well as increase in fixed production expenses such as personnel expenses, plant repairs and maintenance, and amortization of breeder stocks.

<u>Gross profit and margin</u>

Our consolidated gross profit increased by 15.0% from P38,978 million for the six months ended June 30, 2017 to P44,833 million for the six months ended June 30, 2018. This increase resulted from the increase in sales in our Beer and NAB, Spirits, and Food segments.

Beer and NAB

Gross profit increased by 20.0% from P23,180 million for the six months ended June 30, 2017 to P27,810 million for the six months ended June 30, 2018. Gross margin slightly improved by 0.8% from 43.7% in the first half of 2017 to 44.5% in the same period in 2018. The price increase implemented in October 2017 cushioned the impact of the increase in excise taxes in domestic operations.

Spirits

Gross profit increased by 21.7% from P2,554 million for the six months ended June 30, 2017 to P3,107 million for the six months ended June 30, 2018. Gross margin increased by 0.6% from 25.2% in the first half of 2017 to 25.8% in the same period in 2018. Margin have been relatively stable resulting from efficiencies in distillery operations, usage of economically-priced alcohol and some price increase that mitigated the incremental costs from increase in raw materials, excise tax and other costs.

Food

Gross profit increased by 5.1% from P13,244 million for the six months ended June 30, 2017 to P13,916 million for the six months ended June 30, 2018. This was driven by higher revenues and improved operational efficiencies in farms. Gross margin, however, decreased by 1.6% from 23.7% in the first half of 2017 to 22.1% in the same period in 2018 due to margin squeeze brought about by the double-digit increases in major raw material costs of feeds, processed and dairy products which were not sufficiently covered by selling price increases.

<u>Selling and Administrative Expenses</u>

Our consolidated selling and administrative expenses increased by 10.1% from P19,923 million for the six months ended June 30, 2017 to P21,944 million for the six months ended June 30, 2018. This increase was primarily due to the increase in personnel, logistics and contracted services costs. Our selling and administrative expenses generally tend to increase as we expand our market penetration and share.

Beer and NAB

Selling and administrative expenses in our Beer and NAB segment increased by 14.9% from P9,136 million for the six months ended June 30, 2017 to P10,495 million for the six months ended June 30, 2018. Distribution and contracted services costs increased from P1,603 million in the first semester of 2017 to P1,995 million in the same period in 2018 due to higher sales volume for domestic operations. Advertising and promotions is higher by 24.2% in the second quarter of 2018 versus same period last year owing to relevant marketing campaigns and trade and consumer promotions launched to further strengthen the brand's equity. Meanwhile, personnel expenses also increased by 5.9% due to annual salary increases.

Spirits

Selling and administrative expenses in our Spirits segment increased by 12.1% from P2,003 million for the six months ended June 30, 2017 to P2,245 million for the six months ended June 30, 2018. The increase was primarily due to higher personnel expenses by 5.6% and increase in repair and maintenance costs by 130%.

Food

Selling and administrative expenses in our Food segment increased by 4.8% from P8,784 million for the six months ended June 30, 2017 to P9,204 million for the six months ended June 30, 2018. The increase was mainly due to 14.2% increase in logistics costs from P4,271 million for the six months ended June 30, 2017 to P4,877 million for the six months ended June 30, 2018. The Food segment's effort to expand distribution coverage and improve customer servicing resulted in higher warehouse rental, trucking and other related services. Increase in trucking rates, brought about by rising fuel cost, likewise contributed to the increase in logistics costs

Interest Expense and Other Financing Charges

Our consolidated interest expense and other financing charges decreased by 4.2% from P1,372 million for the six months ended June 30, 2017 to P1,314 million for the six months ended June 30, 2018. This decrease was primarily due to the redemption of the Series D bonds in April 2017 of our Beer and NAB segment in the amount of P3,000 million.

Interest Income

Our consolidated interest income increased by 71.6% from P317 million for the six months ended June 30, 2017 to P544 million for the six months ended June 30, 2018. This increase was primarily due to higher average level of money market placements of the Beer and NAB segment but was partially offset by the decline in the average level of money market placements of the Food segment.

Equity in Net Losses of Joint Ventures

Our consolidated equity in net losses of joint ventures increased by 34.1% from P41 million for the six months ended June 30, 2017 to P55 million for the six months ended June 30, 2018. This increase was due to the share in net losses recognized during the period.

Gain on Sale of Investments and Property and Equipment

Our consolidated gain on sale of investments and property and equipment decreased by 75.0% from P12 million for the six months ended June 30, 2017 to P3 million for the six months ended June 30, 2018. This decrease was primarily due to lesser disposal of assets of the Food and Beer and NAB segments during the year.

Other Income (Charges) - Net

Our consolidated other income (charges) - net decreased from P42 million other income-net for the period ended June 30, 2017 to P203 million other charges-net for the six months ended June 30, 2018. Other charges in 2018 was primarily due to higher marked-to-market losses on importations on account of Philippine peso depreciation against other foreign currencies of the Food and Beer and NAB segments.

Net Income before Income Tax
As a result of the foregoing, our consolidated net income before income tax increased by 21.4% from P18,013 million for the six months ended June 30, 2017 to P21,864 million for the six months ended June 30, 2018.

Income Tax Expense
Our income tax expense increased by 24.7% from P5,208 million for the six months ended June 30, 2017 to P6,494 million for the six months ended June 30, 2018. This increase was primarily due to the higher current income tax expense resulting from the increase in consolidated taxable income.

Net Income
As a result of the foregoing, our consolidated net income increased by 20.0% from P12,805 million for the six months ended June 30, 2017 to P15,370 million for the six months ended June 30, 2018. Net income of the Beer and NAB segment increased by 25.6% from P9,400 million in 2017 to P11,803 million in 2018, net income of the Spirits segment increased by 90.9% from P265 million in 2017 to P506 million in 2018 and net income of the Food segment slightly decreased by 2.5% from P3,140 million in 2017 to P3,061 million in 2018.

The Beer and NAB segment continued to make up the majority of our net income, contributing 76.8% of total net income, while the Food and Spirits segments contributed 19.9% and 3.3%, respectively.

Net Income after Tax and Minority Interest
As a result of the foregoing, our consolidated net income after tax and minority interest increased by 16.8% from P7,929 million for the six months ended June 30, 2017 to P9,260 million for the six months ended June 30, 2018. Net income after tax and minority interest of the Beer and NAB segment increased by 25.8% from P4,706 million in 2017 to P5,919 million in 2018, net income after tax and minority interest of the Spirits segment increased by 91.1% from P180 million in 2017 to P344 million in 2018 and net income after tax and minority interest of the Food segment slightly decreased by 1.5% from P3,043 million in 2017 to P2,997 million in 2018.

Business Highlights for the period ended June 30, 2018

Food
The Food segment posted sales revenue growth of 12.4% to P62,886 million, driven by the strong performance of its Feeds, Poultry and Fresh Meats and Branded Value-Added businesses. Poultry and Fresh Meats business sustained its growth momentum with revenues exceeding last year's level on the back of higher chicken volume and better selling prices. Demand outpaced supply growth allowing the prices of chicken and fresh meats to maintain their current levels for the first half of 2018. Branded Value-Added business likewise posted revenues higher than last year's level.

Double-digit increases in major raw materials of Feeds, Processed Meats and Dairy businesses, along with increase in sales volume as well as impact of Philippine Peso depreciation, resulted in higher cost of sales by 14.7% compared to last year's level. Selling price increases were implemented, albeit insufficient to cover for the rising costs of major raw materials.

As a result, income from operations grew by 5.7% to P4,712 million for the six-month period ended June 30, 2018, from P4,460 million last year.

Beer and NAB
Domestic Beer Operations
Domestic operations' posted a sales revenue growth of 19.3% owing to a 12.9% increase in sales volume coupled with the price increase implemented in October 2017. The strong volume growth was mainly driven by robust market demand for the Beer and NAB products supported by relevant marketing campaigns and trade and consumer promotions, further strengthening its brand equity.

Cost of sales increased by 17.8% resulting from the higher sales volume and excise taxes which took effect January 1, 2018.

Income from operations increased by P3,210 million from P13,558 million last year while net income reached P11,353 million, 27.4% higher than the same period in 2017.

International Beer Operations
San Miguel Brewing International Limited's ("SMBIL") consolidated volume for the first semester of 2018 was at 961.0 thousand hectolitres, 3% lower than 2017, largely due to the decline of economy brands in the Hong Kong, Indonesia, North China and Vietnam operations.

Operating income improved by 9% at US$10.5 million as a result of favorable margins due to better sales mix (decline mostly in economy brands) as well as price increases in Indonesia, Hong Kong, Vietnam and Thailand operations, which were partly offset by unfavorable foreign exchange rates and lower volumes. Prudent fixed cost management also contributed to the improvement in operating income.

Six months ended June 30, 2017 compared to six months ended June 30, 2016

The Group sustained its growth for the first half of 2017 resulting to solid financial performance. The consolidated sales for the period ended June 30, 2017 amounted to P119,130 million, 9.4% higher compared to the same period in 2016. Food, Beer and NAB and Sprits increased their sales volume during the first half of the year. The consolidated net income amounted P12,805 million, 17.6% higher than last year, which is mainly attributed to higher sales volume and gross margin across all segment of the Group.

Sales
The consolidated sales increased by 9.4% from P108,930 million for the period ended June 30 2016 to P119,130 million of the same period in 2017.

Beer and NAB
Sales in the Beer and NAB segment increased by 12.0% from P47,396 million for the six months ended June 30, 2016 to P53,060 million of the same period in 2017. This was primarily due to increase in sales from domestic operations.

Spirits
Sales in the Spirits segment increased by 20.5% from P8,402 million for the six months ended June 30, 2016 to P10,123 million of the same period in 2017. This increase was due to the steady improvement of core brand Ginebra San Miguel.

Food
Sales in the food segment increased by 5.3% from P53,132 million for the six months ended June 30, 2016 to P55,947 million for the six months ended June 30, 2017. Poultry and Fresh Meats and Processed Meats businesses continued to deliver good performance. Higher sales volume and better selling prices of chicken and pork drove revenue growth, tempering the impact of lower basic flour's selling prices.

Cost of Sales
Consolidated cost of sales increased by 8.8% from P73,692 million for the six months ended June 30, 2016 to P80,152 million for the six months ended June 30, 2017. This increase was primarily due to the increase in volume and prices in raw materials across all segments and higher excise taxes in the beer and Spirits products.

The table summarizes the cost of sales for the six months ended June 30, 2017:

	Beer and NAB	Spirits	Food	Total
Inventories	P5,269	P3,516	P37,680	P46,465
Excise tax	21,812	3,316	-	25,128
Labor	746	108	621	1,475
Others	2,053	629	4,402	7,084
	P29,880	P7,569	P42,703	P80,152

Beer and NAB
Cost of sales in the Beer and NAB segment increased by 15.0% from P25,982 million for the six months ended June 30, 2016 to P29,880 million for the six months ended June 30, 2017. The increase was due to the increase in sales volume and higher excise taxes of domestic operations.

Spirits
Cost of sales in the Spirits segment increased by 21.7% from P6,219 million for the six months ended June 30, 2016 to P7,569 million for the six months ended June 30, 2017. The increase was primarily due to the increase in raw material prices and excise taxes despite continuous effort to manage costs.

Food
Cost of sales in the Food segment increased by 2.9% from P41,491 million for the six months ended June 30, 2016 to P42,703 million for the six months ended June 30, 2017. This was mainly due to the double-digit increase in prices of major raw materials of the Branded Value-Added business, partly cushioned by lower costs of major raw materials and improved operational efficiencies in the Feeds, Poultry and Fresh Meats businesses.

Gross profit and margin
Our consolidated gross profit increased by 10.6% from P35,238 million for the six months ended June 30, 2016 to P38,978 million for the six months ended June 30, 2017. This increase resulted primarily from the increase in sales in our Beer and NAB, Spirits, and Food segments.

Beer and NAB
Gross profit increased by 8.2% from P21,414 million for the six months ended June 30, 2016 to P23,180 million for the six months ended June 30, 2017. Gross margin decreased by 1.5% from 45.2% in the first half of 2016 to 43.7% in the same period in 2017 primarily due to higher excise tax.

Spirits
Gross profit increased by 17.0% from P2,183 million for the six months ended June 30, 2016 to P2,554 million for the six months ended June 30, 2017. Gross margin slightly declined by 0.8% from 26.0% in the first half of 2016 to 25.2% in the same period in 2017 primarily due to higher excise tax.

Food
Gross profit increased by 13.8% from P11,641 million for the six months ended June 30, 2016 to P13,244 million for the six months ended June 30, 2017. Gross margin increased by 1.8% from 21.9% in the first half of 2016 to 23.7% in the same period in 2018 due to higher sales volume and lower cost of raw materials.

Selling and Administrative Expenses
Our consolidated selling and administrative expenses increased by 6.7% from P18,673 million for the six months ended June 30, 2016 to P19,923 million for the six months ended June 30, 2017. This increase was primarily due to the increase in manpower, logistics and marketing costs.

Beer and NAB
Selling and administrative expenses in the Beer segment increased by 3.4% from P8,836 million for the six months ended June 30, 2016 to P9,136 million for the six months ended June 30, 2017. Distribution and contracted services costs as well as manpower costs in the first semester of 2017 increased by 9% over the same period in 2016 from P3,822 million to P4,165 million as a result of the 12.9% increase in domestic sales volume and the annual salary increases. Higher amortization of 31.5% resulted from the amortization of culletized bottles.

