

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Perfumeria Española Corp., which comprise the balance sheets as at December 31, 2006 and 2005, and the statements of income, statements of changes in stockholders' equity and statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Perfumeria Española Corp. as of December 31, 2006 and 2005, and its financial performance and its cash flows for the years then ended in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Josephine H. Estomo
Partner
CPA Certificate No. 46349
SEC Accreditation No. 0078-AR-1
Tax Identification No. 102-086-208
PTR No. 0266550, January 2, 2007, Makati City

February 2, 2007

INDEPENDENT AUDITORS' REPORT

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Perfumeria Española Corp.

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Perfumeria Española Corp.
Chemphil Building, 851 A. Arnaiz Avenue
Legaspi Village, Makati City

We have audited the financial statements of Perfumeria Española Corp. for the year ended December 31, 2006, on which we have rendered the attached report dated February 2, 2007.

In compliance with SRC Rule 68, we are stating that the above Company has two stockholders owning more than one hundred (100) shares.

SYCIP GORRES VELAYO & CO.

Josephine H. Estomo
Partner
CPA Certificate No. 46349
SEC Accreditation No. 0078-AR-1
Tax Identification No. 102-086-208
PTR No. 0266550, January 2, 2007, Makati City

February 2, 2007

PERFUMERIA ESPAÑOLA CORP.
BALANCE SHEETS

	December 31	
	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	₱7,446,218	₱18,720,421
Receivables (Note 5)	26,534,174	17,587,102
Inventories (Notes 6 and 9)	10,976,461	7,915,339
Due from related parties (Note 9)	57,040	589,458
Other current assets (Notes 9 and 14)	431,604	1,178,141
Total Current Assets	45,445,497	45,990,461
Noncurrent Assets		
Property and equipment - net (Note 7)	242,639	482,254
Deferred income tax assets - net (Note 15)	520,886	424,485
Total Noncurrent Assets	763,525	906,739
TOTAL ASSETS	₱46,209,022	₱46,897,200
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses (Note 8)	₱18,039,699	₱19,883,768
Income tax payable	1,257,619	269,161
Due to related parties (Note 9)	396,726	18,094
Total Current Liabilities	19,694,044	20,171,023
Noncurrent Liability		
Accrued retirement benefits (Note 14)	61,040	-
Total Liabilities	19,755,084	20,171,023
Stockholders' Equity		
Capital stock - ₱1 par value		
Authorized - 75,000,000 shares		
Issued - 18,750,000 shares	18,750,000	18,750,000
Additional paid-in capital	1,095,572	1,095,572
Retained earnings (Note 10)	6,608,366	6,880,605
Total Stockholders' Equity	26,453,938	26,726,177
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	₱46,209,022	₱46,897,200

See accompanying Notes to Financial Statements.

PERFUMERIA ESPAÑOLA CORP.
STATEMENTS OF INCOME

	Years Ended December 31	
	2006	2005
NET SALES	₱68,475,821	₱63,679,334
COST OF SALES (Note 11)	42,415,569	38,643,409
GROSS PROFIT	26,060,252	25,035,925
Selling expenses (Note 12)	(8,904,376)	(9,365,224)
General and administrative expenses (Note 13)	(8,056,870)	(10,838,582)
Interest income (Notes 4 and 9)	645,823	1,444,601
Foreign exchange gain - net	164,715	428,179
Other income - net	116,278	957,596
INCOME BEFORE INCOME TAX	10,025,822	7,662,495
PROVISION FOR INCOME TAX (Note 15)		
Current	3,513,462	2,241,947
Deferred	(96,401)	34,709
	3,417,061	2,276,656
NET INCOME	₱6,608,761	₱5,385,839

See accompanying Notes to Financial Statements.

