SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA Greenhills,
City of Mandaluyong

4 January 2005

P. Four Inc.
c/o SGV & Co.
10/F SGV 11
Makati City

SEC Opinion No. 05-01
Reclassification of paid-in surplus

Gentlemen:

This pertains to your letter dated 7 September 2004 requesting confirmation that the increase in the authorized capital stock of the aforenamed corporation by increasing the par value of its shares of stocks without, however, increasing the number of shares through the reclassification of additional paid-in surplus to paid-up capital is not violative of any provision of law and may thus be allowed by the Commission.

As a factual background, P-Four is a domestic corporation duly registered with the Commission with an authorized capital stock of P30,000,000 divided into 300,000 shares with a par value of P100.00 per share. Of said authorized capital, P180,000 shares are issued and outstanding.

The Board of Directors of subject corporation proposes to increase the authorized capital stock from P30,000,000 to P2,500,020,000 by reclassifying a portion of its paid-in surplus to paid-up capital. In the process, the par value of its shares shall be increased from P100 to P13,899 per share while the authorized number of shares shall be correspondingly decreased from 300,000 to 180,000.

The complex issue posed before the Commission can be restated as follows: whether the corporation may increase its authorized capital stock by increasing its par value, decreasing the number of shares and reclassifying its additional paid-in capital to paid-up capital of the corporation.

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To answer the foregoing issue, the hereunder quoted litany of opinions may shed light on the intended conversion of P-Four's paid-in surplus into paid-up capital which state thus:

Additional paid-in surplus may be applied to reduce or wipe out deficits of the corporation provided that after such restructuring process has been effected, the same shall be disclosed in all subsequent financial statements of the corporation for a period of at least three (3) years. (Mr. S.U. Salvador of SGV & Co., June 6, 1991)

The corporate restructuring or readjustment envisioned by P-Four relates to a reverse stock split , which has been described by Ballantine & Sterling "as the name indicates, is just the opposite of stock split. It is the pro rata combination of all the outstanding shares of a specified class into smaller number of shares of that class by an amendment to articles stating the effect on outstanding shares". (Ballantine & Sterling, California Corporation Laws, p. 8-94) "A reverse stock split may be required to increase the market value per share of a corporation's shares or to restructure other outstanding debt or equity instruments issued by the corporation or it may be used to eliminate certain small minority stockholders." (Ibid. p. 8-97) "A stock split or reverse stock split, like a share dividend, readjusts corporation's capital structure. **Either can therefore, be used as part of a recapitalization of a corporation."** (Ibid.) "Correspondingly, in a reverse stock split the outstanding shares are transformed into a smaller number of outstanding shares and again the effect is disguised unless the par or nominal value of the shares is changed as part of the transaction. In the absence of some feature not associated with the typical stock split (such as an option to receive cash rather than shares or a split or reverse split which does not result in proportionate change in the shareholdings of all holders of the same class or series) the receipt of shares as a result of a split does not result in taxable income to either the stockholder or the corporation." (ibid. pp. 8-96 – 8-96.10)

Reverse stock split may be allowed as can be culled from the hereunder quoted provisos of the **Statement of Financial Accounting Standards No. 18 which laid down the generally accepted accounting standards in this jurisdiction:**

Stock Splits

21. "Stock Split" is defined as the issuance by an enterprise of its own common shares to its common shareholders without consideration and under conditions indicating that such action is prompted mainly by a desire to increase the number of outstanding shares for the purpose of effecting a reduction in their unit market price and thereby, of obtaining wider distribution and improved marketability of the shares.

Stock splits (including reverse splits – see paragraph 23) should be recorded when they are effected.

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23. **Reverse splits-** At times, a corporation may wish to raise the unit market price of its shares and reduce the number of shares outstanding. This may be accomplished by means of a "reverse split" in which the number of shares outstanding is reduced and the par value is increased proportionately.

No accounting entry should be made for reverse splits unless the total par value of the shares is reduced. In that case, the reduction should be reflected in additional paid-in capital properly described, not in income or retained earnings.

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Changes in Par Value

27. Changes in the par values of capital stock should be charged or credited to additional paid-in capital. If increases in capital stock values exceed additional paid-in capital, they should be charged to retained earnings.

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Additional Paid-In Capital

30. The common sources of additional paid-in capital are as follows:

Excess of par value paid for capital stock (paragraph 2)

Resale or retirement of treasury shares (paragraphs 8 and 9)

Distribution of stock dividends (paragraph 10)

The issuance of detachable stock purchase agreements (paragraph 20)

Changes in par value (paragraph 27)

Donated assets (paragraphs 28 and 29)

(3)

That created by corporate readjustment (paragraph 25) or quasi-reorganization.

Additional paid-in capital, however created, shall not be used to relieve income of the current or future years of charges which would otherwise be made against income. This rule might be subject to the exception that, where upon reorganization, a reorganized enterprise would be relieved of charges that would be made against income if the existing enterprise were continued, it might be regarded as permissible to accomplish the same result without reorganization provided the facts were as fully revealed to and the action as formally approved as in reorganization.

Based on the foregoing pronouncements and citations and the legal presumption that the transaction is carried out in good faith on the strength of a legitimate and proper corporate objective, duly warranted by its corporate affairs, the proposed reverse stock split and conversion of additional paid-in capital to paid-up capital are thus legally feasible subject to the following rules:

- As a general rule, the additional paid-in capital may only be declared as stock dividend. It shall not be used to relieve income of the current or future years of charges chargeable against income.

- An exception to the rule is in the case of reorganization wherein a reorganized enterprise may be relieved of such charges against income on condition that if the existing enterprise shall be continued the same result may be attained even without reorganization;

- Provided that the said facts are fully disclosed and formally approved as in reorganization in which event the articles of incorporation shall be amended accordingly to reflect the changes in the capital structure ;

- Provided further that the old shares totaling 300,000 will be restructured and 180,000 shares shall be issued with a par value of ₱13,899 per share for which the corresponding taxes and SEC fees legally imposable shall be paid.

• Provided finally, that there shall be no impairment of legal capital and that no prejudice shall be caused to the stockholders and creditors.

• Lastly, the corporation should file an application for amendment of articles of incorporation and/or certificate of increase/decrease of capital stock, if any, to reflect the changes in the capital structure - the authorized capital stock.

Very truly yours,

VERNETTE G. UMALI PACO
General Counsel