Spirits
Selling and administrative expenses in the Spirits segment increased by 11.4% from P1,798 million for the six months ended June 30, 2016 to P2,003 million for the six months ended June 30, 2017. The increase was primarily due the additional spending by 62% in advertising and promotion programs.

Food
Selling and administrative expenses in the Food segment increased by 9.3% from P8,039 million for the six months ended June 30, 2016 to P8,784 million for the six months ended June 30, 2017. The increase was primarily due to higher logistics costs. The Food segment's effort to expand distribution coverage and improve customer servicing resulted in higher warehouse rental, hauling, trucking and other related services.

Interest Expense and Other Financing Charges
Consolidated interest expense and other financing charges decreased by 7.2% from P1,479 million for the six months ended June 30, 2016 to P1,372 million for the six months ended June 30, 2017. The decrease was mainly due to the decline in short-term loan requirements and settlement of long-term obligation.

Interest Income
Consolidated interest income increased by 26.8% from P250 million for the six months ended June 30, 2016 to P317 million for the six months ended June 30, 2017. The increase was due to higher money market placements of both domestic and international operations of the Beer and NAB segment. This was tempered by the decline in the average level of money market placements and lower short-term money market interest rates of the Food segment.

Equity in Net Losses (Gains) of Joint Ventures
Consolidated equity in net losses of joint ventures decreased from P2 million equity in net gains of joint ventures for the six months ended June 30, 2016 to P41 million equity in net losses of joint ventures for the six months ended June 30, 2017. This decrease was due to the share in net losses recognized during the period.

Gain on Sale of Investments and Property and Equipment
Consolidated gain on sale of investments and property and equipment decreased by 90.3% from P124 million for the six months ended June 30, 2016 to P12 million for the six months ended June 30, 2017. This was lower in the first half of 2017, as gain from disposal of an investment property with substantial value was recorded in the same period in 2016.

Other Income (Charges) - Net
Consolidated other income (charges) - net increased from P40 million other charges-net for the period ended June 30, 2016 to P42 million other income-net for the six months ended June 30, 2017. This increase was primarily due to foreign exchange gains resulting from the appreciation of New Taiwan Dollar, Thai Baht and US Dollar from the Beer and NAB's International operations. Improvement in tolling income of the Spirits segment also contributed to the increase but was partially offset by the increase in derivative losses, brought about by the peso devaluation. Food segment also recognized impairment loss on idle assets of its foreign subsidiary.

Net Income before Income Tax
As a result of the foregoing, consolidated net income before income tax increased by 16.8% from P15,422 million for the six months ended June 30, 2016 to P18,013 million for the six months ended June 30, 2017.

Income Tax Expense
Consolidated income tax expense increased by 15.0% from P4,529 million for the six months ended June 30, 2016 to P5,208 million for the same period this year. This increase was primarily due to the higher consolidated taxable income.

Net Income
As a result of the foregoing, consolidated net income increased by 17.6% from P10,893 million for the six months ended June 30, 2016 to P12,805 million of the same period in 2017. Net income of the Beer and NAB segment increased by 13.9%% from P8,256 million in 2016 to P9,400 million in 2017, net income of the Spirits segment increased by 92.0% from P138 million in 2016 to P265 million in 2017 and net income of the Food segment increased by 25.7% from P2,499 million in 2017 to P3,140 million in 2017.

Net income across all three segments each experienced continued increase for the period. The Beer and NAB segment contributed a significant 73.4% of the total income, while the Food and Spirits segments contributed 24.5% and 2.1%, respectively.

Net Income after Tax and Minority Interest
As a result of the foregoing, consolidated net income after tax and minority interest increased by 19.0% from P6,662 million for the six months ended June 30, 2016 to P7,929 million for the six months ended June 30, 2017. Net income after tax and minority interest of the Beer and NAB segment increased by 13.5% from P4,146 million in 2016 to P4,706 million in 2017, net income after tax and minority interest of the Spirits segment increased by 71.4% from P105 million in 2016 to P180 million in 2017 and net income after tax and minority interest of the Food segment increased by 26.2% from P2,411 million in 2016 to P3,043 million in 2017.

Business Highlights for the period ended June 30, 2017

Food

The Food segment registered sales revenue growth of 5.3% to P55,947 million, as Poultry and Fresh Meats and Processed Meats businesses delivered good performance. Revenues of the Poultry and Fresh Meats business went up versus 2016 level as chicken and pork selling prices sustained uptrend given the temporary tightness in supply of broiler and fresh meats. Processed Meats business recorded revenue growth on the back of better sales mix, increased volume in all sales channels and continued market expansion. Revenue growth was tempered by the slide in basic flour selling prices brought about by the soft global wheat prices and intense industry competition.

Lower costs of major raw materials and improved operational efficiencies in the Feeds, Poultry and Fresh Meats business cushioned the impact of Philippine Peso depreciation as well as the double-digit increase in prices of major raw materials of the Branded Value-Added business, resulting in 2.9% increase in cost of sales.

With better margins and improved operational efficiencies, income from operations increased by 23.8% to P4,460 million from P3,602 million in the same period in 2016.

Beer and NAB

Domestic Beer Operations

Domestic operations posted revenues of P47,148 million, 13.2% higher than 2016, with volume growth of 9.9 million cases or a 10% increase versus 2016. The growth in sales volume was driven by relevant and consistent through-the-line campaigns, consumer and trade promos alongside favorable economic growth.

Cost of sales increased by P3,977 or 17.8% versus the same period in 2016 due to higher sales volume and excise taxes which took effect on January 1, 2017.

Driven by strong volume, income from operations grew by 10.9% to P13,558 million for the first half of 2017. Net income reached P8,911 million, 12.9% higher than the P7,895 million earned in 2016.

International Beer Operations

SMBIL's first semester consolidated volume for 2017 was at 986.7 thousand hectoliters, 5% behind 2016 primarily due to lower volumes in the Indonesia operations. The Indonesian market remains cautious following pronouncements by political parties suggesting total alcohol ban. North China operations' volumes also declined slightly due to slower offtake in Baoding City and the Blue Star brand. Hong Kong operations' volumes remained relatively flat versus 2016 with the continuation of the penetration drive in targeted trade channels. However, the volume declines were offset by the turnaround growth in domestic sales of the South China and Thailand operations, as well as the continued growth in the Vietnam operations. Export volumes also managed a 2% growth versus 2016, despite the temporary control on export shipments to selected markets, as SMBIL made improvements in its distribution system.

Despite lower volumes, 2017 first semester consolidated operating income for SMBIL was at US$9.6 million, a 28% increase versus 2016 levels due to higher margins resulting from better pricing, improved brand mix and lower variable costs.

III. FINANCIAL POSITION

(Amounts exclude inter-segment transactions)

Unaudited Financial Position as at June 30, 2018 vs Audited December 31, 2017

Consolidated total assets as of June 30, 2018 amounted to P212,040 million, P6,937 million higher than December 31, 2017. The increase was primarily due to the increase in plant, property and equipment and other noncurrent assets. Consolidated total liabilities as of June 30, 2018 amounted to P89,103 million, P1,379 million lower than last year. The decrease was primarily due to the settlement of short-term loans availed by Food and Spirits segments.

Cash and cash equivalents was slightly lower than December 31, 2017 balance as funds were used to finance ongoing expansion projects of the Food and Beer and NAB segments, as well as to pay one-time SEC filing fees in connection with the Company's increase in authorized capital stock.

Trade and other receivables decreased by 15.0% or P2,729 million due to higher collection of receivables from peak season sales, lower credit sales and continued effort to improve receivables' days level during the period for the Food and Beer and NAB segments.

Inventories increased by 9.1% or P2,574 million due to increase in purchases of finished goods, raw materials and containers in preparation for higher demand towards the second half of the year.

Current biological assets increased by 11.7% or P400 million on account of the purposive volume build-up of grown broiler to support expected higher demand for chicken for the Food segment.

Prepaid expenses and other current assets increased by 5.0% or P244 million due to higher deposit for excise tax of the domestic operations of the Beer and NAB segment but was partially offset by the utilization of input taxes and creditable withholding taxes applied against tax liabilities during the first half of 2018 of the Food segment.

Property, plant and equipment increased by 8.1% or P4,159 million mainly due to the expansion projects of the Food and Beer and NAB segments.

Other noncurrent assets increased by 15.7% or P2,162 million mainly due to domestic operations of the Beer and NAB segment's purchase of new bottles.

Notes payable decreased by 9.4% or P1,314 million mainly due to the settlement of short-term borrowings of the Spirits segment.

Dividends payable increased by 10.0% or P3 million mainly due to the unclaimed dividends payable to common stockholders of the Beer and NAB segment.

Current maturities of long-term debt increased to P12,850 million pertains to the Beer and NAB's Series C and Series E fixed rate bonds which will mature in April 2019 were reclassified from long-term debt.

Other noncurrent liabilities decreased by 5.9% or P137 million was due to payment of retirement liabilities of the Spirits segment and Food segment's reclassification of deposit for future stock subscription to non-controlling interests, following the issuance by a domestic subsidiary of shares of stock to a minority shareholder.

Consolidated total equity as of June 30, 2018 amounted to P122,937 million, P8,316 million higher than December 31, 2017. The increase was primarily due to the net income amounting to P15,370 million which was offset by the dividends declared by the Group amounting P7,578 million during the period.

Unaudited Financial Position as at June 30, 2017 vs Audited December 31, 2016

Consolidated total assets as of June 30, 2017 amounted to P188,115 million, P3,728 million higher than December 31, 2016. The increase was primarily due to the increase in plant, property and equipment. Consolidated total liabilities as of June 30, 2017 amounted to P82,381 million, P2,962 million lower than last year. The decrease was primarily due to the settlement of long-term loan availed by the Beer and NAB segment.

Cash and cash equivalents increased by 6.0% or P1,835 million mainly due to higher collection of receivables during the year of the food and Beer and NAB segments.

Trade and other receivables decreased by 24.7% or P4,630 million due to the collection of peak season sales made in December 2016 of the Food segment and the Group's continued effort to improve receivables' days level.

Inventories increased by 7.4% or P1,869 million mainly due to the increased importation of certain major raw materials for processed meats and feeds, and the intentional build-up of other major raw materials to support expected increase in volume in the second half of 2017 of the Food segment.

Current biological assets increased by 8.2% or P256 million due to increase in volume of the Food segment's grown broiler and poultry breeding stock, in anticipation of higher demand, resulted in 8.2% and 8.5% surge in current and noncurrent biological assets, respectively.

Property, plant and equipment increased by 10.5% or P4,367 million mainly due to Food segment's ongoing expansion projects.

Deferred tax assets decreased by 6.3% or P198 million due to Food segment's reversal of deferred tax asset provision and the Spirits segment's application of prior year taxes paid to current taxes due.

Notes payable decreased by 13.9% or P1,825 million mainly due to the settlement of short-term borrowings of the Food and Sprits segments.

Trade and other current liabilities increased by 8.8% or P2,374 million mainly due to higher volume of transactions with third party suppliers of the Food segment.

Income tax and other taxes payable decreased by 8.4% or P427 million mainly due to lower taxable income for the period ended June 30, 2017 compared to the year ended December 31, 2016 of the Food and Beer and NAB segments.

Dividends payable increased by 7.7% or P2 million mainly due to the unclaimed dividends payable to common stockholders of the Beer and NAB segment.

Current maturities of long-term debt decreased to P114 million was due to the Beer and NAB segment's Series D fixed rate bonds that were redeemed in April 2017.

Consolidated total equity as of June 30, 2017 amounted to P105,734 million, P6,690 million higher than December 31, 2016. The increase was primarily due to the net income amounting to P12,805 million which was offset by the dividends declared by the Group amounting P6,694 million during the period.

III. SOURCES AND USES OF CASH

A brief summary of cash flow movements is shown below:

	June 30	
	Unaudited 2018	**Unaudited 2017**
	(in Millions)	
Net cash flows provided by operating activities	P19,096	P21,589
Net cash flows used in investing activities	(10,128)	(8,274)
Net cash flows used in financing activities	(9,642)	(11,579)

Net cash from operations basically consisted of income for the period and changes in non-cash current assets, certain current liabilities and others.

Net cash used in investing activities include the following:

	June 30	
	Unaudited 2018	**Unaudited 2017**
	(in Millions)	
Additions to property, plant and equipment and investment property	(P5,254)	(P5,541)
Increase in biological assets, intangible assets and other noncurrent assets	(4,887)	(2,749)
Proceeds from sale of investments and property, plant and equipment	13	16

Net cash used in financing activities consist of the following:

	June 30	
	Unaudited 2018	**Unaudited 2017**
	(in Millions)	
Proceeds from short-term borrowings	P80,410	P99,730
Payments of short-term and long-term borrowings	(81,783)	(104,616)
Cash dividends paid	(7,577)	(6,693)
Payment of share issuance costs	(692)	-

The effect of exchange rate changes on cash and cash equivalents amounted to P582 million and P99 million for the period ended June 30, 2018 and 2017, respectively.