PERFUMERIA ESPAÑOLA CORP.
STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	₱10,025,822	₱7,662,495
Adjustments for:		
Depreciation (Note 7)	239,615	246,946
Loss from inventories written - off	-	2,216,046
Interest income	(645,823)	(1,444,601)
Unrealized foreign exchange gain - net	-	(191,572)
Operating income before working capital changes	9,619,614	8,489,314
Decrease (increase) in:		
Receivables	(9,210,054)	(1,452,078)
Inventories	(3,061,122)	1,029,712
Other current assets	746,537	(994,654)
Increase (decrease) in:		
Accounts payable and accrued expenses	(1,900,364)	2,139,002
Due to related parties	378,632	2,127
Provision for retirement benefits cost (Note 14)	117,335	89,735
Net cash generated from (used in) operations	(3,309,422)	9,303,158
Interest received	876,158	1,430,201
Income taxes paid, including creditable tax withheld	(2,525,004)	(2,469,075)
Net cash flows from (used in) operating activities	(4,958,268)	8,264,284
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment (Note 7)	-	(33,227)
Decrease (increase) in amounts due from related parties	532,418	(157,854)
Interest received from related parties	32,647	14,400
Net cash flows from (used in) investing activities	565,065	(176,681)
CASH FLOW FROM FINANCING ACTIVITY		
Dividends paid (Note 10)	(6,881,000)	(8,000,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	(11,274,203)	87,603
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		
	18,720,421	18,632,818
CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 4)		
	₱7,446,218	₱18,720,421

See accompanying Notes to Financial Statements.

PERFUMERIA ESPAÑOLA CORP.**STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005**

	Capital Stock	Additional Paid-in Capital	Retained Earnings	Total
BALANCES AT DECEMBER 31, 2004	₱18,750,000	₱1,095,572	₱9,494,766	₱29,340,338
Cash dividends - ₱0.43 per share (Note 10)	–	–	(8,000,000)	(8,000,000)
Net income for the year	–	–	5,385,839	5,385,839
BALANCES AT DECEMBER 31, 2005	18,750,000	1,095,572	6,880,605	26,726,177
Cash dividends - ₱0.37 per share (Note 10)	–	–	(6,881,000)	(6,881,000)
Net income for the year	–	–	6,608,761	6,608,761
BALANCES AT DECEMBER 31, 2006	₱18,750,000	₱1,095,572	₱6,608,366	₱26,453,938

See accompanying Notes to Financial Statements.

PERFUMERIA ESPAÑOLA CORP.

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

Perfumeria Española Corp. (the Company) was incorporated in the Philippines. The Company is 51% owned by Perfumeria Gal of Spain (GAL), a company incorporated in Spain, and 49% owned by Chemical Industries of the Philippines (CIP), a company incorporated in the Philippines. The Company is engaged in the marketing and distribution of soap and beauty products through a local distributor.

The registered office address of the Company is Chemphil Building, 851 A. Arnaiz Avenue, Legaspi Village, Makati City.

The accompanying financial statements were authorized for issue by the Board of Directors (BOD) on February 2, 2007.

2. Summary of Significant Accounting and Financial Reporting Policies

Basis of Preparation

The accompanying financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

The financial statements of the Company have been prepared on the historical cost basis and are presented in Philippine peso, which is the Company's functional currency.

Adoption of New and Revised Accounting Standards

The Company adopted Philippine Accounting Standards (PAS) 19, *Amendments to Employee Benefits*, which provides additional option to recognize all actuarial gains and losses immediately outside of profit or loss (i.e., in equity). If the new option is adopted, present actuarial gains and losses in a statement of changes in equity titled 'Statement of Recognized Income and Expenses'. The Company chose not to apply the new option offered to recognize all actuarial gains and losses immediately outside of profit or loss.

The Company also adopted PAS 39, *Amendments to Financial Instruments: Recognition and Measurement*, which became effective beginning January 1, 2006. This revised standard restricts the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement. Adoption of the revised accounting standard did not result to restatement of prior year's financial statements. Additional disclosures required by the revised standard were included in the financial statements, where applicable.

Future Changes in Accounting Policies

The Company has not applied the following PFRS and Philippine Interpretations which are not yet effective for the year ended December 31, 2006:

- *PFRS 7, Financial Instruments: Disclosures, and the complementary amendment to PAS 1, Presentation of Financial Statements: Capital Disclosures* - effective for annual periods beginning on or after January 1, 2007

- *PFRS 8, Operating Segments* - effective for annual periods beginning on or after January 1, 2009
- *Philippine Interpretation International Financial Reporting Interpretations Committee (IFRIC)-7, Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies* - effective for annual periods beginning on or after March 1, 2006
- *Philippine Interpretation IFRIC-8, Scope PFRS 2* - effective for annual periods beginning on or after May 1, 2006
- *Philippine Interpretation IFRIC-10 Interim Financial Reporting and Impairment* - effective for annual periods beginning on or after November 11, 2006
- *Philippine Interpretation IFRIC-11, Group and Treasury Share Transactions* - effective for annual periods beginning on or after March 1, 2007
- *Philippine Interpretation IFRIC-12, Service Concession Arrangements* - effective for annual periods beginning on or after January 1, 2008

Cash and Cash Equivalents

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

Inventories

Inventories are valued at the lower of cost and net realizable value (NRV). Cost of finished goods consists of direct materials and manufacturers' toll fee. Cost of raw materials is determined using the moving average method.