IV. KEY PERFORMANCE INDICATORS

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

KPI	Unaudited June 2018	Unaudited December 2017
Liquidity:		
Current Ratio	1.40	1.69
Solvency:		
Debt to Equity Ratio	0.72	0.79
Asset to Equity Ratio	1.72	1.79
Profitability:		
Return on Average Equity Attributable to Equity Holders of the Parent Company	26.90%	28.04%
Interest Rate Coverage Ratio	17.64	16.00

	Unaudited Period Ended June 2018	Unaudited Period Ended June 2017
Operating Efficiency:		
Volume Growth	10.94%	6.80%
Revenue Growth	15.37%	9.36%
Operating Margin	16.65%	16.00%

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

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities (Current + Noncurrent)}}{\text{Equity}}$
Asset to Equity Ratio	$\frac{\text{Total Assets (Current + Noncurrent)}}{\text{Equity}}$
Return on Average Equity Attributable to Equity Holders of the Parent Company	$\frac{\text{Net Income Attributable to Equity Holders of the Parent Company*}}{\text{Average Equity Attributable to Equity Holders of the Parent Company**}}$
Interest Rate Coverage Ratio	$\frac{\text{Earnings Before Interests and Taxes}}{\text{Interest Expense and Other Financing Charges}}$

KPI	Formula
Volume Growth	$\left(\frac{\text{Sum of all Businesses' Sales at Prior Period Prices}}{\text{Prior Period Net Sales}}\right) - 1$
Revenue Growth	$\left(\frac{\text{Current Period Net Sales}}{\text{Prior Period Net Sales}}\right) - 1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

* *Annualized for quarterly reporting; excluding cash dividends paid to preferred shareholders*

** *Excluding preferred capital stock and related additional paid-in capital*

Annex E of SEC Form 17-A of San Miguel Brewery Inc. as filed with the Securities and Exchange Commission on

April 16, 2018

ANNEX E

Management's Discussion and Analysis

SAN MIGUEL BREWERY INC.

A subsidiary of San Miguel Corporation

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND FINANCIAL PERFORMANCE

This discussion summarizes the significant factors affecting the consolidated financial performance, financial position and cash flows of San Miguel Brewery Inc. (SMB or the Company) and its subsidiaries (collectively referred to as the Group) for the three-year period ended December 31, 2017. The following discussion should be read in conjunction with the attached audited consolidated statements of financial position of the Group as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2017. All necessary adjustments to present fairly the Group's consolidated financial position as of December 31, 2017 and the financial performance and cash flows for the year ended December 31, 2017, and for all the other periods presented, have been made.

I. BASIS OF PREPARATION

Statement of Compliance

The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations issued by the Financial Reporting Standards Council (FRSC).

The consolidated financial statements were approved and authorized for issue in accordance with a resolution by the Board of Directors of the Company (BOD) on March 9, 2018.

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis of accounting except for the following items which are measured on an alternative basis at each reporting date:

Items	Measurement Basis
Derivative financial instruments	Fair value
Available-for-sale (AFS) financial assets	Fair value
Net defined benefit retirement asset (liability)	Fair value of the plan assets less the present value of the defined benefit retirement obligation

Functional and Presentation Currency

The consolidated financial statements are presented in Philippine peso, which is the Company's functional currency. All amounts have been rounded-off to the nearest million (000,000), unless otherwise indicated.

Significant Accounting Policies
The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards
The FRSC approved the adoption of a number of new and amended standards and interpretations as part of PFRS.

Amendments to Standards Adopted in 2017

The Group has adopted the following amendments to PFRS starting January 1, 2017 and accordingly, changed its accounting policies in the following areas:

- Disclosure initiative *(Amendments to PAS 7, Statement of Cash Flows)*. The amendments resulted in improved disclosures about the net debt of an entity relevant to the understanding of its cash flows. The amendments require entities to provide disclosures that enable users of the consolidated financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g., by providing a reconciliation between the opening and closing balances in the consolidated statements of financial position for liabilities arising from financing activities.

- Recognition of Deferred Tax Assets for Unrealized Losses (*Amendments to PAS 12, Income Taxes*). The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the consolidated financial statements.

II. KEY TRANSACTIONS

- On November 3, 2017, the BOD approved the amendment of the change of control default provision on the trust agreements covering its outstanding Series C, E and F bonds (Series CEF Bonds Trust Agreement) to align the same with the change of control default provision of the trust agreement covering the Company's Series G and H bonds (Series GH Bonds Trust Agreement). Under the Series GH Bonds Trust Agreement, a change in control of the Company occurs when San Miguel Corporation (SMC) ceases to have the ability to consolidate the Company as a subsidiary in its consolidated financial statements in accordance with the accounting principles and standards applicable to SMC then in effect.

  The amendment was made to ensure that the Series CEF Bonds Trust Agreement remain consistent with its original intended purpose that SMB continues to be under the effective control of its parent company, SMC while SMC implements its corporate reorganization. The reorganization involves the grouping of SMC's food and beverage businesses under one entity (San Miguel Pure Foods Company, Inc. to be later renamed San Miguel Food and Beverage, Inc. after corporate and regulatory approvals).

- The BOD also approved the conduct of a solicitation of the consents of the majority of the Series C, E and F bondholders of record as of November 8, 2017 for the foregoing proposed amendment to the change of control default provision under the Series CEF Bonds Trust Agreement. The Company obtained the consents of bondholders of record of its Series C bonds representing 88.28% of the outstanding aggregate principal amount of the Series C bonds, and 78.1803% of the outstanding aggregate principal amount of the Series E bonds and Series F bonds. The supplemental agreements amending the Series CEF Bonds Trust Agreement were executed by the Company and the respective trustees of the said bonds on December 19, 2017 and the consent payments were paid to the consenting bondholders of record on December 22, 2017.

III. FINANCIAL PERFORMANCE

Comparisons of key financial performance for the last three years are summarized in the following tables.

	Years Ended December 31		
(in Millions)	**2017**	2016	2015
Sales	**₱ 113,255**	₱ 97,160	₱ 82,374
Gross Profit	**50,281**	44,851	37,563
Selling and Administrative Expenses	**(19,120)**	(17,663)	(14,932)
Operating Income	**31,161**	27,188	22,631
Net Income	**20,711**	17,658	13,518
Net Income Attributable to Equity Holders of the Company	**20,178**	17,217	13,251

2017 vs. 2016

The Group continued to deliver outstanding performance in 2017, surpassing its record-breaking 2016 results. Consolidated sales revenue reached ₱113,255 million, 17% higher than last year mainly due to the 13% increase in volume and to a lesser extent due to the price increase implemented effective October 1, 2017 for domestic operations. Domestic operations contributed ₱100,234 million, while international operations contributed US$258.8 million or ₱13,057 million.

Cost of sales also increased by 20% to ₱62,974 million resulting from the increase in sales volume and higher excise taxes of domestic operations. Domestic operations accounted for ₱55,449 million and US$149.9 million or ₱7,561 million for international operations.

Operating expenses amounted to ₱19,120 million, an increase of 8% from 2016 due to higher personnel expenses, advertising and promotional expenses, distribution and contracted services costs. Domestic operations accounted for ₱15,068 million, while international operations accounted for US$80.4 million or ₱4,052 million.

Income from operations amounted to ₱31,161 million, 15% higher than last year. Domestic operations contributed ₱29,717 million while international operations contributed US$28.6 million or ₱1,444 million.

Interest income increased by 48% or ₱173 million mainly due to higher money market placements of both domestic and international operations.

On the other hand, interest expense and other financing charges decreased by 15% due to the redemption of the Series D bonds of the Company in April 2017.

Impairment loss of ₱534 million or US$10.5 million pertains to the impairment of San Miguel (Baoding) Brewery Co. Ltd.'s (SMBB) fixed assets.

Other income also increased by ₱56 million primarily due to the foreign exchange gains resulting from the appreciation of New Taiwan Dollar, Thai Baht and United States Dollar.

Consolidated net income for the year reached ₱20,711 million, an increase of 17% over last year's ₱17,658 million income. Domestic operations contributed ₱19,723 million while international operations contributed US$19.6 million or ₱989 million. Without the impairment, consolidated net income would have been ₱21,245 million.

Net income attributable to non-controlling interests increased by ₱92 million mainly due to the higher income of PT. Delta Djakarta Tbk. (PTD).

The operating and financial highlights of each segment are as follows:

Domestic Beer Operations

Domestic operations sustained its growth with an 18% increase in revenue, ending the year with ₱100,234 million. Sales volume reached 232.5 million cases, surpassing last year's volume by 15%. The strong volume growth was mainly driven by the country's favorable economic condition alongside with SMB's strong marketing campaigns and integrated sales initiatives.

Cost of sales increased by 23% to ₱55,449 million due to the increase in sales volume and higher excise tax rates imposed on beer products which took effect on January 1, 2017. Operating expenses likewise increased by ₱1,141 million due to higher personnel expenses, advertising and promotional expenses, distribution and contracted services costs.

With the significant increase in volumes, income from operations ended higher by 14% versus last year and net income grew by 19%, ending the year with ₱19,723 million.

International Beer Operations

San Miguel Brewing International Limited's (SMBIL) consolidated volume for year 2017 stood at 2.1 million hectolitres, slightly lower than 2016 as the growth in volumes in the SMBIL Exports, South China and Thailand operations are not enough to offset declines in the local brands in the Indonesia and North China operations. Indonesia operations' volumes continue to be challenged mainly due to market cautiousness owing to a possible total alcohol ban in Indonesia, while the purposive push of higher margins variants in the North China operations accounted for a slight dip in its economy brand variant segments. However, SMBIL continued the growth of San Miguel brands (including Red Horse) with all major brands growing versus 2016.

SMBIL's operating income in 2017 reached US$28.6 million, a 23.4% growth from last year due to improvements in the Indonesia, SMBIL Exports, South China, Hong Kong, and Vietnam operations. The Indonesia operations, despite the volume decline, benefitted from better margins owing to the price increases implemented in mid-2016. Programs have been put in place to rebuild the local brand sales in the Indonesia and North China operations as well as to sustain the continuous growth of the San Miguel brand globally.

2016 vs. 2015

2016 was a banner year for the Group, with record breaking growth in revenues, sales volume and income. Consolidated sales revenue reached ₱97,160 million, 18% higher than 2015. Domestic operations contributed ₱84,939 million, while international operations contributed US$257.9 million or ₱12,263 million.

Cost of sales also increased by 17% to ₱52,309 million resulting from the increase in sales volume and higher excise taxes of domestic operations. Domestic operations accounted for ₱44,930 million and US$156.1 million or ₱7,421 million for international operations.

Operating expenses amounted to ₱17,663 million, an increase of 18% from higher personnel expenses, advertising and promotional expenses, distribution costs and containers amortization. Domestic operations accounted for ₱13,927 million, while international operations accounted for US$78.6 million or ₱3,736 million.

Income from operations amounted to ₱27,188 million, 20% higher than 2015. Domestic operations contributed ₱26,082 million while international operations contributed US$23.1 million or ₱1,106 million.

Interest income increased by 38% or ₱100 million mainly due to higher money market placements of both domestic and international operations.

Other income also increased by ₱99 million with the higher rental income of international operations with San Miguel Brewery Hong Kong Limited's (SMBHK) additional spaces for rent and the foreign exchange gain resulting from the appreciation of Indonesian Rupiah and Thai Baht against the United States Dollar.

Consolidated net income for the year reached ₱17,658 million, an increase of 31% over 2015. Domestic operations contributed ₱16,551 million while international operations contributed US$23.2 million or ₱1,110 million.

Net income attributable to non-controlling interests increased by ₱174 million mainly due to higher income of PTD.

The operating and financial highlights of each segment are as follows:

Domestic Beer Operations

Domestic operations performed strongly posting a 20% increase in sales revenue from 2015. Sales volume grew by 15% for beer products despite the price increase implemented in April 1, 2016. The growth in sales volumes was mainly driven by the implementation of new brand campaigns, consumer and outlet promotions and trade programs to boost consumption of SMB brands, combined with favorable economic growth and election-related spending.

Cost of sales increased by 20% due to higher sales volume and upward adjustment in excise tax rates which took effect on January 1, 2016. Operating expenses, likewise, increased by ₱2,654 million due to higher advertising and promotional expenses, container amortization and distribution costs.

Income from operations ended higher by 18.3% versus 2015 and net income grew by ₱2,760 million, 20% higher than 2015.

International Beer Operations

SMBIL's consolidated volume for 2016 settled at 2.1 million hectolitres, 3% lower than the previous year mainly with the decline in the China and Hong Kong operations due to tough market conditions and economic slowdown. Thailand volumes also declined due to the 30-day mourning period which followed the passing of the King in October.

The above decline was partially offset by the growth in the volumes in Vietnam and SMBIL Exports.

SMBIL reported an operating income of US$23.1 million for 2016, an 85.5% improvement versus 2015, after a challenging 2015 which saw SMBIL operating income declining by 57.6% from 2014-level due to a new government regulation in Indonesia and the termination of the distribution agreement for certain premium brands in the last quarter of 2014 in Hong Kong.

To address the challenges in 2015, SMBIL adjusted the distribution system in Indonesia to adapt to the new regulation. It also implemented a distribution and warehousing restructuring in Hong Kong to generate additional rental income and reduce costs. These strategies, combined with margin improvements through portfolio mix and pricing in all markets, tight cost management and enhancement of operational efficiencies, significantly improved profitability in 2016.

IV. FINANCIAL POSITION

2017 vs. 2016

The Group's total assets increased by 8% as of December 31, 2017 primarily due to the increase in current assets.

Cash and cash equivalents increased by ₱6,282 million mainly due to higher cash generated from both domestic and international operations.

Inventories decreased by ₱882 million primarily due to lower inventory of finished goods and containers because of higher sales of domestic operations.

Prepaid expenses and other current assets increased by 28% due to higher deposit for excise tax and down payments for various capital projects of domestic operations.

Investment property decreased by 27% or ₱484 million with SMBHK's reclassification of land use rights to intangible assets.

Deferred tax assets decreased by 8% as a result of domestic operations' actuarial gains on pension assets and lower allowance for impairment of receivables.

Other noncurrent assets increased from ₱10,302 million in December 2016 to ₱12,109 million due to the purchase of new bottles and shells.

Accounts payable and accrued expenses increased by ₱934 million due to domestic operations' higher trade payables.

Income and other taxes payable increased by 7% over last year mainly due to higher taxable income for the fourth quarter of 2017 versus 2016 of domestic operations.

The current maturities of long-term debt decreased as the Company's Series D bonds of ₱3,000 million were redeemed in April 2017.

Deferred tax liabilities decreased by ₱87 million or 77% due to the impairment loss on the fixed assets of SMBB.

Other noncurrent liabilities decreased by ₱479 million due to the decrease in pension liability of both domestic and international operations resulting from actuarial gains and higher contributions for 2017.

Equity reserves which include reserve for retirement plan and cumulative translation adjustment, decreased by 33% due to the actuarial gains of the retirement plans of both domestic and international operations and the appreciation of the United States Dollar against the Philippine Peso.

The Company appropriated an additional P12,810 million of retained earnings, which the BOD of the Company approved on December 8, 2017, for the redemption of the Company's Series C and E bonds which will mature in April 2019. Of the P5,200 million appropriations in 2016, the P3,000 million allotted for the redemption of the Series D bonds was reversed upon redemption of the said bonds in April 2017. The remaining P2,200 million appropriation is for the various ongoing projects namely, the additional packaging line in the Company's production facility in Sta. Rosa, Laguna, the new brewery in Tagaloan, Misamis Oriental and additional non-alcoholic beverage facilities in the Company's production plants in Valenzuela City and Davao City.

Non-controlling interests, which pertain to the share of the non-controlling stockholders in the net assets of PTD, San Miguel Holdings (Thailand) Limited (SMHTL), San Miguel Beer (Thailand) Limited (SMBTL), SMBHK group and Brewery Properties Inc. (BPI), increased by 6% due to the higher earnings of PTD.

<u>2016 vs. 2015</u>

The Group's total assets increased by 9% as of year-end 2016 primarily due to the increase in current assets.

Cash and cash equivalents increased by ₱6,165 million mainly due to higher cash generated from both domestic and international operations.

Inventories increased by ₱1,148 million primarily due to domestic operations' purchase of new bottles and shells and inventory build-up to ensure availability of products and take advantage of the sales uptrend.

Prepaid expenses and other current assets increased by 6% due to payments made for various capital projects.

Investments decreased by 32% due to the return of PTD's investment in PT San Miguel Indonesia Foods and Beverages (PTSMIFB). PTSMIFB ceased operations in 2013 and completed its liquidation in July 2016.

Investment property increased by 17% or ₱267 million with SMBHK's reclassification of building space previously used in business that is now rented out to third parties, from property, plant and equipment to this account.

Deferred tax assets decreased by 9% as a result of domestic operations' actuarial gains on pension assets and write off of allowance for inventory losses on containers.

Other noncurrent assets increased from ₱9,236 million in December 2015 to ₱10,302 million due to purchase of new bottles and shells.

Accounts payable and accrued expenses increased by ₱709 million due to domestic operations higher trade payables.

Income and other taxes payable increased by 20% over 2015 mainly due to higher taxable income for the fourth quarter of 2016 versus 2015 for both domestic and international operations.

Current maturities of long-term debt pertains to the Series D bonds that were reclassified from long-term debt amounting to ₱3,000 million. The bonds will mature in April 2017.

Other noncurrent liabilities decreased by ₱1,587 million due to decrease in pension liability of both domestic and international operations resulting from actuarial gains and higher contributions for 2016.

Equity reserves which include reserve for retirement plan and cumulative translation adjustment, decreased by 36% due to actuarial gains of the retirement plans of both domestic and international operations and the appreciation of the United States Dollar against the Philippine Peso.

The Company appropriated retained earnings amounting to ₱5,200 million for (a) the Company's major projects to support volume growth which will commence in 2017 and are expected to be completed in two to five years, such as the installation of an additional packaging line in the Company's Sta. Rosa, Laguna production facility and the planned new brewery in Tagaloan, Misamis Oriental and additional non-alcoholic beverage facilities in the Company's breweries in Valenzuela City and Davao City for new product introductions; and (b) the redemption of the Company's Series D bonds which will mature in April 2017.

Non-controlling interests, which pertain to the share of the non-controlling stockholders in the net assets of PTD, SMHTL, SMBTL, SMBHK group and BPI, increased by 18% due to the higher earnings of PTD and the depreciation of the Philippine Peso against the United States Dollar in 2016 versus 2015.

Increase in Equity 2017 vs. 2016

The increase in equity is due to:

	December 31	
(in Millions)	**2017**	2016
Income during the year	**₱20,711**	₱17,658
Cash dividends declared	**(11,298)**	(10,299)
Equity reserve for retirement plan	**169**	466
Effect of translation adjustments and others	**444**	942
	₱10,026	₱8,767

V. SOURCES AND USES OF CASH

A brief summary of cash flow movements is shown below:

	December 31		
(in Millions)	**2017**	2016	2015
Net cash flows provided by operating activities	**₱ 26,601**	₱ 21,652	₱ 18,523
Net cash flows used in investing activities	**(6,047)**	(5,467)	(3,052)
Net cash flows used in financing activities	**(14,299)**	(10,297)	(9,714)

Net cash flows from operations basically consist of income for the year and changes in noncash current assets, certain current liabilities and others.

Net cash flows used in investing activities included the following:

	December 31		
(in Millions)	**2017**	2016	2015
Interest received	**₱516**	₱355	₱258
Proceeds from sale of:			
Property and equipment	**7**	14	12
Investments	**4**	35	-
Increase in intangible assets and other noncurrent assets	**(4,827)**	(4,653)	(2,292)
Additions to:			
Property, plant and equipment	**(1,747)**	(1,218)	(1,026)
Investment property	**-**	-	(4)

Major components of cash flows used in financing activities are as follows:

	December 31		
	2017	2016	2015
Payments of:			
Cash dividends	**(₱11,059)**	(₱10,138)	(₱9,525)
Long-term debt	**(3,000)**	-	-
Dividends to non-controlling shareholders	**(240)**	(159)	(183)
Redemption of common shares	**-**	-	(6)

The effect of exchange rate changes on cash and cash equivalents amounted to ₱27 million, ₱277 million, and ₱207 million in December 31, 2017, 2016 and 2015, respectively.

VI. KEY PERFORMANCE INDICATORS

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

	December 31	
	2017	**2016**
Liquidity:		
Current Ratio	3.06	2.29
Solvency:		
Debt-to-Equity Ratio	0.80	1.00
Interest-bearing Debt-to-Equity Ratio	0.57	0.74
Asset-to-Equity Ratio	1.80	2.00
Profitability:		
Return on Average Equity Attributable to Equity Holders of the Company	38.37%	39.56%
Interest Rate Coverage Ratio	15.30	11.68

	Years Ended December 31	
	2017	2016
Operating Efficiency:		
Volume Growth*	12.76%	12.09%
Revenue Growth	16.6%	18.0%
Operating Margin	27.5%	28.0%

**Represents beer and malt-based beverage volumes only as conversion factors to arrive at comparable volumes for non-alcoholic beverages have yet to be determined as of the reporting date.*

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

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt-to-Equity Ratio	$\frac{\text{Total Liabilities (Current + Noncurrent)}}{\text{Equity + Non-controlling Interests}}$
Interest-bearing Debt-to-Equity Ratio	$\frac{\text{Total Interest-Bearing Debt}}{\text{Equity + Non-controlling Interests}}$
Asset-to-Equity Ratio	$\frac{\text{Total Assets (Current + Noncurrent)}}{\text{Equity + Non-controlling Interests}}$
Return on Average Equity	$\frac{\text{Net Income Attributable to Equity Holders of the Company}}{\text{Average Equity Attributable to Equity Holders of the Company}}$
Interest Coverage Ratio	$\frac{\text{Earnings Before Interests, Taxes, Depreciation and Amortization}}{\text{Interest Expense and Other Financing Charges}}$
Volume Growth (Decline)	$\left(\frac{\text{Current Period Sales Volume}}{\text{Prior Period Sales Volume}}\right) -1$
Revenue Growth	$\left(\frac{\text{Current Period Net Sales}}{\text{Prior Period Net Sales}}\right) -1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

VII. OTHER MATTERS

a. *Commitments*

The outstanding purchase commitments of the Group as of December 31, 2017 amounted to P9,267 million.

Amount authorized but not yet disbursed for capital projects as of December 31, 2017 is approximately P8,291 million.

b. *Foreign Exchange Rates*

The foreign exchange rates used in translating the US dollar accounts of foreign subsidiaries to Philippine peso in 2017 and 2016 were closing rates of P49.93 and P49.72, respectively for consolidated statements of financial position accounts, and average rates of P50.40, P47.48 and P45.50 in 2017, 2016 and 2015, respectively, for income and expense accounts.

c. *Claims for Tax Refund*

i. Filed by SMC

On April 12, 2004 and May 26, 2004, SMC was assessed by the BIR for deficiency excise tax on "San Mig Light," one of its beer products. SMC contested the assessments before the Court of Tax Appeals (CTA) First Division under two cases, CTA Case Nos. 7052 and 7053. To these cases was consolidated SMC's claim for refund of taxes paid in excess of what it believes to be the excise tax rate applicable to it for its "San Mig Light" product for the period of February 2, 2004 to November 30, 2005 (docketed as CTA Case No. 7405). The CTA, through its First Division, and the CTA En Banc (on appeal), both ruled in favor of SMC. On April 1, 2013, the BIR elevated the consolidated cases to the Supreme Court (docketed as G.R. No. 205723).

SMC filed with the CTA by way of petition for review (Third Division and docketed as CTA Case No. 7708), a second claim for refund for overpayments of excise taxes for the period of December 1, 2005 to July 31, 2007 on November 27, 2007, as SMC was obliged to continue paying excise taxes in excess of what it believes to be the applicable excise tax rate. The CTA Third Division granted SMC's petition for review and ordered the BIR to refund or issue a tax credit certificate in favor of SMC. The BIR elevated the decision of the Third Division to the CTA En Banc but its appeal was denied. Subsequently, the BIR filed a petition for review with the Supreme Court (docketed as G.R. No. 205045).

On January 25, 2017, the Supreme Court decided in the consolidated cases of GR Nos. 205045 and 205723 to uphold the decision of the CTA requiring the BIR to refund excess taxes erroneously collected in the amount of P926 for the period December 1, 2005 to July 31, 2007, and P782 million for the period February 2, 2004 to November 30, 2005. The office of the Solicitor General filed motions for reconsideration, which were denied by the Supreme Court with finality on April 19, 2017.

SMC filed its third claim for refund with the CTA (Third Division docketed as CTA Case No. 7953) on July 24, 2009 for overpayments of excise taxes for the period of August 1, 2007 to September 30, 2007. This case was consolidated with CTA Case No. 7973 below.

ii. Filed by SMB

In the meantime, effective October 1, 2007, SMC spun off its domestic beer business into SMB. SMB continued to pay the excise taxes on "San Mig Light" at the higher rate required by the BIR and in excess of what it believes to be the excise tax rate applicable to it.

SMB filed eight claims for refund for overpayments of excise taxes with the BIR which were then elevated to the CTA by way of petition for review on the following dates:

(a) first claim for refund of overpayments for the period from October 1, 2007 to December 31, 2008 - Second Division docketed as CTA Case No. 7973 (September 28, 2009);

(b) second claim for refund of overpayments for the period of January 1, 2009 to December 31, 2009 - First Division docketed as CTA Case No. 8209 (December 28, 2010);

(c) third claim for refund of overpayments for the period of January 1, 2010 to December 31, 2010 - Third Division docketed as CTA Case No. 8400 (December 23, 2011);

(d) fourth claim for refund of overpayments for the period of January 1, 2011 to December 31, 2011 - Second Division docketed as CTA Case No. 8591 (December 21, 2012);

(e) fifth claim for refund of overpayments for the period of January 1, 2012 to December 31, 2012 - Second Division docketed as CTA Case No. 8748 (December 19, 2013);

(f) sixth claim for refund of overpayments for the period of January 1, 2013 to December 31, 2013 - docketed as CTA Case No. 8955 (December 2014);

(g) seventh claim for refund of overpayments for the period of January 1, 2014 to December 31, 2014 - docketed as CTA Case No. 9223 (December 2015);

(h) eighth claim for refund of overpayments for the period of January 1, 2015 to December 31, 2015 - docketed as CTA Case No. 9513 (December 2016); and

(i) ninth claim for refund of overpayments for the period of January 1, 2016 to December 31, 2016 – docketed as CTA Case No. 9743.