NRV of finished goods is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

NRV of raw materials is the current replacement cost.

Financial Assets and Liabilities

Financial assets in the scope of PAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. Financial liabilities, on the other hand, are classified as either financial liabilities at fair value through profit or loss or other liabilities, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Company determines the classification of its financial assets and financial liabilities after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

All regular way purchases and sales of financial assets are recognized on the trade date, which the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets or financial liabilities at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets or financial liabilities at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognized in the statement of income.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Other long-term investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortized cost. This cost is computed as the amount initially recognized minus principal repayments, plus or minus the cumulative amortization using the effective interest rate method of any difference between the initially recognized amount and the maturity amount less allowance for impairment. This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortized cost, gains and losses are recognized in the statement of income when the investments are derecognized or impaired, as well as through the amortization process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. Such assets are carried at amortized cost using the effective interest rate method. Gains and losses are recognized in the statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized as a separate component of equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is recognized in the statement of income.

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using generally accepted valuation techniques.

Derecognition of Financial Assets and Liabilities

Financial Assets

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

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

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

Financial Liabilities

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

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

Impairment of Financial Assets

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

Assets Carried at Amortized Cost

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

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset

is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

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

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets Carried at Cost

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

Available-for-Sale Financial Assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from stockholder's equity to the statement of income. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization and any impairment in value.

The initial cost of property and equipment comprises its purchase price, including import duties, taxes and any other costs directly attributable to bringing the asset to its working condition and location for its intended use. Expenditures incurred after the property and equipment have been put into operation, such as repairs and maintenance, are normally charged to operations in the period such costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property and equipment.

Depreciation and amortization is calculated on a straight-line basis over the estimated useful lives as follows:

Machinery and equipment	3 years
Office furniture, fixtures and equipment	3 years
Transportation equipment	5 years
Leasehold improvements	2 years

The useful lives, depreciation and amortization method and estimated residual values are reviewed periodically to ensure that these are consistent with the expected pattern of economic benefits from items of property and equipment.

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

Impairment of Long-lived Non-Financial Assets

The carrying values of the property and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amounts, the assets are written down to their recoverable amounts. An asset's recoverable amount is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present values using a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset. Any impairment loss is recognized in the statement of income.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of income unless the asset is carried at a revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation expense is adjusted in future years to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining life.

Revenue

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

Sales

Sales revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be measured reliably.

Interest

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

Retirement Benefits Cost

Retirement benefits cost is actuarially computed using the projected unit credit method. This method reflects services rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. Actuarial valuations are conducted with sufficient regularity, with option to accelerate when significant changes to underlying assumptions occur. Retirement benefits cost includes current service cost, interest cost, expected return on any plan assets, actuarial gains and losses, past service cost and the effect of any curtailment or settlement. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses of the defined benefit plan at the end of the previous reporting year exceeded 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the defined benefit plan.

The net retirement liability recognized by the Company in respect of the defined benefit pension plan is the aggregate of the present value of the defined benefit obligation and unrecognized actuarial gains and losses reduced by the unrecognized past service cost and the fair value of plan assets out of which the obligations are to be settled directly.

The net retirement asset recognized by the Company in respect of the defined benefit pension plan is the lower of: (a) the present value of the defined benefit obligation at the balance sheet date less the fair value of the retirement plan assets, together with adjustments for unrecognized actuarial gains or losses and past service costs that shall be recognized in later periods or (b) the total of any net cumulative unrecognized actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The defined benefit obligation is calculated annually by an independent actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using risk-free interest rates of government bonds that have terms to maturity approximating to the terms of the related retirement liability.

Operating Leases

Lease payments under an operating lease are recognized as expense in the statement of income on a straight-line basis over the lease term.