CTA Case No. 7973 was consolidated with CTA Case No. 7953. For CTA Case No. 7973, the CTA Third Division decided in favor of SMB and ordered the BIR to refund SMB the amount of P828 million. The BIR appealed to the CTA En Banc which affirmed the Decision of the Third Division. The BIR then elevated the case to the Supreme Court but its petition was denied by the Supreme Court through its September 11, 2017 and December 11, 2017 Resolutions. With the decisions in favor of SMB, the Company, through counsel, shall move for the execution of the Decision.

CTA Case No. 8209 was decided in favor of SMB by the CTA's First Division. The case was not elevated within the prescribed period, thus, the decision became final and executory. The BIR filed a Petition for Relief from Judgment which was denied by the CTA. Separately, the First Division granted SMB's Motion for Execution for the refund of P730 million, while the BIR filed a Petition for Certiorari before the Supreme Court. The Petition was dismissed by the Supreme Court with finality but the BIR still filed an Urgent Motion for Clarification. Subsequently, SMB received a clarificatory Resolution dated February 20, 2017 wherein the Supreme Court reiterated its grounds for the denial of the BIR's Petition for Certiorari and expunged from the records all pleadings of the BIR filed after its denial of BIR's Petition for Certiorari had become final and executory. SMB, through counsel, shall proceed with the enforcement of the writ of execution.

CTA Case No. 8400 was decided in favor of SMB by both the CTA's Third Division and the CTA En Banc. The BIR was ordered to refund SMB the amount of P699 million. The BIR elevated the case to the Supreme Court but the Supreme Court denied the BIR's petition through its March 20, 2017 Resolution. The BIR moved for reconsideration but the same was similarly denied by the SC through its July 24, 2017 Resolution. With the decisions in favor of SMB, the Company, through counsel, shall move for the execution of the Decision.

CTA Case No. 8591 was decided in favor of SMB by the CTA's Second Division and En Banc. The BIR elevated the case to the Supreme Court, where it remains pending to date.

CTA Case Nos. 8748, 8955, 9223, 9513 and 9743 are still pending in the CTA En Banc or in their respective Divisions.

d. *Pending Tax Cases*

The BIR issued a Final Assessment Notice dated March 30, 2012 (2009 Assessment), imposing on IBI deficiency tax liabilities, including interest and penalties, for the tax year 2009. IBI treated the royalty income earned from the licensing of its intellectual properties to SMB as passive income, and therefore subject to 20% final tax. However, the BIR is of the position that said royalty income is regular business income subject to the 30% regular corporate income tax.

On May 16, 2012, IBI filed a protest against the 2009 Assessment. In its Final Decision on Disputed Assessment issued on January 7, 2013, the BIR denied IBI's protest and reiterated its demand to pay the deficiency income tax, including interests and penalties. On February 6, 2013, IBI filed a Petition for Review before the CTA contesting the 2009 Assessment. The case was docketed as CTA Case No. 8607 with the First Division. On August 14, 2015, the CTA First Division partially granted the Petition for Review of IBI, by cancelling the compromise penalty assessed by the BIR. However, IBI was still found liable to pay the deficiency income tax, interests and penalties as assessed by the BIR. The Motion for Reconsideration was denied by the CTA's First Division on January 6, 2016. On January 22, 2016, IBI filed its Petition for Review before the CTA En Banc and the case was docketed as CTA EB Case No. 1417. To interrupt the running of interests, IBI filed a Motion to Pay without Prejudice, which was granted by the CTA En Banc. As a result, IBI paid the amount of P270 million on August 26, 2016. On January 30, 2018, the CTA En Banc rendered a decision affirming the decision of the CTA First Division. IBI filed a Motion for Reconsideration which is still pending before the CTA En Banc.

On November 17, 2013, IBI received a Formal Letter of Demand with the Final Assessment Notice for tax year 2010 (2010 Assessment) from the BIR with a demand for payment of income tax and VAT deficiencies with administrative penalties. The BIR maintained its position that royalties are business income subject to the 30% regular corporate tax. The 2010 Assessment was protested by IBI before the BIR through a letter dated November 29, 2013. A Petition for Review was filed with the CTA Third Division and the case was docketed as CTA Case No. 8813. The CTA Third Division held IBI liable to pay deficiency income tax, interests and penalties. IBI thus filed its Petition for Review before the CTA En Banc. In 2017, IBI filed an application for abatement, with corresponding payment of basic tax, in the amount of P110 million, where the Company requested for the cancellation of the surcharge and interests. As of December 31, 2017, both the Petition for Review and IBI's application for abatement remain pending for resolution by the CTA En Banc and the BIR, respectively.

On December 27, 2016, IBI received a Formal Letter of Demand for tax year 2012 with a demand for payment of income tax, VAT, withholding tax, documentary stamp tax and miscellaneous tax deficiencies with administrative penalties. The Company addressed the assessment of each tax type with factual and legal bases in a Protest filed within the reglementary period. Due to the inaction of the BIR, IBI filed a Petition for Review with the CTA Third Division and docketed as CTA Case No. 9657. The case is currently pending while, at the same time, an application for abatement was submitted to the BIR in August 2017. As of December 31, 2017, both the Petition for Review and the application for abatement remain pending for resolution by the CTA and the BIR, respectively.

e. There are no unusual items as to nature and amount affecting assets, liabilities, equity, net income or cash flows, except those stated in Management's Discussion and Analysis of Financial Position and Performance.

f. There were no material changes in estimates of amounts reported in prior interim periods of the current year or changes in estimates of amounts reported in prior financial year.

g. There were no known trends, demands, commitments, events or uncertainties that will have a material impact on the Group's liquidity.

h. There were no known trends, events or uncertainties that have had or that are reasonably expected to have a favorable or unfavorable impact on net sales or revenues or income from continuing operation.

i. There were no known events that will trigger direct or contingent financial obligation that is material to the Group, including any default or acceleration of an obligation, other than those disclosed in the Management's Discussion and Analysis and the Audited Consolidated Financial Statements.

j. There were no material off-statements of financial position transactions, arrangements, obligations (including contingent obligations), and other relationship of the Group with unconsolidated entities or other persons created during the reporting period.

Annex C of SEC Form 17-A of Ginebra San Miguel Inc. as filed with the Securities and Exchange Commission on

April 13, 2018

Annex "C"

GINEBRA SAN MIGUEL INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL POSITION AND FINANCIAL PERFORMANCE

This discussion summarizes the significant factors affecting the consolidated financial performance, financial position and cash flows of Ginebra San Miguel Inc. ("the Parent Company") and its subsidiaries (collectively referred to as the "Group") for the three-year period ended December 31, 2017. The following discussion should be read in conjunction with the attached audited consolidated statements of financial position of the Group as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2017. All necessary adjustments to present fairly the Group's consolidated financial position as of December 31, 2017 and the financial performance and cash flows for the year ended December 31, 2017 and for all the other periods presented, have been made.

I. BASIS OF PREPARATION

Statement of Compliance
The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards issued by the International Accounting Standards Board. PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations issued by the Philippine Financial Reporting Standards Council (FRSC).

Basis of Measurement
The consolidated financial statements of the Group have been prepared on a historical cost basis of accounting except for the following items which are measured on an alternative basis at each reporting date:

Items	Measurement Basis
Derivative financial instruments	Fair value
Defined benefit retirement asset (liability)	Fair value of the plan assets less the present value of the defined benefit retirement obligation

Functional and Presentation Currency
The consolidated financial statements are presented in Philippine peso, which is the functional currency of the Company. All financial information are rounded off to the nearest thousand (000), except when otherwise indicated.

Significant Accounting Policies
The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards
The FRSC approved the adoption of a number of new and amended standards and interpretation as part of PFRS.

Amendments to Standards Adopted in 2017

The Group has adopted the following PFRS starting January 1, 2017 and accordingly, changed its accounting policies in the following areas:

- Disclosure Initiative *(Amendments to PAS 7, Statement of Cash Flows)*. The amendments resulted in improved disclosures about the net debt of an entity relevant to the understanding of its cash flows. The amendments require entities to provide disclosures that enable users of the consolidated financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g., by providing a reconciliation between the opening and closing balances in the consolidated statements of financial position for liabilities arising from financing activities.

- Recognition of Deferred Tax Assets for Unrealized Losses *(Amendments to PAS 12, Income Taxes)*. The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.

- Annual Improvements to PFRS Cycles 2014 - 2016 contain changes to three standards, of which only the *Amendments to PFRS 12, Disclosures of Interests in Other Entities* on clarification of the scope of the standard is applicable to the Group. The amendments clarify that the disclosure requirements for interests in other entities also apply to interests that are classified as held for sale or distribution.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the financial statements.

II. FINANCIAL PERFORMANCE

2017 vs. 2016

With the continuous endeavor to strengthen the market position in the hard liquor industry, the Group reported a 43% and 67% improvement in Operating Income and Net Income, respectively.

Revenue growth maintained at 12% in 2017, equivalent to P20,892 million, due to the consistent increase in sales volume of its core brand Ginebra San Miguel and Vino Kulafu. Coupled with various programs on cost improvement to cushion increase in costs of key inputs, the Group was able to generate a proportionate increase in gross profit of 12%.

Selling and marketing expenses increased by 11% on account of additional spending in advertising and promotion programs to support the continuous growth in sales volume.

With the regained strength on its cash position, the Group continually decreased short term loan availments, resulting to a 32% decline in interest expenses, net of interest income.

Other income increased by 34% to P81 million pesos, due to the Company's tolling operation. On the other hand, equity in joint ventures significantly decreased by 93% as a result of the recognition for possible losses on uncollectible receivables by the Thailand venture.

As a result of the remarkable income growth, income taxes raised by 135% to P346 million.

2016 vs. 2015

Revenue of P18,572 million was 12% higher than last year due to the volume improvement of the Company's core brand and price increase on liquor products implemented in January 2016. Gross profit also grew by 7% from the previous year despite the 14% increase in cost of sales.

Additional spending in advertising and promotion programs brought the 4% increase in selling and marketing expenses. On the other hand, general and administrative expenses decreased by 3% on account of lower outside services, insurance, rent, and taxes and licenses.

Interest expense, net of interest income declined by 18% because of the decrease in short-term loan availments and settlement of long-term obligation. Meanwhile, the 12% reduction in share in equity in net loss of joint venture was due to a better operating results in 2016.

Gain on sale of property and equipment was significantly lower than a year ago because of the one-time gain on sale of asset earned in 2015. On the contrary, other income of P60 million was higher compared to last year's other charges of P51 million due to the impairment loss for goodwill recognized in 2015.

Income tax expense decreased by 71% from a year ago because of lower Net Operating Loss Carry Over (NOLCO) in 2016. These resulted in a better net income from continuing operations of P361 million against last year's net loss of P386 million. Moreover, the Parent Company will continue to endeavor and implement its consumer-focused strategies to sustain full recovery and further strengthen its market position in the hard liquor industry.

III. FINANCIAL POSITION

2017 vs. 2016

Cash and cash equivalents were significantly reduced by 74% to pay off short term and long term obligations. As a result, short term loans decreased by P2,465 million or 31% and long term loans by P114 million or 50%.

Continuous improvement in collection and effective management of the Group's receivables reduced trade and other receivables by 30%. These collections supported the purchase and build-up of inventories with a rise of 10% against last year.

Prepaid taxes and other current assets and deferred tax assets were reduced by a total of P224 million due to the utilization of accumulated prior year tax credits.

Investment in joint ventures decreased by 26% on account of translation adjustments which increased by P67 million, offset by the current year equity in net losses of P186 million.

Retirement liabilities and reserve for retirement plan increased to 24% and 26%, respectively, as a result of actuarial valuation for the net defined benefit retirement liability.

2016 vs. 2015

Cash and cash equivalents increased by 74% while trade and other receivables decreased by 14% because of the improvement in collection and effective management of Company's receivable.

Furthermore, investment in joint ventures decreased by 11% because of the additional impairment loss recognized for the year. The 13% decrease in other noncurrent assets was due to reduction in long-term receivables.

With the Company's sustained recovery in 2016, trade payables, short-term and long-term obligations were settled and managed to decrease by P862 million. Income and other taxes also decreased by 5% because of higher input taxes claimed against output taxes.

Cumulative translation adjustments decreased by 47% due to the translation adjustments in Investment in joint venture's net assets. While the decrease in Reserve for Retirement Plan was due to the recognition of remeasurement loss on the retirement plan assets.

Equity

The increase (decrease) in equity for the period ended December 31, 2017 and 2016 is due to:

	December 31	
	2017	2016
	(In Millions)	
Income during the period	**P602**	P361
Other comprehensive loss	**(19)**	(34)
	P583	P327

IV. Sources and Uses of Cash

A brief summary of cash flow movements is shown below:

	December 31	
	2017	2016
	(In Millions)	
Net cash flows provided by operating activities	**P2,502**	P1,632
Net cash flows used in investing activities	**(217)**	(369)
Net cash flows used in financing activities	**(2,863)**	(933)

Net cash flows provided by operating activities consist of income before income tax for the period and the effect of changes in current assets and certain current liabilities, including net movement in inventory level.

Net cash flows provided by (used in) investing activities include the following:

	December 31	
	2017	2016
	(In Millions)	
Additions to property, plant and equipment	**(P218)**	(P382)
Decrease in other non current assets	-	12

Major components of net cash flows used in financing activities are as follows:

	December 31	
	2017	2016
	(In Millions)	
Proceeds from:		
Short-term borrowings	**P64,909**	P74,243
Payments of:		
Short-term borrowings	**(67,374)**	(74,652)
Long-term borrowings	**(114)**	(114)
Interest	**(283)**	(411)

The effect of exchange rate changes on cash and cash equivalents amounted to (P0.33) million and P1.5 million for the periods ended December 31, 2017 and 2016, respectively.

V. KEY PERFORMANCE INDICATORS

The following are the major performance measures used by the Group. Analyses are employed by comparisons and measurements based on the financial data of the current period against the same period of previous year. Please refer to Item II, "Financial Performance" of the Management Discussion and Analysis (MD&A), for the discussion of certain computed Key Performance Indicators.

KPI	**December 31, 2017**	December 31, 2016
Liquidity:		
Current Ratio	**0.86**	0.76
Solvency:		
Debt to Equity Ratio	**1.66**	2.42
Asset to Equity Ratio	**2.66**	3.42
Profitability:		
Return on Average Equity	**13%**	8%
Interest Rate Coverage Ratio	**4.36**	2.22

KPI	**Period Ended December 31**	
	2017	2016
Operating Efficiency:		
Volume Growth	**10%**	9%
Revenue Growth	**12%**	12%
Operating Margin	**7%**	5%

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

KPI	Formula
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\frac{\text{Total Liabilities (Current + Noncurrent)}}{\text{Equity}}$
Asset to Equity Ratio	$\frac{\text{Total Assets (Current + Noncurrent)}}{\text{Equity}}$
Return on Average Equity	$\frac{\text{Net Income}}{\text{Average Equity}}$
Interest Rate Coverage Ratio	$\frac{\text{Earnings Before Interests and Taxes}}{\text{Interest Expense and Other Financing Charges}}$
Volume Growth	$\left(\frac{\text{Sum of All Businesses' Volume}}{\text{Prior Period Volume}}\right) - 1$
Revenue Growth	$\left(\frac{\text{Current Period Net Sales}}{\text{Prior Period Net Sales}}\right) - 1$
Operating Margin	$\frac{\text{Income from Operating Activities}}{\text{Net Sales}}$

VI. OTHER MATTERS

a. *Commitments*

The outstanding purchase commitments of the Company amounted to US$80,564 (P4,022,565) as of December 31, 2017.

b. *Contingencies*

The Company 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 to 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 separate financial statements. No provision was recognized in 2017 and 2016.

- Tax Cases Pending with the Court of Tax Appeals (CTA)

1. *Ginebra San Miguel Inc. vs. Commissioner of Internal Revenue*
   CTA Case Nos. 8953 and 8954 (Consolidated)
   Third Division

   These cases pertain GSMI's Claims for Refund with the BIR, in the amount of P581,708 in Case No. 8953, and P133,551 in Case No. 8954, or in the total amount of P715,259, representing payments of excise tax erroneously, excessively, illegally, and/or wrongfully assessed on and collected from GSMI by the BIR on removals of its distilled spirits or finished products for the periods from 1 January 2013 up to 31 May 2013 in Case No. 8953, and from 8 January 2013 up to 31 March 2013 in Case No. 8954.

   The aforementioned assessment and collection arose from the imposition and collection of excise taxes on GSMI's finished products processed and produced exclusively from its inventory of ethyl alcohol, notwithstanding that excise taxes had already been previously paid by GSMI on said ethyl alcohol.

   These cases are still pending with the CTA.

2. *Ginebra San Miguel Inc. vs. Commissioner of Internal Revenue*
   CTA Case No. 9059
   Second Division

   This case pertains to GSMI's Claim for Refund with the BIR, in the total amount of Php26,243, representing payments of excise tax erroneously, excessively, illegally, and/or wrongfully assessed on and collected from GSMI by the BIR on removals of its distilled spirits or finished products for the period from 1 June 2013 up to 31 July 2013.

   The aforementioned assessment and collection arose from the imposition and collection of excise taxes on GSMI's finished products processed and produced exclusively from its inventory of ethyl alcohol, notwithstanding that excise taxes had already been previously paid by GSMI on the said ethyl alcohol.

   This case is still pending with the CTA.

- Intellectual Property Cases Pending with the Supreme Court (SC)

1. *Ginebra San Miguel Inc. vs. Director General of the Intellectual Property Office*
   G.R. No. 196372
   Third Division

   This case pertains to GSMI's application for the registration of the trademark "GINEBRA" under Class 33 ("gin") with the Intellectual Property Office of the Philippines (IPOPHL). The IPOPHL rejected GSMI's application on the ground that "GINEBRA" is a Spanish word for gin, and is a generic term incapable of appropriation.

   When the Court of Appeals (CA) affirmed the IPOPHL's ruling, GSMI filed a Petition for Review on Certiorari (the Petition) with the SC. The SC denied GSMI's Petition. GSMI moved for a reconsideration thereof, and likewise filed a Motion to Refer its Motion for Reconsideration to the SC *En Banc*. Unfortunately, the SC denied GSMI's Motion for Reconsideration "with FINALITY", as well as GSMI's Motion to Refer to Court *En Banc*.

Subsequently, GSMI filed a Manifestation with Motion for Relief from Judgment and invoked the case of "*League of Cities vs. Commission of Elections*" (G.R. Nos. 176951, 177499 and 178056) to invite the SC *En Banc* to re-examine the case. This case is still pending with the SC.

2. *Tanduay Distillers, Inc. vs. Ginebra San Miguel Inc.*
   G.R. Nos. 210224 and 219632
   Third Division

   These cases pertain to GSMI's complaint for trademark infringement and unfair competition against Tanduay Distillers, Inc. (TDI) filed with the Regional Trial Court (RTC), arising from TDI's distribution and sale of "Ginebra Kapitan" and use of a bottle design similar to that used by GSMI. The RTC dismissed GSMI's complaint.

   When GSMI elevated the case to the CA, due to technicalities, two (2) cases were lodged in the CA: 1.) Petition for Review (CA-G.R. SP No. 127255), and 2.) Notice of Appeal (CA-G.R. SP No. 100332).

   Acting on GSMI's Petition for Review, the CA reversed, set aside the RTC's Decision, and ruled that "GINEBRA" is associated by the consuming public with GSMI. Giving probative value to the surveys submitted by GSMI, the CA ruled that TDI's use of "GINEBRA" in "Ginebra Kapitan" produces a likelihood of confusion between GSMI's "Ginebra San Miguel" gin product and TDI's "Ginebra Kapitan" gin product. The CA likewise ruled that "TDI knew fully well that GSMI has been using the mark/word "GINEBRA" in its gin products and that GSMI's "Ginebra San Miguel" had already obtained, over the years, a considerable number of loyal customers who associate the mark "GINEBRA" with GSMI.

   On the other hand, upon GSMI's Appeal, the CA also set aside the RTC's Decision and ruled that "GINEBRA" is not a generic term, there being no evidence to show that an ordinary person in the Philippines would know that "GINEBRA" is a Spanish word for "gin". According to the CA, because of GSMI's use of the term in the Philippines since the 1800s, the term "GINEBRA" now exclusively refers to GSMI's gin products and to GSMI as a manufacturer. The CA added that "the mere use of the word 'GINEBRA' in "Ginebra Kapitan" is sufficient to incite an average person, even a gin-drinker, to associate it with GSMI's gin product, and that TDI "has designed its bottle and label to somehow make a colorable similarity with the bottle and label of Ginebra S. Miguel".

   TDI filed separate Petitions for Review with the SC, docketed as G.R. Nos. 210224 and 219632, which were eventually consolidated by the SC. These cases are still pending with the SC.

3. *Tanduay Distillers, Inc. vs. Ginebra San Miguel Inc.*
   G.R. No. 216104
   Third Division

   This case pertains to TDI's application for the registration of the trademark "GINEBRA KAPITAN" for Class 33 ("gin") with the IPOPHL.

   GSMI opposed TDI's application, alleging that it would be damaged by the registration of "GINEBRA KAPITAN" because the term "GINEBRA" has acquired secondary meaning and is now exclusively associated with GSMI's gin products. GSMI argued that the registration of "GINEBRA KAPITAN" for use in TDI's gin products will confuse the public and cause damage to GSMI. TDI countered that "GINEBRA" is generic and incapable of exclusive appropriation, and that "GINEBRA KAPITAN" is not identical or confusingly similar to GSMI's mark.

The IPOPHL ruled in favor of TDI and held that: (a) "GINEBRA" is generic for "gin", (b) GSMI's products are too well known for the purchasing public to be deceived by a new product like Ginebra Kapitan, and (c) TDI's use of "GINEBRA" would supposedly stimulate market competition.

The CA reversed and set aside the IPOPHL's ruling and disapproved the registration of "GINEBRA KAPITAN". The CA ruled that "GINEBRA" could not be considered as a generic word in the Philippines considering that, to the Filipino gin-drinking public, it does not relate to a class of liquor/alcohol but rather has come to refer specifically and exclusively to the gin products of GSMI.

TDI filed a Petition for Review on Certiorari with the SC, which was subsequently consolidated with the case of "*Tanduay Distillers, Inc. vs. Ginebra San Miguel Inc.*", docketed as G.R. No. 210224. This case is still pending with the SC.

c. *Foreign Exchange Rates*

The foreign exchange rates used in translating the Thai Baht accounts of foreign joint ventures to Philippine peso were closing rates of P1.53 and P1.39 in 2017 and 2016, respectively, for consolidated statements of financial position accounts; and average rates of P1.54, P1.39, and P1.33 in 2017, 2016 and 2015, respectively, for income and expense accounts.

d. Certain accounts in prior years have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported financial performance for any period.

Annex D of SEC Form 17-A of San Miguel Pure Foods Company, Inc. as filed with the Securities and Exchange Commission on April 13, 2018

Annex "D"

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND FINANCIAL PERFORMANCE

This discussion summarizes the significant factors affecting the consolidated financial position, financial performance and cash flows of San Miguel Pure Foods Company Inc. ("SMPFC" or the "Parent Company") and its subsidiaries (collectively, referred to as the "Group") for the three-year period ended December 31, 2017. The following discussion should be read in conjunction with the attached audited consolidated statements of financial position of the Group as at December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows for each of the three years in the period ended December 31, 2017. All necessary adjustments to present fairly the Group's consolidated financial position as at December 31, 2017 and the financial performance and cash flows for the year ended December 31, 2017 and for all the other periods presented, have been made.

I. BASIS OF PREPARATION

Statement of Compliance
The accompanying consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS are based on International Financial Reporting Standards issued by the International Accounting Standards Board. PFRS consist of PFRS, Philippine Accounting Standards (PAS) and Philippine Interpretations issued by the Philippine Financial Reporting Standards Council (FRSC).

Basis of Measurement
The consolidated financial statements of the Group have been prepared on the historical cost basis except for the following items which are measured on an alternative basis on each reporting date:

Items	Measurement Basis
Derivative financial instruments	Fair value
Available-for-sale (AFS) financial assets	Fair value
Defined benefit retirement asset (liability)	Fair value of the plan assets less the present value of the defined benefit retirement obligation
Agricultural produce	Fair value less estimated costs to sell at the point of harvest

Functional and Presentation Currency
The consolidated financial statements are presented in Philippine peso, which is the functional currency of the Parent Company. All values are rounded off to the nearest thousand (₱000), except when otherwise indicated.

Significant Accounting Policies
The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements, except for the changes in accounting policies as explained below.

Adoption of New and Amended Standards and Interpretations
The FRSC approved the adoption of a number of new and amended standards and interpretations as part of PFRS.

Amendments to Standards Adopted in 2017

The Group has adopted the following amendments to PFRS starting January 1, 2017 and accordingly, changed its accounting policies in the following areas:

- Disclosure Initiative *(Amendments to PAS 7, Statement of Cash Flows).* The amendments resulted in improved disclosures about the net debt of an equity relevant to the understanding of its cash flows. The amendments require entities to provide disclosures that enable users of the consolidated financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes - e.g. by providing a reconciliation between the opening and closing balances in the consolidated statements of financial position for liabilities arising from financing activities.

- Recognition of Deferred Tax Assets for Unrealized Losses *(Amendments to PAS 12, Income Taxes).* The amendments clarify that: (a) the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset; (b) the calculation of future taxable profit in evaluating whether sufficient taxable profit will be available in future periods excludes tax deductions resulting from the reversal of the deductible temporary differences; (c) the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this; and (d) an entity assesses a deductible temporary difference related to unrealized losses in combination with all of its other deductible temporary differences, unless a tax law restricts the utilization of losses to deduction against income of a specific type.

- Annual Improvements to PFRS Cycles 2014-2016 contain changes to three standards, of which only the *Amendments to PFRS 12, Disclosure of Interests in Other Entities* on clarification of the scope of the standard is applicable to the Group. The amendments clarify that the disclosure requirements for interests in other entities also apply to interests that are classified as held for sale or distribution.

Except as otherwise indicated, the adoption of amendments to standards did not have a material effect on the consolidated financial statements.

II. FINANCIAL PERFORMANCE

2017 vs 2016

The Group recorded another growth year as it ended 2017 with consolidated revenues of P117.4 billion, 5% higher than last year, mainly on account of the strong performance of Poultry and Fresh Meats, and Processed Meats businesses. Favorable chicken prices, amidst the short-lived and localized avian flu outbreak in August 2017, improved selling prices of fresh meats and higher sales of processed meats were the revenue growth drivers. Consolidated revenues of the Group would have been better had it not been tempered by the continuous downtrend in basic flour selling prices attributable to declining global wheat prices.