Income Taxes

Current Income Tax

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

Deferred Income Tax

Deferred income tax is recognized, using the balance sheet liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, carryforward benefits of unused tax credits from the excess of the minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT) or unused tax losses from net operating loss carryover (NOLCO) but only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward benefits of unused tax credits and losses from excess MCIT over RCIT and NOLCO, respectively, can be utilized before their reversal or expiration.

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

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

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

Foreign Currency Transactions and Translations

The functional and presentation currency of the Company is the Philippine peso. Transactions denominated in foreign currencies are initially recorded in Philippine peso based on the applicable exchange rates prevailing at the transaction dates. Outstanding foreign currency-denominated monetary assets and liabilities are translated to Philippine peso at applicable exchange rates prevailing at the balance sheet date. Exchange differences are recognized in the statement of income.

Provisions

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

Events After Balance Sheet Date

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

3. Significant Accounting Judgments and Estimates

Judgment

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

Determination of the Company's functional currency

Based on the economic substance of the underlying circumstances relevant to the Company, the functional currency has been determined to be Philippine peso. It is the currency that mainly influences the sale of goods and the cost of sales.

Classification of financial instruments

The Company classifies financial instruments, or its component parts, on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of the instruments. The substance of a financial instrument, rather than its legal form, governs its classification in the Company's balance sheets. The Company determines the classification at initial recognition and re-evaluates this designation at every reporting date.

Operating lease - the Company as lessee

The Company has entered into property leases, where it has determined that the risks and rewards related to those properties are retained by the lessors. As such, these lease agreements are accounted for as operating lease.

Estimation Uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are as follows:

Estimation of allowance for doubtful accounts

Allowance for doubtful accounts is provided for accounts that are specifically identified to be doubtful as to collection. The level of allowance is evaluated by management on the basis of factors that affect the collectibility of the accounts.

The Company's receivables amounted to ₱26,534,174 and ₱17,587,102 as of December 31, 2006 and 2005, respectively.

Retirement benefits

The determination of the obligation and cost of retirement benefits is dependent on the selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in Note 14 and include among others, annual salary increase, expected returns on plan asset and discount rates. Actual results that differ from the Company's assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. While the management believes that the assumptions are reasonable and appropriate, significant differences in the actual experience or significant changes in the assumptions may materially affect the retirement obligations.

The Company's net retirement liability (assets) amounted to ₱61,040 and (₱56,296) as of December 31, 2006 and 2005, respectively.

Recognition of deferred income tax assets

The Company reviews the carrying amounts at each balance sheet date and adjusts the balance of deferred income tax assets to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized.

The Company's deferred income tax assets amounted to ₱520,886 and ₱424,485 as of December 31, 2006 and 2005, respectively.

Impairment of long-lived non-financial assets

The Company determines whether its long-lived non-financial assets are impaired, at least on an annual basis. This requires an estimation of the value-in-use of the cash-generating units to which the assets belong. Estimating the value-in-use requires the Company to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. There were no impairment of assets as of December 31, 2006 and 2005.

Estimated useful lives of property and equipment

The Company estimates the useful lives of its property and equipment based on the period over which the assets are expected to be available for use. The Company reviews annually the estimated useful lives of property and equipment based on factors that include asset utilization, internal technical evaluation, technological changes, environmental and anticipated use of the assets tempered by related industry benchmark information. It is possible that future results of operation could be materially affected by changes in these estimates brought about by changes in factors mentioned. A reduction in the estimated useful lives of property and equipment would increase depreciation expense and decrease noncurrent assets.

The carrying value of the property and equipment amounted to ₱242,639 and ₱482,254 as of December 31, 2006 and 2005, respectively.

4. **Cash and Cash Equivalents**

	2006	2005
Cash on hand and in banks	₱1,444,818	₱1,713,382
Short-term cash investments	6,001,400	17,007,039
	₱7,446,218	₱18,720,421

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

5. **Receivables**

	2006	2005
Trade	₱26,242,236	₱17,188,509
Others	291,938	398,593
	₱26,534,174	₱17,587,102

6. Inventories

	2006	2005
Raw materials:		
On hand (at NRV)	₱7,476,010	₱3,634,055
In-transit (at cost)	1,100,440	2,777,795
Finished goods - at cost	2,400,011	1,503,489
	₱10,976,461	₱7,915,339

Cost of raw materials on hand amounted to ₱8,790,866 and ₱4,948,910 in 2006 and 2005, respectively.

7. Property and Equipment

As of December 31, 2006:

	2006				
	Machinery and Equipment	Office Furniture, Fixtures and Equipment	Transportation Equipment	Leasehold Improvements	Total
Cost					
Beginning balances	₱447,818	₱555,225	₱886,182	₱2,123	₱1,891,348
Additions	-	-	-	-	-
Ending balances	447,818	555,225	886,182	2,123	1,891,348
Accumulated Depreciation					
Beginning balances	406,638	482,392	517,942	2,122	1,409,094
Depreciation	26,311	36,318	176,986	-	239,615
Ending balances	432,949	518,710	694,928	2,122	1,648,709
Net Book Value	₱14,869	₱36,515	₱191,254	₱1	₱242,639

As of December 31, 2005:

	2005				
	Machinery and Equipment	Office Furniture, Fixtures and Equipment	Transportation Equipment	Leasehold Improvements	Total
Cost					
Beginning balances	₱427,818	₱541,998	₱886,182	₱2,123	₱1,858,121
Additions	20,000	13,227	-	-	33,227
Ending balances	447,818	555,225	886,182	2,123	1,891,348
Accumulated Depreciation					
Beginning balances	₱379,012	₱440,308	₱340,706	₱2,122	₱1,162,148
Depreciation	27,626	42,084	177,236	-	246,946
Ending balances	406,638	482,392	517,942	2,122	1,409,094
Net Book Value	₱41,180	₱72,833	₱368,240	₱1	₱482,254

8. Accounts Payable and Accrued Expenses

	2006	2005
Trade (Note 9)	₱13,138,984	₱13,806,476
Accrued advertising and promotions	2,782,977	2,254,007
Accrued royalties (Note 9)	699,694	1,498,447
Other accrued expenses	1,418,044	2,324,838
	₱18,039,699	₱19,883,768

9. Related Party Transactions

The Company, in the normal course of business, has entered into the following significant transactions with its related parties:

- a. License agreement with GAL for the use of the latter's trademark and for the manufacture of the latter's products for a royalty fee of 3% of net sales as defined in the agreement. This agreement is effective until May 31, 2008. Royalty fees charged to operations amounted to ₱2,032,871 and ₱1,731,783 in 2006 and 2005, respectively (see Note 13). Outstanding liability, included in "Accounts payable and accrued expenses" account in the balance sheets, amounted to ₱699,694 and ₱1,498,447 as of December 31, 2006 and 2005, respectively.
- b. Purchases of raw materials from GAL with terms similar to third parties. Total purchases amounted to ₱14,804,280 in 2006 and ₱11,394,780 in 2005 (see Note 11). Outstanding liability, included in the "Accounts payable and accrued expenses" account in the balance sheets, amounted to ₱3,867,055 and ₱3,851,537 as of December 31, 2006 and 2005, respectively.
- c. Rental agreement with CIP for the Company's office space for one year renewable at the option of both parties effective January 1, 2006 to December 31, 2006. Rent expense charged to operations amounted to ₱286,354 in 2006 and ₱266,295 in 2005 (see Note 13).

Service agreement with CIP for the Company's management support activities from January 2000 until June 2003. The agreement was further renewed starting January 2005 for an indefinite period. Deposit amounting to ₱720,000 was paid by the Company to CIP to avail of the 12% discount on early payment. The shared services fee is calculated based on the terms of agreement but not to exceed ₱145,000 a month, excluding value-added tax. Share in common services charged to operations amounted to ₱1,412,015 in 2006 and ₱1,611,989 in 2005 (see Note 13).

- d. Insurance premium payments to Vision Insurance Consultants, Inc. (VIC).
- e. Compensation of key management personnel consists of short-term employee benefits and termination benefits amounting to ₱2,088,978 and ₱85,773, respectively, in 2006 and ₱2,016,719 and ₱81,688, respectively, in 2005.