Gross profit rose by 8% on the back of higher revenues, improved operational efficiencies and cost breaks in some raw materials for feeds, partly offset by the impact of peso depreciation and double-digit increases in the prices of dairy and processed meats major raw materials which resulted in 5% increase in cost of sales.

Selling and administrative expenses went up by 6% mainly due to increased logistics and manpower costs. The Group's effort to expand distribution coverage and improve customer servicing resulted in higher warehouse rental, hauling, trucking and other related services.

Interest expense and other financing charges dropped by 26% as borrowing costs directly attributable to the construction of plants were capitalized.

Interest income decreased by 12% largely due to the decline in the average level of money market placements.

Disposal of an investment property in the first half of 2016 yielded one-time gain, thus, the lower amount of gain on sale of investment property and property and equipment in 2017 compared to same period year ago.

Other charges - net went down by 74% as 2016 includes marked-to-market loss on importations and impairment loss recognized on idle assets of a foreign subsidiary. On the other hand, marked-to-market gain on importations in 2017 partly tempered the impact of other charges during the year.

Considering all the above factors, the Group achieved a P9.8 billion income before income tax, 15% higher than 2016's level.

Income tax expense increased by 12% primarily due to higher taxable income of certain subsidiaries.

Consolidated net income of the Group was at P6.9 billion, 16% higher versus last year.

Net income attributable to equity holders of both the Parent Company and non-controlling interests increased by 16% and 15%, respectively, in proportion with the results of the business operation.

Business Highlights:

Agro-Industrial

Agro-Industrial, comprising of San Miguel Foods, Inc.'s (SMFI) Poultry and Fresh Meats, and Feeds businesses, contributed P80.8 billion to the Group's total revenues, 6% higher compared to previous year. Operating income, on the other hand, posted double-digit growth due to favorable selling prices of chicken and fresh meats, better sales mix, lower costs of some major raw materials and improved operational efficiencies.

Revenue of the combined Poultry and Fresh Meats business went up by 7% versus 2016 level on account of higher volume and improved selling prices. Although the business experienced a significant decline in chicken prices in third quarter brought about by the short-lived and localized avian flu outbreak in certain areas of North Luzon, it was able to quickly recover in the fourth quarter of 2017 as soon as the outbreak was contained and demand started to improve. Meanwhile, favorable selling prices of fresh meats was sustained until end of 2017.

The Feeds business, on the other hand, posted revenue growth of 2% driven mainly by better sales achievement in broiler and some specialty feeds, offset by the setback in hog feeds segment resulting from the contraction of backyard hog raising market.

Branded Value-Added

Total revenue and operating income of the Branded Value-Added business grew by 6% and 2%, respectively, versus same period last year primarily driven by the good performance of The Purefoods-Hormel Company, Inc.'s (PF-Hormel) Processed Meats business.

Processed Meats business posted revenue growth of 8% on the back of increased volume in major sales channels and growing contribution of the mid-priced product segment.

The Parent Company's Dairy, Spreads and Biscuits business under Magnolia, Inc. (Magnolia) grew revenue by 5% attributable to higher sales volume as well as price increases implemented to temper the impact of higher raw material prices.

The Coffee business under San Miguel Super Coffeemix Co., Inc. (SMSCCI) posted lower revenue this year, as 2016 had the benefit of election spending.

Milling

The decline in basic flour's selling prices resulting from continuous downtrend of global wheat prices, aggravated by intense industry competition, prevented the Parent Company's Flour Milling business under San Miguel Mills, Inc. (SMMI) to surpass last year's revenue and operating income.

Others

The combined revenue and operating income of the Parent Company's international operations in Indonesia and Vietnam improved versus 2016 level due to Vietnam's increased volume.

2016 vs 2015

The Group delivered another strong full year result as 2016 consolidated revenues reached P111.6 billion, 4% higher than 2015 mainly on account of the sustained strong performances of Poultry, Feeds and Branded Value-Added businesses. Driving the revenue growth were the favorable selling prices of chicken, even surpassing last year's average selling prices, increased volume achievement, and better selling prices of branded value-added products. The growth, however, was tempered by the industry-wide downtrend in basic flour's selling prices, brought about by the declining wheat costs, and intense competition. Lower pork prices likewise affected revenue growth.

Higher volume, combined with improved operational efficiencies and generally lower cost of raw materials, resulted in 13% gross profit growth.

Selling and administrative expenses grew by 11% due to increased advertising and promotions, manpower and logistics costs. The Parent Company, in its thrust of growing its value-added businesses, boosted its spending on marketing and brand-building campaigns. Logistics costs, which include warehouse rental, hauling, trucking and related services, went up on account of the Group's effort to expand distribution coverage and improve customer servicing.

The 66% drop in interest expense and other financing charges was mainly due to SMFI's full payment in December 2015 of its matured five-year corporate notes with aggregate principal amount of P4.5 billion.

Interest income decreased by 30% due to the decline in the average level of money market placements versus 2015.

Gain on sale of investment property and property and equipment was up by 30% compared to 2015's level due to the disposal of an investment property in the first semester of 2016 that yielded higher one-time gain.

Other charges - net dropped by 14% mainly due to lower than 2015's impairment loss recognized on idle assets of a foreign subsidiary.

Taking into account the above factors, the Group registered an income before income tax of P8.6 billion for 2016, 23% higher than 2015.

Income tax expense rose by 17% due to higher taxable income of certain subsidiaries.

The overall solid performance of the Group yielded a consolidated net income of P6.0 billion, a 26% growth versus same period in 2015.

Net income attributable to equity holders of the Parent Company was up by 26% due to better combined performances of subsidiaries where SMPFC holds significant ownership.

Net income attributable to non-controlling interests increased by 16% on account of the improved performance of certain subsidiaries where non-controlling stockholders hold stake.

Business Highlights:

Agro-Industrial

Agro-Industrial, comprised of SMFI's Poultry and Fresh Meats, and Feeds businesses, contributed a total of P76.5 billion to the Group's total revenues, a 5% increase over 2015's level. The increase in sales was driven mainly by the favorable chicken selling prices, as the Poultry business sustained its recovery from first half of 2015's period of low selling prices, and robust volume resulting from expanded distribution, increased trade penetration and effective marketing efforts. These, combined with the drop in cost of some major raw materials, translated to an operating income that surpassed 2015's level.

Revenue of the combined Poultry and Fresh Meats business of SMFI went up by 7% versus 2015 mainly on account of Poultry's increased sales volume and better selling prices, tempered by the drop in prices of pork.

The Feeds business of SMFI maintained its growth momentum and ended 2016 with revenue growing by 3% on the back of higher sales volume driven by sustained market leadership, improved distribution and consistent feed quality.

Branded Value-Added

PF-Hormel's Processed Meats business recorded revenue growth of 7% mainly due to increased volume in almost all trade channels and better sales mix which translated to higher average selling prices.

The Parent Company's Dairy, Spreads and Biscuits business under Magnolia posted an 8% increase in revenue as effective marketing and brand-building activities boosted volume growth in most categories. Favorable sales mix that resulted in better selling prices likewise contributed to higher revenue.

Notwithstanding the increased competitive pressure from major players, the Coffee business under SMSCCI registered revenue growth of 2% as various marketing campaigns and the positive response of the market to its new product launched in August 2016 helped increased volume versus same period in 2015.

The strong performance of the Branded Value-Added businesses, coupled with the favorable impact of lower costs of certain major raw materials, resulted in higher combined operating income versus 2015.

Milling

The performance of the Parent Company's Flour Milling business under SMMI remained affected by the industry-wide continuing decline in the selling prices of basic flour as downtrend in global wheat prices prevailed due to abundant wheat supply in the world market. Further aggravating the situation is the intense competition brought about by the proliferation of lower-priced imported flour and the presence of new industry entrants. All these factors led to the bigger drop in basic flour's selling prices compared to the decline in wheat costs. As a result, revenue and operating income were lower than 2015.

Others

Combined revenue of the Parent Company's foreign operations in Indonesia and Vietnam grew by 1% versus 2015. Vietnam continued to register operating income growth with the rationalization of its non-profitable businesses. Indonesia, on the other hand, posted higher operating loss largely on account of lower revenue and increased trade returns.

III. FINANCIAL PERFORMANCE

2017 vs 2016

Consolidated financial position of the Group remained healthy. The double-digit growth in current payables, which caused the slide in current ratio from 1.73:1 in 2016 to 1.36:1 in 2017 and the increase in debt to equity ratio from 0.55:1 in 2016 to 0.70:1 in 2017, was mainly due to increased volume of transactions with third party suppliers in the last quarter of 2017 and higher short-term loan availments to partly finance the Group's expansion programs and working capital requirements.

The increase in total assets from P67.0 billion to P81.9 billion is attributed to the expansion projects and higher inventories. Total equity, on the other hand, went up from P43.2 billion to P48.1 billion on account of the net income for 2017, partly reduced by the cash dividends declared to all common and preferred shareholders of the Parent Company.

Below were the major developments in 2017:

INVESTMENTS IN SUBSIDIARIES

In June 2017, the Board of Directors (BOD) and shareholders of SMFI approved, among others, the: (i) increase in SMFI's authorized capital stock by P5,000.0 million, equivalent to 50,000,000 common shares at P100.00 par value per share, and (ii) amendment to Article VII of SMFI's Articles of Incorporation to reflect such increase.

On January 10, 2018, the Securities and Exchange Commission (SEC) issued the Certificate of Filing of Amended Articles of Incorporation approving the increase in SMFI's authorized capital stock, from P10,000.0 million, consisting of 85,000,000 common shares and 15,000,000 preferred shares both with par value of P100.00 per share, to P15,000.0 million, consisting of 135,000,000 common shares and 15,000,000 preferred shares at the same par value.

TRADEMARKS AND OTHER INTANGIBLE ASSETS

In September 2017, SMPFC entered into separate Intellectual Property Rights Transfer Agreements (the "Agreements") with POMS Ventures Corporation (PVC) and Agana Circle Enterprises, Inc. (ACEI) for the transfer to SMPFC of several Philippine cooking oil trademarks, brands and logos registered in the name of PVC and ACEI (collectively, the "IP Rights"), subject to the fulfillment of certain terms and conditions specified in the Agreements.

In December 2017, the acquisition by SMPFC of the IP Rights was completed following the substantial fulfillment of the closing conditions of the Agreements and the payment of the consideration for such IP Rights.

EQUITY

Cash dividends declared in 2017 by the BOD of the Parent Company to common and preferred shareholders amounted to P6.00 per share and P56.569 per share, respectively.

OTHER MATTERS

a) On November 3, 2017, the BOD of SMC approved the internal restructuring of the San Miguel Group of Companies to consolidate its food and beverage businesses under SMPFC. To implement such consolidation, SMC will transfer all of its 7,859,319,270 common shares in San Miguel Brewery Inc. (SMB) and all of its 216,972,000 common shares in Ginebra San Miguel, Inc. (GSMI) (collectively, the "Exchange Shares") to SMPFC. In consideration for the Exchange Shares, SMPFC will issue 4,242,549,130 new common shares (the "New Shares") to SMC.

   In this connection, the following corporate actions were approved by the BOD of SMPFC on November 3, 2017: (a) amendments to the Articles of Incorporation to change/expand the primary purpose of SMPFC to include the beverage business and accordingly change its corporate name to "San Miguel Food and Beverage, Inc.", reduce the par value of SMPFC common shares from P10.00 per share to P1.00 per share, and deny pre-emptive rights for issuances or dispositions of all common shares (collectively, the "First Amendments"); (b) upon approval by the SEC of the

First Amendments, the increase in SMPFC's authorized capital stock by P9,540,000,000.00 divided into 9,540,000,000 common shares with a par value of P1.00 per share, and the amendment to the Articles of Incorporation to reflect such increase (the "Increase"); (c) the acquisition of the Exchange Shares from SMC and issuance by SMPFC of New Shares to SMC from the Increase, as consideration for the Exchange Shares; (d) the tender offer for SMB and GSMI shares held by minority shareholders, if required; and (e) the listing on the Philippine Stock Exchange (PSE) of the additional shares resulting from the reduction of par value of common shares and the New Shares to be issued to SMC.

The stockholders of the Parent Company approved the foregoing corporate actions in its special stockholders meeting on January 18, 2018.

On March 23, 2018, the SEC approved the First Amendments by virtue of the Certificate of Filing of Amended Articles of Incorporation of San Miguel Food and Beverage, Inc. (formerly San Miguel Pure Foods Company Inc.) issued on the said date, a copy of which the Parent Company received on March 27, 2018.

On April 5, 2018, SMC and the Parent Company signed a Deed of Exchange of Shares pursuant to which SMC shall transfer to the Parent Company the Exchange Shares, and in consideration therefor, the Parent Company shall issue New Shares from the Increase, subject to and conditioned upon the approval by the SEC of the Increase.

b) On December 15, 2017, Magnolia entered into an Asset Purchase Agreement (the "Agreement") with Felicisimo Martinez & Co., Inc. (FMC) for the purchase of FMC's parcels of land, buildings and improvements, and machineries and equipment (collectively, the "Purchased Assets") pertaining to the manufacturing plant where Magnolia's *La Pacita* biscuits are being toll-manufactured. The refundable deposit paid by Magnolia in December 2017 was recognized by Magnolia as part of "Non-trade receivables" as at December 31, 2017.