The outstanding balances of transactions of related parties as of December 31, 2006 and 2005 are as follows:

	2006	2005
Due from related parties:		
CAWC, Inc.	P37,659	P12,110
Kemwater Philippines Corp.	19,166	-
CMC	215	-
CIP	-	571,659
LMG Chemicals Corp. (LMG)	-	5,689
	P57,040	P589,458
Accounts payable and accrued expenses - GAL	P4,566,749	P5,349,984
Due to related parties:		
LMG	P366,873	P-
CIP	20,663	-
VIC	9,190	18,094
	P396,726	P18,094

10. Declaration of Dividends

On September 20, 2006, the BOD approved the declaration of P6,881,000 cash dividends to stockholders of record as of September 30, 2006 to be paid on or before October 31, 2006. These dividends were fully paid as of December 31, 2006.

On November 9, 2005, the BOD approved the declaration of P8,000,000 cash dividends to stockholders of record as of October 31, 2005. These dividends were fully paid as of December 31, 2005.

11. Cost of Sales

	2006	2005
Raw materials cost (Note 9)	P20,020,261	P18,481,026
Toll manufacturing fee (Note 18)	22,395,308	20,162,383
	P42,415,569	P38,643,409

12. Selling Expenses

	2006	2005
Promotions and distribution (Note 18)	P7,016,289	P4,836,096
Advertising	1,888,087	4,529,128
	P8,904,376	P9,365,224

13. General and Administrative Expenses

	2006	2005
Salaries and wages	₱2,301,987	₱2,383,322
Royalty fees (Note 9)	2,032,871	1,731,783
Share in common services (Note 9)	1,412,105	1,611,989
Taxes and licenses	522,702	396,877
Professional and other service fees	385,275	453,531
Rent (Note 9)	286,354	266,295
Depreciation (Note 7)	239,615	246,946
Employee benefits (Note 14)	165,743	144,256
Communication, light and water	146,743	191,058
Travel	57,483	72,038
Loss from inventories write-off	-	2,216,046
Others	505,992	1,124,441
	₱8,056,870	₱10,838,582

14. Retirement Benefits Cost

The Company, together with its affiliated companies, is a participant in a multi-employer funded and non-contributory defined benefit retirement plan covering substantially all its regular employees. The benefits are based on the years of service and latest monthly compensation of the employees.

Net retirement benefits cost for the years then ended are as follows:

	2006	2005
Current service cost	₱85,581	₱66,573
Interest cost	115,241	96,600
Expected return on plan assets	(86,276)	(81,422)
Net actuarial loss	2,789	4,077
Net transition obligation recognized in the year	-	3,907
Net retirement benefits cost for the year	₱117,335	₱89,735
Actual return on plan assets	₱83,487	₱77,345

Net retirement liability (asset) recognized by the Company are as follows:

	2006	2005
Present value of pension liabilities	₱1,212,054	₱968,170
Fair value of plan assets	(954,562)	(862,756)
Unfunded present value of pension liabilities	257,492	105,414
Unrecognized net actuarial loss	(196,452)	(161,710)
Net retirement liability (asset)	₱61,040	(₱56,296)

Changes in the present value of the pension liabilities are as follows:

	2006	2005
Balances at beginning of year	₱968,170	₱804,997
Current service cost	85,581	66,573
Interest cost	115,241	96,600
Actuarial loss for the year	43,062	-
Balances at end of year	₱1,212,054	₱968,170

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

	2006	2005
Balances at beginning of year	₱862,756	₱678,518
Expected return on plan assets	86,276	81,422
Actual contributions	-	102,816
Actuarial gain	5,530	-
Balances at end of year	₱954,562	₱862,756

The principal actuarial assumptions used to determine net retirement costs were an annual salary increase of 6% for both years and investment yield of 10% in 2006 and 12% in 2005. Discount rates used were 8% and 12% in 2006 and 2005, respectively.

The Company's contribution to the retirement plan consists of a payment covering the current service cost for the year plus a payment toward funding the actuarial accrued retirement benefits cost.