   In February 2018, the refundable deposit was reversed and the acquisition by Magnolia of the Purchase Assets was completed following the substantial fulfillment of the closing conditions of the Agreement and the payment of the consideration for such Purchased Assets.

<u>Analysis of Financial Position Accounts</u>

Cash and cash equivalents declined by 7% as funds were used to pay raw materials importation and capital expenditures.

Inventories grew by 21% mainly due to increased importation of certain major raw materials to support expected surge in sales volume and in anticipation of further increase in raw material costs in 2018.

The purposive increase in volume of live broiler grown and poultry breeding stock to support expected higher demand for chicken resulted in 10% and 19% surge in current and noncurrent biological assets, respectively.

Prepaid expenses and other current assets rose by 20% due to the increase in the level of creditable input taxes for application against future tax liabilities.

The purchase of land by a subsidiary resulted in 15% increase in investment property - net.

Property, plant and equipment - net went up by 55% on account of the Group's ongoing expansion projects.

The reversal of certain deferred tax benefit provisions resulted in 9% drop in deferred tax assets.

The increase in other noncurrent assets was mainly due to higher non-trade receivables.

Notes payable rose by 64% as additional short-term borrowings were availed to partly finance capital expenditure and working capital requirements.

Trade payables and other current liabilities registered a 32% increase due to higher volume of transactions with third party suppliers in the last quarter of 2017.

Income tax payable was 76% higher versus 2016 level as total income tax due of a domestic subsidiary in 2016 was fully paid using excess creditable withholding taxes carried over from previous year.

Higher other noncurrent liabilities was due to the increase in pension payable and recognition of deposit for future stock subscription for the additional investment made by a minority shareholder pending submission to the SEC of the application to increase authorized capital stock of a domestic subsidiary.

The increment in equity reserves was the result of the remeasurement of the Group's plan assets and obligations for the year 2017.

Unappropriated retained earnings increased by 29% on account of the Group's net income for the year, net of the cash dividends paid.

The share in the net income of subsidiaries where non-controlling stockholders hold stake, as well as the additional investment of a minority stockholder, translated to a 22% increase in the balance of non-controlling interests.

2016 vs 2015

Consolidated financial position of the Group remained healthy. Debt to equity ratio registered at 0.55:1 in 2016 from 0.56:1 in 2015. Current ratio of 1.73:1 in 2016 was slightly lower versus 1.89:1 in 2015 due to higher short-term loan availments to partly finance the Group's expansion program. The increase in total assets from P61.0 billion to P67.0 billion is likewise attributed to the expansion projects. Total equity went up from P39.0 billion to P43.2 billion on account of the net income for 2016, partly reduced by the cash dividends declared to all common and preferred shareholders of the Parent Company.

INVESTMENTS IN SUBSIDIARIES

a) In April 2016, the SEC issued the Certificate of Filing of Amended Articles of Incorporation approving the increase in PF-Hormel's authorized capital stock from P1,500.0 million, consisting of 1,500,000,000 common shares at a par value of P1.00 per share, to P3,500.0 million, consisting of 3,500,000,000 common shares at the same par value.

b) In June 2016, the BOD and shareholders of Magnolia approved, among others, the: (i) increase in Magnolia's authorized capital stock by P2,000.0 million, equivalent to 2,000,000,000 common shares at P1.00 par value per share, and (ii) declaration of stock dividend in favor of SMPFC amounting to P600.0 million, equivalent number of common shares of which totalling 600,000,000 will be taken from the proposed increase in authorized capital stock.

In December 2016, the SEC issued the Certificate of Filing of Amended Articles of Incorporation approving the increase in Magnolia's authorized capital stock from P1,000.0 million, consisting of 1,000,000,000 common shares at a par value of P1.00 per share, to P3,000.0 million, consisting 3,000,000,000 common shares at the same par value.

OTHER NONCURRENT ASSETS

In 2016, San Miguel Pure Foods (VN) Co., Ltd. recognized an impairment loss on idle assets amounting to P109.3 million.

LONG-TERM DEBT

In December 2016, PT San Miguel Pure Foods Indonesia fully paid its unsecured facility loans amounting to Indonesian Rupiah 19.0 billion (equivalent to P70.3 million).

EQUITY

Appropriated Retained Earnings

a) In March 2016, the BOD of PF-Hormel approved the reversal of the retained earnings appropriation amounting to P2,000.0 million.

   In July 2016, PF-Hormel reversed the retained earnings appropriation amounting to P2,000.0 million.

b) In March 2016, SMMI reversed the June 2015 retained earnings appropriation amounting to P2,000.0 million.

Cash Dividends

Cash dividends declared in 2016 by the BOD of the Parent Company to common and preferred shareholders amounted to P5.70 per share and P56.569 per share, respectively.

Analysis of Financial Position Accounts

Cash and cash equivalents went down by 19% mainly as a result of expansion-related expenditures.

The 11% increase in trade and other receivables - net resulted from higher credit sales due to conversion of certain distributors from cash to credit term.

Inventories grew by 16% largely due to higher importation of major raw materials to take advantage of lower prices, and increased cassava harvest.

Current biological assets declined by 6% due to lower production of marketable hogs and decrease in volume of hatching eggs.

Higher taxable income of a domestic subsidiary in the first three quarters of 2016 resulted in higher utilization of creditable withholding taxes, hence, the 33% drop in prepaid expenses and other current assets.

Investment property - net grew by 6% due to additional foreclosed property of a subsidiary.

The Group's expansion projects increased property, plant and equipment - net by 42%.

Additional short-term borrowings to partly finance capital expenditure requirements resulted in 43% increase in notes payable.

Higher volume of transactions with third party suppliers in the last quarter of 2016 resulted in a 6% increase in trade payables and other current liabilities.

Income tax payable was 16% lower versus 2015 level due to the decline in a certain subsidiaries' taxable income in the fourth quarter of 2016 versus same period in 2015.

The 100% drop in current maturities of long-term debt - net of debt issue costs was due to the full settlement of a foreign subsidiary's unsecured facility loan in December 2016.

Other noncurrent liabilities decreased by 69% due to the payment of retirement contribution.

Remeasurement of the Group's retirement plan assets and obligations for the year 2016 resulted in incremental equity reserves.

The 52% decrease in appropriated retained earnings was due to the reversal of the P3.2 billion retained earnings appropriation following the approval by the SEC of the increase in authorized capital stock of certain domestic subsidiaries.

Unappropriated retained earnings, on the other hand, rose by 76% on account of the Group's net income for 2016, net of the cash dividends paid, and the reversal of retained earnings appropriation.

The share in net income of a domestic subsidiary where non-controlling stockholders hold stake, net of the cash dividend declaration, translated to a 5% increase in the balance of non-controlling interests.

IV. SOURCES AND USES OF CASH

A brief summary of cash flow movements is shown below:

	December 31		
	2017	2016	2015
		(in Millions)	
Net cash flows provided by operating activities	**P12,254**	P7,216	P11,995
Net cash flows used in investing activities	**(14,322)**	(8,440)	(5,704)
Net cash flows provided by (used in) financing activities	**1,573**	(524)	(11,219)

Net cash from operations basically consisted of income for the period and changes in non-cash current assets, certain current liabilities and others.

Net cash used in investing activities included the following:

	December 31		
	2017	2016	2015
		(in Millions)	
Acquisitions of:			
Property, plant and equipment	**(P10,890)**	(P6,467)	(P3,128)
Investment property	**(104)**	-	-
Intangible assets	**(51)**	(52)	(464)
Increase in biological assets and other noncurrent assets	**(3,573)**	(2,257)	(2,215)
Proceeds from sale of investment property and property and equipment	**296**	336	103

Major components of cash flow provided by (used in) financing activities are as follows:

	December 31		
	2017	2016	2015
		(in Millions)	
Availments of notes payable	**P129,486**	P126,376	P265,898
Payments of notes payable	**(126,205)**	(124,833)	(271,071)
Cash dividends paid	**(1,847)**	(1,997)	(2,067)
Payment of stock transaction cost	**(10)**	-	-
Payments of current maturities of long-term debt	**-**	(70)	(4,500)
Redemption of outstanding PFP Shares	**-**	-	(15,000)
Proceeds from:			
Issuance of PFP2 Shares, net of transaction costs	**-**	-	14,884
Divestment of non-controlling interest	**-**	-	557
Addition to non-controlling interest	**89**	-	15
Deposit for future stock subscription	**60**	-	-
Availments of long-term debt	**-**	-	65

The effect of exchange rate changes on cash and cash equivalents amounted to (P0.2 million), P3.4 million and (P3.5 million) in 2017, 2016 and 2015, respectively.

V. ADDITIONAL INFORMATION ON UNAPPROPRIATED RETAINED EARNINGS

The unappropriated retained earnings of the Parent Company as at December 31, 2017 and 2016 is restricted in the amount of P182.1 million representing the cost of common shares held in treasury.

The Group's unappropriated retained earnings includes the accumulated earnings in subsidiaries which is not available for declaration as dividends until declared by the respective investees.

VI. KEY PERFORMANCE INDICATORS

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

KPI	December 2017	December 2016
Liquidity: Current Ratio	1.36	1.73
Solvency: Debt to Equity Ratio	0.70	0.55
Asset to Equity Ratio	1.70	1.55
Profitability: Return on Average Equity Attributable to Equity Holders of the Parent Company	19.78%	19.65%
Interest Rate Coverage Ratio	100.75	64.57

KPI	For the year ended December 2017	For the year ended December 2016
Operating Efficiency: Volume Growth	3.92%	5.36%
Revenue Growth	5.25%	4.42%
Operating Margin	8.45%	8.00%

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

KPI	Formula
Current Ratio	$\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$
Debt to Equity Ratio	$\dfrac{\text{Total Liabilities (Current + Noncurrent)}}{\text{Non-controlling Interests + Equity}}$
Asset to Equity Ratio	$\dfrac{\text{Total Assets (Current + Noncurrent)}}{\text{Non-controlling Interests + Equity}}$
Return on Average Equity Attributable to Equity Holders of the Parent Company	$\dfrac{\text{Net Income Attributable to Equity Holders of the Parent Company*}}{\text{Average Equity Attributable to Equity Holders of the Parent Company**}}$
Interest Rate Coverage Ratio	$\dfrac{\text{Earnings Before Interests and Taxes}}{\text{Interest Expense and Other Financing Charges}}$
Volume Growth	$\left(\dfrac{\text{Sum of all Businesses' Revenue at Prior Period Prices}}{\text{Prior Period Net Sales}}\right) -1$
Revenue Growth	$\left(\dfrac{\text{Current Period Net Sales}}{\text{Prior Period Net Sales}}\right) -1$
Operating Margin	$\dfrac{\text{Income from Operating Activities}}{\text{Net Sales}}$

* *Excluding cash dividends paid to preferred shareholders*

** *Excluding preferred capital stock and related additional paid-in capital*

VII. OTHER MATTERS

a) Declaration of Cash Dividends

On February 1, 2018, the Parent Company's BOD declared cash dividends to all common shareholders of record as at February 19, 2018 amounting to P2.00 per share payable on March 1, 2018. SMPFC's BOD likewise declared on February 1, 2018 cash dividends to all preferred (series 2) shareholders of record as at February 19, 2018 amounting to P14.14225 per share payable on March 12, 2018.

b) Ratification of SMSCCI's Increase in Authorized Capital Stock

On February 6, 2018, the BOD and shareholders of SMSCCI ratified the increase in SMSCCI's authorized capital stock from P500.0 million, consisting of 50,000,000 million common shares at a par value of P10.00 per share, to 1,000.0 million, consisting of 100,000,000 million common shares at the same par value, as previously approved by the BOD and shareholders of SMSCCI on December 14, 2016.

c) 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 to 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 consolidated financial statements of the Group.

d) Commitments

The outstanding purchase commitments of the Group as at December 31, 2017 amounted to P19,139.7 million, of which P5,569.1 million pertains to contractual commitments on capital projects in progress.

e) Foreign Exchange Rate

The foreign exchange rates used in translating the US dollar accounts of foreign subsidiaries to Philippine peso were closing rates of P49.93 and P49.72 in 2017 and 2016, respectively, for consolidated statements of financial position accounts; and average rates of P50.40, P47.48 and P45.50 in 2017, 2016 and 2015, respectively, for income and expense accounts.

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

g) There are no unusual items as to the nature and amount affecting assets, liabilities, equity, net income or cash flows, except those stated in Management's Discussion and Analysis of Financial Position and Financial Performance.

h) There were no material changes in estimates of amounts reported in prior interim periods of the current year or changes in estimates of amounts reported in prior financial years.

i) There were no known trends, demands, commitments, events or uncertainties that will have a material impact on the Group’s liquidity.

j) There were no known trends, events or uncertainties that have had or that are reasonably expected to have a favorable or unfavorable impact on net sales or revenues or income from continuing operations.

k) There were no known events that will trigger direct or contingent financial obligation that is material to the Group, including any default or acceleration of an obligation and there were no changes in contingent liabilities and contingent assets since the last annual reporting date, except for “Contingencies” under Section VII (c) that remain outstanding as at and for the period ended December 31, 2017.

l) There were no material off-statements of financial position transactions, arrangements, obligations (including contingent obligations), and other relationship of the Group with unconsolidated entities or other persons created during the reporting period, except for the outstanding derivative transactions entered by the Group as at and for the period ended December 31, 2017.

m) Certain accounts in prior years have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported financial performance for any period.