15. Income Taxes

a. The components of the Company's net deferred tax assets are as follows:

	2006	2005
Tax effects of:		
Allowance for inventory obsolescence	₱460,200	₱460,200
Unamortized past service costs	39,323	51,039
Net pension liability (asset)	21,363	(19,704)
Unrealized foreign exchange gain - net	-	(67,050)
	₱520,886	₱424,485

b. A reconciliation of provision for income tax computed at the applicable statutory income tax rate to provision for income tax as shown in the statements of income follows:

	2006	2005
Income tax computed at statutory income tax rate	₱3,509,037	₱2,490,311
Adjustments to income tax resulting from:		
Interest income subjected to lower final tax	(91,976)	(178,775)
Effect of change in income tax rate	-	(34,880)
Provision for income tax	₱3,417,061	₱2,276,656

c. The components of the Company's current income tax are as follows:

	2006	2005
Regular corporate income tax	₱3,390,827	₱1,955,907
Final tax on interest income	122,635	286,040
	₱3,513,462	₱2,241,947

d. On May 24, 2005, the new Expanded-Value Added Tax (E-VAT) law was signed as Republic Act (RA) No. 9337 or the E-VAT Act of 2005. The E-VAT law took effect on November 1, 2005 following the approval on October 19, 2005 of Revenue Regulations (RR) 16-2005 which provides for the implementation of the rules and regulations of the new E-VAT law. Among the relevant provisions of the new E-VAT law are:

- i. Change in RCIT rate from 32% to 35% for the next three years effective on November 1, 2005, and 30% starting on January 1, 2009 and thereafter;
- ii. A 70% cap on the input VAT that can be claimed against output VAT;
- iii. Increase in the VAT rate imposed on goods and services from 10% to 12% effective January 1, 2006 provided that the VAT collection as a percentage of Gross Domestic Product (GDP) of the previous year exceeds 2.8% or the Philippine national government deficit as a percentage of GDP of the previous year exceeds 1.5%; and
- iv. The amount of interest paid or incurred within a taxable year on indebtedness in connection with the taxpayer's profession, trade or business shall be allowed as a deduction from gross income, provided that, the taxpayer's otherwise allowable deduction for interest expense shall be reduced by 42% of the interest income subject to final tax, provided that, effective January 1, 2009, the rate shall be 33%.

On January 31, 2006, the President, upon recommendation of the Secretary of Finance, approved the 2% increase in VAT rate effective on February 1, 2006.

On November 21, 2006, the President signed into law Republic Act No. 9361 which amends Section 110 (B) of the Tax Code. This law, which became effective on December 13, 2006, provides that if the input tax, inclusive of the input tax carried over from the previous quarter exceeds the output tax, the excess input tax shall be carried over to the succeeding quarter or quarters. The Department of Finance, through the Bureau of Internal Revenue, issued RR No. 2-2007 (the Regulation) to implement the provisions of the said law. Based on the Regulation, the amendment shall apply to the quarterly VAT returns to be filed after the effectivity of RA No. 9361 except VAT returns covering taxable quarters ending earlier than December 2006.

16. Financial Risk Management Objectives and Policies

The Company's principal financial instruments comprise cash and cash equivalents. The Company has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

The main risks arising from the Company's financial instruments are foreign currency risk and credit risk and liquidity risk. The BOD reviews and approves policies for managing each of these risks and they are summarized below.

Foreign Currency Risk

The Company has transactional currency exposures. Such exposure arises from purchases in currencies other than the functional currency. Approximately 65% of the Company's purchases are denominated in currencies other than the functional currency.

Credit Risk

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant.

Liquidity Risk

The Company's objective is to maintain a balance between continuity of funding and flexibility through availment of cash advances from affiliates.

17. Financial Assets and Liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements.

	Carrying Amount		Fair Value	
	2006	2005	2006	2005
Financial assets:				
Cash and cash equivalents	₱7,446,218	₱18,720,421	₱7,446,218	₱18,720,421
Trade receivables	26,242,236	17,188,509	26,242,236	17,188,509
Financial liability:				
Trade payables	13,138,984	13,806,476	13,138,984	13,806,476

Due to their short-term nature, the carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate their fair values.

18. Other Matters

- a. The Company has an agreement with JDH Philippines Inc. (JDH) for the distribution of its products. The agreement was terminated effective January 31, 2005. The said agreement provided that upon termination, JDH will resell to the Company and the Company will repurchase all stock of the products in inventory at the original costs. The total value of inventory buy-back from JDH as of January 31, 2005 amounted to ₱12.8 million. A total of ₱11 million worth of the said inventory was sold to the new distributor.
- b. The Company engaged SYSU International, Inc. in lieu of JDH for the distribution of its products effective February 1, 2005. Under the new agreement, the Company will sell the products net of 20% distribution fee (inclusive of value added tax) and any other present and future applicable taxes.